PROTECT PATIENTS BY REPEALING
THE MEDICAL DEVICE TAX

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You don’t make health care more affordable by increasing its cost. Yet that is precisely what the currently suspended medical device tax threatens unless Congress permanently repeals it. Although permanent repeal failed in the last Congress, Senators Pat Toomey (R-PA) and Amy Klobuchar (D-MN) have introduced the Protect Medical Innovation Act, which continues the bipartisan repeal effort in the 116th Congress.

The medical device tax was implemented to help cover the costs of the Affordable Care Act (ACA), but the potential revenues from taxing pacemakers, CT Scans, MRIs, and artificial joints were never going to be large enough to meaningfully fund even a miniscule proportion of the ACA’s massive costs. Despite raising de minimis revenues, if this tax were effective the economic damage to the medical device industry, as well as the broader health care sector, would be large.

THE TAX IMPOSES AN ADDITIONAL 2.3% COST ON ALL MANUFACTURERS OF MEDICAL DEVICES SUBJECT TO THE TAX.

Since the price of a state-of-the-art 3 Tesla MRI machine can reach as high as $3 million, for instance, if the 2.3% medical tax were not temporarily suspended, then there would be an additional $69,000 of costs imposed on all purchases of these MRI machines that someone must pay.

One possibility is that the manufacturer will simply pass these costs along to the hospital when it purchases a new MRI machine. Perhaps the additional costs would make the new MRI machine unaffordable for some hospitals. In such instances, the medical device tax would be responsible for reducing patients’ access to state-of-the-art MRI machines. As a result, the quality of health care in the U.S. would be adversely impacted.

Perhaps, the hospital would still purchase the now more expensive MRI machine, but would increase prices to cover the costs. In this case, the tax is worsening the affordability problem plaguing the U.S. health care system.

Of course, it is not certain that the costs of the tax will be passed along to hospitals or other purchasers of medical equipment. It is equally possible that the medical device manufacturers won’t be able to increase their prices at all.

If this were to happen, then the revenues of these manufacturers will be negatively impacted. Since the tax is applied to the gross revenues of the manufacturers, not the profits, the negative impact
on these companies will be much larger than might be appreciated.

The Government Accountability Office (GAO), examined the financials of the vast majority of the medical device manufacturers back in 2015. According to the GAO, the total revenues of the medical device industry examined were $136 billion in 2014. The profits of the industry were $16.5 billion, indicating that the profit margin for medical manufacturers was 12%. Between 2005 and 2014, the industry’s profit margin ranged between 9% and 14%, indicating that the 12% profit margin is around the longer-run average.

Assuming that the entire $136 billion in revenues was subject to the tax (for illustrative purposes), then this tax would increase manufacturers’ costs by $3.1 billion. If the manufacturers were unable to pass along any of the costs associated with the medical device tax, their revenues would not increase. Instead, the tax directly reduces their profits. Based on the 12% profit margin, the $3.1 billion reduction in the industry’s profits would represent a 19% reduction in the industry’s profitability. Such a large reduction in the industry’s profits would weaken the ability of these firms to invest in the next generation of medical technologies. It was due to these concerns that a Pacific Research Institute study found that the medical device tax could reduce total industry research and development expenditures by $2 billion a year.

Importantly, these negative impacts would not be distributed evenly. Smaller firms, particularly start-ups who are typically less profitable or even unprofitable, will be hit particularly hard. Since smaller firms also tend to be more innovative, the tax could disproportionately harm innovation.

It is uncertain which one of these impacts will happen in practice if the medical device tax suspension were allowed to expire. What is certain is that some combination of these impacts will occur, and regardless of which impacts occurred, patients will be made worse-off.

Fortunately, Congress had the foresight to suspend the medical device tax, but a suspension is not sufficient. The only way to ensure that the threat of these negative impacts is gone is to permanently repeal the medical device tax.

The Protect Medical Innovation Act is the vehicle that the 116th Congress can use to achieve this goal. Hopefully, unlike the 115th, this Congress will finally eliminate this unnecessary albatross on the U.S. health system.