

## **A Tax on Work for the Elderly: Medicare as a Secondary Payer**

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This study is the second in a series of investigations on how the design of public policy may serve as a disincentive to continued work at older ages. In previous work, we examined how the structure of Social Security tends to discourage long careers. In this paper, we focus on another federal policy that creates disincentives towards working long careers or at least working beyond age 65. The policy is known as Medicare as a Secondary Payer (MSP), which took effect in 1983.

MSP policy applies to Medicare-eligible workers at firms with 20 or more employees, and establishes Medicare as the secondary payer for all health care expenses, rather than the primary payer. The employer's health insurance program is the first and primary payer. Because employer-sponsored health plans tend to be more comprehensive than Medicare, these workers are effectively foregoing their Medicare benefits by working. If these same individuals were not working, they would receive Medicare as their primary health insurance. The loss of Medicare as a primary payer acts as an implicit tax on continued work past age 65.

To assess the incentives in MSP, we examine a change in policy whereby Medicare would be the primary insurance provider for everyone age 65 and older, whether they work or not. We refer to this alternative as the Medicare as a Primary Payer policy (or MPP). With the shift from MSP to MPP, workers would no longer forgo their primary Medicare benefits by continuing to work past age 65, and the implicit tax on work would be removed. We estimate the effective wage increase that would arise from an MPP policy. Then, using measures of labor supply elasticity by age, we estimate the impact of an MPP policy on labor supply, both alone and in conjunction with reforms to Social Security that reduce the penalties for long careers. We also estimate the net cost of switching from MSP to MPP.

We find that the magnitude of the implicit tax in MSP policy is 15-20 percent at age 65, and increases to 45-70 percent by age 80. Eliminating this implicit tax (by making Medicare a primary payer), along with eliminating other provisions that discourage long careers, could have a significant effect on lifetime labor supply. We find, in addition, that the increased personal income tax revenues gained from increased work at older ages could offset to a significant extent the incremental cost of extending primary Medicare benefits to these older workers.

We found estimating the impact to date of MSP policy on labor force participation to be difficult to isolate specifically, due to periods of less stringent enforcement and the concurrent easing of the Social Security earnings test. However, given the high labor supply elasticities of older workers, eliminating the large tax on working that is created by MSP could potentially have a very substantial effect.

The full working paper is available on our website, [www.nber.org/programs/ag/rrc/books&papers.html](http://www.nber.org/programs/ag/rrc/books&papers.html) as paper NB07-11 and as NBER Working Paper # 13383.

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