Work Incentives, Accumulated Legislation, and the Economy

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How Today's Fragmented Welfare System Fails to Lift Up Poor Families"

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by

Casey B. Mulligan

University of Chicago

Chairman Reichert, Ranking Member Doggett, members of the committee: thank you for the opportunity and honor to discuss with you today how public policy has changed the reward to work. A multitude of programs have accumulated to affect that reward, and thereby affect who is employed and who is living near or below the poverty line.

Overview

A basic economic principle is that the monetary reward to working has important effects on how many people are employed, and how much they work.

People without jobs or otherwise with low incomes sometimes receive benefits from social safety net programs. The benefits are rarely called taxes by laymen, but economists understand the benefits to have many of the characteristics of tax rates because a program beneficiary loses some or all of her benefits as a consequence of accepting a new job. The more income that a person receives when *not* working, the less is the reward to working.

I have illustrated the reward idea in Figure 1. The left bar measures the resources available when working, and the right bar measures the resources the same person would have if not working, including subsidies received net of taxes paid. The difference between the two bars is the monetary reward to working.

The combined effect of taxes and subsidies on the reward to accepting a new job can be summarized as a penalty: the effective amount that is lost from paying taxes and replacing benefits associated with not working. I like to express the penalty as a marginal tax rate: namely, as a percentage of employee compensation.

If there were no penalty, then the marginal tax rate would be zero. Thanks to a labyrinth of tax and subsidy programs, the marginal tax rate can equal or exceed 100 percent, which means that at least as many resources are available when not working as when working. In such cases, a person might have *more* resources available to use or save as a consequence of working *less*.

Legislation that "cuts" or "credits" taxes can nonetheless reduce the reward to working, and increase the marginal tax rate, if it cuts taxes more for those who work less than it cuts taxes for those who work more.

The reward to working affects behavior. High marginal tax rates are associated with small incentives to seek, create, and retain jobs. The consequences of high marginal tax rates are felt all over the economy, even by persons whose individual rates might not be all that high.

At the same time that safety net programs implicitly tax job acceptance, they also implicitly subsidize layoffs because the programs absorb some of the income and production that employer and employee together lose when an employee stops working. Layoff subsidies give employers and employees less incentive to take steps that might avoid or delay layoffs.

America absolutely must have taxes and safety net programs, even though they reduce the reward to working and subsidize layoffs. But if this Congress wants to understand what is happening in the labor market or to the budgets of social programs, it would be counter-productive to approximate marginal tax rates as zero, or to assume them to be eternally constant regardless of what incentives are embodied in new legislation.

Of course, unemployment insurance program benefits are now available longer into unemployment spells than they were six years ago. But also don't forget that new modernization provisions now provide unemployment benefits in a variety of circumstances when benefits were formerly unavailable. The food stamp program expanded in a variety of dimensions. While it lasted, the 2009 American Recovery and Reinvestment Act (hereafter, ARRA or "Recovery Act") helped unemployed people pay for their health insurance, and the Affordable Care Act will make premium assistance permanent, and do so on a grander scale.

Figure 2 shows my estimates of ten years' marginal tax rates coming from tax and subsidy programs, taking into account that some of the poor and unemployed do not participate in all, or any, of the safety net programs.

The combined effect of these and other changes through 2013 was to reduce the reward to work – that is, increase marginal tax rates – for most of the non-elderly population. The reward to work will be further eroded beginning in January when several significant provisions of the Affordable Care Act take effect.

The new work-disincentive provisions include (i) the sliding scale that sets premiums for people who buy health insurance on the new marketplaces, (ii) a scheme for premium assistance that essentially resurrects the Recovery Act's COBRA subsidy in a more comprehensive form, (iii) employer penalties, and (iv) hardship relief from the individual mandate.

The cumulative effect of all of this legislation is to increase average marginal labor income tax rates by 10 percentage points over what they were in 2007. As early as next year, the average marginal rates will exceed 50 percent of employee compensation, which means a decision to work or prevent a layoff will deliver more resources to the government than it will deliver to the employers and employees making the decisions.

We shouldn't have been surprised to see layoffs surge during the recession at the same time that new laws were adding to the layoff subsidies or to see unemployment durations lengthen as new rules added to marginal tax rates. A presumably unintended consequence of the recent safety net expansions has been to reduce the reward to working and thereby keep employment rates low, keep unemployment and poverty rates high, and keep national spending low, longer than they would have been if safety net program rules had remained unchanged.

The remainder of my testimony offers more detail as to penalty and subsidy rate changes in recent years, and how they relate to the government safety net. The testimony is my own and does not necessarily reflect the views of the University of Chicago.

A Labyrinth of Public Policies Combine to Reduce the Reward to Working

The monetary reward to working is the difference between the resources a person has available to use or save if she works and what she has available when she does not work. Federal, state, and local governments deal in massive amounts of resources, and affect the reward to working both in the process of obtaining revenue and in the process of distributing revenue to beneficiaries.

The Bureau of Economic Analysis estimates that income, payroll, sales, and excise taxes amounted to about 23 percent of national income and over 30 percent of the nation's labor income, on average between 2000 and 2010. Even if none of that revenue had been spent on safety net programs, the tax collections by themselves would have reduced the reward to working.

Safety net program spending is also significant, especially during the last several years. Federal, state, and local spending on non-elderly beneficiaries of unemployment insurance, nutrition assistance, Medicaid, and other means-tested subsidies occurred at a combined rate of more than $400 billion per year in 2009 and 2010, measured in fiscal year 2010 dollars (Mulligan 2012). Even if governments had somehow been able to fund these programs without any taxes, the process of distributing the program benefits would have reduced the reward to working.

The effects of public policy on the reward to working and thereby poverty rates, the labor market, and the economy can be summarized in terms of various measures of marginal tax rates. My testimony primarily discusses one of those measures: the difference between taxes paid net of subsidies received when working and net taxes paid when not working, sometimes expressed as a fraction of the total compensation to be earned on the job.

This difference is a marginal tax rate concept related to the decision margins of when to accept a new job and when to experience a layoff. Among the variety of measures that economists use to study the reward to working, this concept of the marginal tax rate has the advantages that (a) it readily captures important combined incentive effects of a multitude of tax and subsidy programs and (b) it relates to decisions to exit and reenter employment (Gruber and Wise 1999).

Thanks to the labyrinth of relevant programs moving large amounts of resources, marginal tax rates can equal or exceed 100 percent in some cases, which means that the reward to working is zero or negative. In such cases, a person might have *more* resources available to use or save as a consequence of working *less*.

The reward to working affects behavior. High marginal tax rates mean small incentives to seek, create, and retain jobs, and to make the sacrifices of time, hassle, etc., naturally required by employers, customers, and clients in exchange for a paycheck. The consequences of a low reward to working are felt all over the economy, even by persons whose individual reward to working might not be all that low.

The economic distortions created by marginal tax rates are not proportional: an increase from 90 percent to 100 percent has a greater effect on incentives than an increase from 40 to 50 percent, which itself has a greater effect on incentives than an increase from 0 to 10 percent. A rate increase from 0 to 10, for example, still leaves a worker with 90 percent of her reward from working, whereas a rate increase from 90 to 100 leaves her with no reward.

Because disincentives accumulate in this way, taxes and safety net programs need to be examined as a whole. A new tax has a different effect when it is added to an assortment of pre-existing programs than it would if the new tax were to be the only program contributing to the reward to work.

Recent Changes in Government Safety Net Rules Related to the Reward to Work

More than a dozen new and important federal and state safety net benefit rules have collectively changed the reward to working, especially for groups whose employment rates are particularly sensitive to safety net benefits.

Before the recession, an unemployed person in a typical state without high unemployment would often have his UI benefits limited to a maximum of twenty-six weeks (United States Department of Labor 2007). The federal law in place before the recession included some local labor market "Extended Benefit" triggers that, based on the statewide unemployment rate, would automatically lengthen the maximum benefit period, and thereby increase marginal tax rates faced by

the affected persons. These automatic triggers began to extend the duration of benefits around the nation in the middle of 2008 (United States Department of Labor 2011a). New "Emergency Unemployment Compensation" (EUC) legislation extended maximum benefit periods, so that unemployment insurance benefits could be paid up to 99 weeks (United States Department of Labor 2011b), which continued until 2012.

The ARRA further expanded eligibility by encouraging states to "modernize" (and relax) their UI eligibility requirements by processing earnings histories through an "alternative base period," include persons who quit their job for compelling family reasons, adding 26 weeks of eligibility for persons enrolled in training programs, and/or pay benefits to persons who search only for part-time work (United States Department of Labor 2009). The modernization provisions raised marginal tax rates for people who would have found it difficult or impossible to qualify for UI under the previous rules.

The ARRA also raised marginal tax rates by exempting the first $2,400 of unemployment benefits received by an unemployed person from 2009 federal income tax (United States Department of Labor 2011b) and by adding $25 per week to unemployment compensation checks.

For laid off workers who wanted to remain on their former employer's health plan, the ARRA's COBRA subsidy offered to pay 65 percent of the cost: a subsidy worth more than $700 per month in many cases (Mulligan 2012).

The rules for SNAP eligibility were relaxed in and around the 2008-9 recession as states were eliminating the "asset test," as the 2002 Farm Bill permitted them to do. The asset test elimination increased marginal tax rates on labor income because households could receive SNAP benefits based solely on their net income, and not based on the value of their assets. For persons in the few states that retained asset tests, federal asset eligibility rules were relaxed by the 2008 Farm Bill (Eslami, Filion and Strayer 2011, 6).

Both the 2008 Farm Bill and the 2009 ARRA increased the amount of the SNAP benefits paid to eligible households, and thereby increased marginal tax rates.

Prior to the recession, able-bodied adults without dependents who were not working or participating in a work program had their receipt of SNAP benefits limited to three months in a three year period (United States Department of Agriculture, Food and Nutrition Service 2012).[1] Entire states could obtain waivers from the work requirement whenever the Department of Labor indicated that the state was eligible for extended unemployment benefits (United States Department of Agriculture, Food and Nutrition Service 2009). The ARRA waived all states through October 2010. Since then, almost all states have obtained waivers pursuant to the Department of Labor triggers (United States Department of Agriculture, Food and Nutrition Service 2011). Altogether, the state-wide waivers and ARRA changed eligibility requirements in the direction of making SNAP eligibility more inclusive than it would have been if able-bodied adults without dependents were required to work (or have their benefits limited), as they typically were before the recession began.

The 2009 ARRA created a refundable personal income tax credit for calendar years 2009 and 2010 called the "Making Work Pay Tax Credit" (hereafter, MWPTC). For most people, the MWPTC had no effect on the reward to working because they or their household would have received the same amount of the credit regardless of an individual's work decision. A few persons saw their reward to working increase from the MWPTC (by itself), a few others saw it reduced.

In contrast to the many provisions cited above, the employee portion of the federal payroll tax was cut – effective between January 2011 and December 2012 – and thereby reduced marginal tax rates during that time frame.

Mulligan (2012) summarizes the work incentive effects of all of these rule changes, and more, with a statutory marginal tax rate index time series for the average non-elderly household head or spouse with median earnings potential. Each value in the series reflects, on the basis of the rules in place at the time, the causal effect of a work decision of about two months duration on the resources available to the worker and his family, expressed as a percentage of the total compensation (including fringes) that would be earned during that period. The index accounts for the fact that many people do not participate in safety net programs even when they are not working.[2] By construction, the index changes when and only when new safety net program rules come into effect.

Figure 2 displays the index, updated through the end of 2016. The cumulative effect of the many rule changes was marginal tax rates that were five percentage points greater in early 2013 than they were in 2007. Marginal tax rates have increased even more for less-skilled people and for unmarried people (Mulligan 2013).

Imminent Changes in Government Safety Net Rules Related to the Reward to Work

The Patient Protection and Affordable Care Act (hereafter, ACA) was passed in March 2010. It contains numerous provisions affecting the reward to work, with the net result of sharply reducing the reward beginning in January of next year.

A commonly recognized incentive-related provision is the sliding scale for the cost-sharing and premium subsidies (hereafter, jointly referenced as "exchange subsidies") for households between 100 and 400 percent of the poverty line that purchase non-group insurance on the health insurance marketplaces established by the ACA. Households will have a choice of plans – one of which will be the plan that their Congressman purchases for himself – and the sliding scale will determine what they pay in premiums and out-of-pocket costs.

Figure 3 displays a sliding scale for the year 2014 based on a family of two with a $13,000 annual actuarial value plan.[3] The horizontal axis measures calendar year household income as a ratio to the federal poverty line. The vertical axis measures the combination of the required premium (net of premium assistance tax credits) and the average amount households will pay for out-of-pocket expenses as they participate in the plan. The schedule has various jumps, but for our purposes the important point is that it slopes up: households with more income pay more for the same plan than households with less income.

If one of the household members were to spend more of the calendar year not working – perhaps because it took additional time to find a new job or because his employer laid him off earlier in the year – the household would have less calendar year income and thereby be required to pay less for its health insurance. The amount of the payment reduction is about 20 percent of the lost income, which is why the sliding scale by itself adds about 20 percentage points to the marginal tax rates of those eligible for the exchange subsidies. The sliding scale's implicit assistance with health payments adds to the various assistance programs that pre-dated the ACA: unemployment benefits, reduced tax obligations, perhaps access to food stamps for part of the year, etc.

A majority of the workforce will obtain health insurance through their employer, and thereby typically not be on the sliding scale while they are working.[4] Nevertheless, their opportunity for exchange subsidies when not employed reduces the costs of eliminating their job, temporarily suspending it, or failing to create the job in the first place. Employees with affordable health insurance are deemed ineligible for exchange subsidies until the moment they leave employment. People without jobs who receive the exchange subsidies will find that their eligibility ceases the moment they start a job and can be enrolled in affordable health insurance from the employer. From

this perspective, the ACA's exchange subsidies have many of the economic characteristics of the ARRA's COBRA subsidies and of unemployment benefits.

In effect, workers with employer health insurance under the ACA do not "slide" down the scale in Figure 3 when they work less – they *jump* down from paying (together with their employer) essentially full price to the point on the scale commensurate with their household income.[5] They remain on the scale as long as they are out of work. Tens of millions of workers will have their reward to work significantly eroded through this mechanism.

There's more. Under the ACA, uninsured individuals are expected to pay a penalty for failing to have insurance, except during periods of hardship. If unemployment is deemed "hardship," then the ACA offers a new form of assistance to uninsured people when they lose their jobs: relief from the individual mandate.

Regardless if more taxes are collected from workers or more subsidies are provided to people without jobs, or both, an essential consequence is the same: a reduction in the reward to work. For the purposes of analyzing the quantity of labor, it also does not matter whether new taxes are collected from employees or whether they are collected from employers on the basis of how many employees they have, which is why the ACA's employer shared responsibility penalties also reduce the reward to work.

Large employers that do not offer affordable health insurance to their employees in 2014 will owe a $2,000 shared responsibility penalty per full-time employee-year if at least one of them receives an exchange subsidy (Congressional Budget Office 2010b). The penalty applies to all full-time employees beyond thirty, regardless of whether the employee obtained health insurance through a family member or through Medicare, and regardless of whether the employee's household was between 100 and 400 percent of the federal poverty line. The penalty on an employee is pro-rated by month: it begins as soon as he is added to the payroll and ceases as soon as he is removed.

Small employers are exempt from the penalty, but an employer with 49 full-time employees, and not offering affordable health insurance, will find the penalty to be about $40,000 (also not business tax deductible) for hiring just one more full-time employee. Thus, while the small-employer exemption is better than none from the perspective of small employers, the labor-market-wide effects of the penalty on the reward to work are much the same as they would be without a small-employer exemption. In effect, tens of millions of workers will be paying a penalty equal to $3,000 of their annual wages that non-workers do not pay.

The ACA also expands Medicaid for able-bodied adults by raising the household income limit, although it remains to be seen how many states opt out of that provision. The quantitative effect of the Medicaid expansion on the nationwide reward to work is likely small and depends on a number of factors.[6] The ACA does replace or claw back some of the pre-ACA assistance program benefits, especially those from uncompensated care (Goolsbee 2011, oral testimony at 77:45) and unemployment insurance.[7] The employer shared responsibility penalty also indirectly reduces employer personal income and payroll tax bills by depressing employee salaries.

Accounting for (i) all of the above ACA provisions, (ii) the fact that many people will not participate in subsidy programs for which they are eligible, (iii) that multiple significant population segments will not be eligible for any of the above subsidies or penalties, and (iv) that the households that do participate have heterogeneous family and health situations, I find that that the ACA adds about five percentage points to the average marginal labor income tax rate among non-elderly household heads and spouses whose monthly compensation would be between $3,800 and $4,600 if and when they are working full-time.[8] Five percentage points is the amount of the 2014 jump up in Figure 2's marginal tax rate series.[9]

The ACA adds more percentage points to the marginal tax rates faced by less-skilled household heads and spouses (i.e., those whose monthly compensation would be less than $3,800 when working full-time), and adds fewer percentage points to the marginal tax rates faced by more-skilled household heads and spouses.

My findings of large marginal tax rates, despite an accounting for imperfect take-up, are not the result of "cliffs" or "notches" in transfer program formulas in which many dollars of benefits are lost for earning a single marginal dollar (Yelowitz 1995) because I look at the consequence of more "discrete" decisions of accepting a job, or initiating a layoff, that change calendar year income by thousands of dollars. Instead, my large rates reflect the *combination* of tax and subsidy rules from the assortment of safety net programs in which millions of Americans have been and will be participating.

It might seem that the ACA has little direct effect on work incentives for the poor because the exchange subsidies are only available to households above the poverty line (and below four times the poverty line). However, exchange subsidy eligibility is determined by calendar year income, and households can live much of the year below the poverty line but nonetheless have a calendar year income above it. Just as important, the employer shared responsibility penalties apply to all employees (beyond 30) of an assessable employer, even if many of those employees live at or below the poverty line.

Wage Garnishment and Related Private Sector Activities Raising Marginal Tax Rates

The Internal Revenue Service, Department of Agriculture, and state unemployment agencies are not the only institutions looking at a person's employment status and federal individual income tax return to determine how much she should pay or receive. My own employer, the University of Chicago, and thousands of other universities, colleges, and schools look at federal income tax returns through their financial aid programs to determine how much a parent should pay for her child's education. While we welcome the opportunity to help students from disadvantaged families, economists have long recognized that financial aid practices affect incentives for students' parents to work and save (Dick and Edlin 1997).

Workers sometimes have their wages garnished by creditors and/or child support agencies. Garnishments may be a necessary part of a well-functioning credit market and necessary to properly support children, but they also serve to reduce the reward to working by the person whose wages would be garnished (Holzer, Offner and Sorensen 2005).

Even if these private sector actions affecting the reward to work had been constant over time, they still interact with the safety net expansions cited above because the economic distortions resulting from marginal tax rates depend on the sum total of all taxes, subsidies and garnishments that derive from a person's wages.

Moreover, it does not appear that the private sector's influence on marginal tax rates has been constant over time. A new federal bankruptcy law went into effect in late 2005. Perhaps the most dramatic single increase in marginal tax rates has been associated with the federal guidelines for the settlement of "under-water" home mortgages. Mortgage modification initiatives have been one of the main ways the federal government has sought to reduce home mortgage foreclosures, especially when those foreclosures are motivated by negative home equity (Congressional Oversight Panel 2009, 4).

These programs often recommend a new mortgage payment amount that is lower than the payment specified in the original mortgage contract. More important in terms of marginal tax rates, the new payment is set in proportion to the borrower's income at the time of the modification. The more the borrower is earning, the more she will be required to pay her lender over the next five to seven years, or more. The marginal tax rate on income earned at the time of modification can easily exceed one hundred percent and sometimes exceed two hundred percent as a result of the federal modification guidelines, not to mention the many other taxes and subsidies that also reduce the reward to working (Herkenhoff and Ohanian 2011; Mulligan 2012).

The Income Maximization Fallacy

It is sometimes claimed, by non-economists at least, that the safety net does not prevent anyone from working because everyone strives to have more income rather than less, and would gladly take any available job that paid them more than the safety net did. This "income maximization" hypothesis is contradicted by the most basic labor market observations, not to mention decades of labor market research.

Before the recession began, over 80 million American adults were not working. To be sure, some of them could find no reward in the labor market and would be stuck without gainful employment no matter how lean the safety net got. But many others were not working by choice. You probably know skilled stay-at-home mothers or fathers who could readily find a job but believe that the net pay from that job would not justify the personal sacrifices required. They are examples of people who deliberately do not maximize their income. Other examples are people who turn down an out-of-town promotion in order to avoid relocating their families, and workers who eschew higher paying but less safe occupations. Earning income requires sacrifices, and people evaluate whether the net income earned is enough to justify the sacrifices.

When the food stamp or unemployment programs pay more, the sacrifices that jobs require do not disappear. The commuting hassle is still there, the possibility for injury on the job is still there, and jobs still take time away from family, schooling, hobbies, and sleep. But the reward to working declines, because some of the money earned on the job is now available even when not working.

A related fallacy is that employees would do absolutely anything to avoid a layoff, regardless of the layoff subsidy rate. It is true that employers sometimes experience reductions in demand from their customers, as auto manufacturers and home builders did early in the recession. But layoffs are not always the inevitable result. Employers and employees could adapt to less demand by work sharing (D. Baker 2011), reducing prices charged to customers, reducing wages, or have pursued a less cyclical line of business in the first place. Heavy layoff subsidies give them less reason to pursue the alternatives to layoffs (Topel and Welch 1980).

Decades of empirical economic research show that the reward to working, as determined by the safety net and other factors, affects how many people work and how many hours they work. To name a small fraction of the many studies: Hoynes and Schanzenbach (2012) show how potential participants stopped working or reduced their work hours when the food stamp program was introduced. Studies of unemployment insurance find that program rules have a statistically significant effect on how many people are employed, and how long unemployment lasts. Yelowitz' (2000) research shows how a number of single mothers found employment exactly when, and where, state-level Medicaid reforms increased their reward from working. Gruber and Wise (1999) and collaborators show how the safety net for the elderly results in less employment among elderly people. Autor and Duggan (2006) and the Congressional Budget Office (2010a) explain how the

number of disabled people who switch from work to employment-tested disability subsidies depends on the amount of the subsidy relative to the earnings from work. Murphy and Topel (1997) show how poor wage growth among less-skilled men helps explain their declining employment rates during the 1970s and 1980s.

Programs assisting the poor and unemployed interact with private-sector demand shocks in determining the number unemployed. An adverse demand shock increased unemployment more under the ARRA than it would if the same demand shock had been experienced under 2007 tax and subsidy rules because each dollar that wages are reduced is a bigger proportion of the reward to work for someone whose reward has been largely whittled away by tax and subsidy programs than it is for someone who keeps a large fraction of what she earns.

Other Misconceptions about the Reward to Working

I previously cited at least a dozen changes in subsidy rules that served to raise marginal tax rates. Any one of them may appear insignificant by itself, especially for the purpose of aggregate labor market analysis. But that does not mean that the combination of a dozen or more potentially small marginal tax rate increases is itself small.

Focusing on just one of any of the safety net expansions is also misleading as to the magnitude of the overall increase in marginal tax rates and therefore potentially misleading as to the sources of the major changes in the labor market since 2007. It is even possible that attention to one program in isolation of the wider safety net could motivate backwards public policy responses.

To see this, imagine that UI rules became more generous, and that added to the number of households who were unemployed and with less income than they have when working. A number of the added unemployed people apply for food stamps, which from the food stamp program's point of view makes it look like "the economy is getting worse," so food stamp officials recommend enhancing food stamp benefits, which further increases the marginal tax rate. But, in this example, the added food stamp applications come from higher marginal tax rates created by UI, and the right food stamp policy response may be to reduce benefits in order to stabilize the overall marginal tax rate. The point of this example is not that the actual safety net expansions were excessive but rather that the economics of the safety net can be different when the safety net is viewed as a whole rather than on a program-by-program basis. The distinction is more than academic: contemporary events involve expansions of the safety net in many dimensions, and all of that occurs on top of an assortment of other safety net programs.

Among the hundreds of labor market studies, two of them – Rothstein (2011) and Ben-Shalom, Moffitt and Scholz (2011) – have been misrepresented as showing that recent safety net expansions had no visible effect on employment. Ben-Shalom et al. (2011) looks at the pre-recession safety net, and thereby does not consider the safety net expansions that have occurred since then. Rothstein (2011) looks at the allowable duration of unemployment benefits, finding that benefit durations have a statistically significant effect on unemployment exits, but otherwise does not examine a single one of the safety net program parameters that are included in Figure 2's marginal tax rate series. Neither study considers layoff subsidies or what happens when marginal tax rates approach one hundred percent.

The number of job openings per unemployed person fell sharply during the recession (U.S. Bureau of Labor Statistics 2013). This fact has been misinterpreted by journalists as proving that unemployment subsidies are not a significant factor depressing the labor market. To the contrary, expanding unemployment subsidies can by themselves, or in conjunction with other factors, reduce

job openings per unemployed person (Pissarides 2000). If you want to understand what caused and prolonged the recession, you have to look beyond the ratio of job openings to people unemployed.

It is sometimes thought that safety net transactions only affect the people who participate in the programs. To the contrary, the safety net is funded by taxpayers, lenders, owners of government debt, beneficiaries of government programs other than the safety net, or some combination thereof. As a portion of the beneficiaries opt to earn less, they also opt to spend and save less, as their household budget constraint frequently requires. They lawfully pay less tax. Businesses anticipate having fewer employees and invest less. These behavioral changes are bad news for employers in general, for people who produce the consumer and investment goods that beneficiaries would be buying if they were back at work (and goods the program funders would be buying if they were not funding the expansions), and for people who live in places like Michigan whose economies are especially intensive in the production of such goods (Galí, Gertler and Lopez-Salido 2007).

Research has shown that the poor and unemployed tend to quickly spend what they have on basic needs, which is why helping them is intrinsically valuable (Gruber 1997), but "stimulus" advocates sometimes further assert that spending patterns of the poor are why redistribution serves as a great boost in total spending and thereby total employment. Even if redistribution did not depress the reward to working, the stimulus assertions would be wrong because they ignore the spending of the people who fund the programs. Redistributing resources to the poor from everyone else changes the composition of spending and employment in the direction of industries like discount groceries that disproportionately serve poor customers and away from industries like high-end restaurants serving relatively few poor customers, but redistribution by itself has little effect on *aggregate* spending.[10]

When redistribution is combined with increases in marginal tax rates – as a number of recent policies have done – it significantly reduces aggregate spending because people typically spend less when they are not working.[11]

Conclusions

The bottom line is that helping the poor and economically vulnerable has a price in terms of labor market inefficiency. In recent years, we have been paying progressively more: American public policies moved significantly in the direction of less labor market efficiency.

As long as marginal tax rates remain far above what they were six or seven years ago, we cannot reasonably expect the labor market to return to where it was back then. We cannot expect the poverty rate to fall back to its pre-recession levels. We cannot expect employment per capita to go back to where it was.

Nobel laureate James Tobin was a leading Keynesian economist and key adviser to President Kennedy, and pointedly described high implicit tax situations. He said that they "caus[e] needless waste and demoralization…. It is almost as if our present programs of public assistance had been consciously contrived to perpetuate the conditions they are supposed to alleviate." (Tobin 1965, 890)

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Endnotes

[1] States could exempt up to 15 percent of such persons from the work requirement, or request a waiver for people in areas with an unemployment rate over 10 percent.

[2] The index combines incentives to work full-time relative to unemployment, out of the labor force, and part-time work.

[3] Schedules for smaller and larger families would look similar when plotted in Figure 3 because the axes are relative to the federal poverty line. For comparison, note that the population-weighted average of actuarial values for various family situations is $14,643, assuming a $19,000 AV for families of 3 or more and a $7,000 AV for a family of one, and limited to households with heads aged 26-64 and calendar year incomes between 100 and 400 percent FPL.

[4] The earnings of any person with employer-provided health insurance are included in his household income, and he may have family members who obtain subsidized insurance on the ACA's marketplaces.

[5] Employer-provided insurance is implicitly subsidized because the premiums are excluded from the payroll and personal income tax bases. This implicit subsidy remains under the ACA, which means that the subsidy is irrelevant for understanding the *impact* of the ACA on the reward to work for people that would have employer-provided insurance while they are working.

[6] The factors include whether the asset test is relaxed along with the income limit, the number of people who were earning above the pre-ACA threshold, and the relative value that people place on Medicaid versus plans they might obtain in the ACA's health insurance marketplaces.

[7] Unemployment benefits are part of taxable personal income and thereby increase (at roughly a 20 percent rate) the amount the sliding scale requires a household to pay for the health insurance it purchases from the ACA's marketplaces.

[8] This is at the middle of the distribution of potential earnings among non-elderly household heads and spouses (Mulligan 2012). Also recall that my marginal tax rates are percentages of employee compensation (including fringe benefits): a 50 percent rate in my units is approximately a 60 percent rate when expressed as a percentage of cash income.

[9] My estimation of marginal tax rates 2014-16 assumes that the ACA contains all of the changes in safety net program rules during that time. If, for example, Congress reacts to a weak labor market by further expanding unemployment insurance or food stamps at some time during 2014-16, then marginal tax rates would be greater than shown in Figure 2. I also assume that the ACA's formulae for penalties and exchange subsidies are applied in all 50 states.

[10] Redistribution to the poor may reduce aggregate labor demand if the poor tend to purchase goods and services that are less labor intensive in their production than are the rest of the goods and services in the economy. Also note that (a) government transfers are very different from government purchases of goods and services such as military spending or highway construction, which have been shown to significantly increase GDP in many instances (if nothing else, government purchases are automatically considered part of GDP, whereas transfers are not), and (b) aggregate spending is the sum of investment spending, consumer spending, government purchases, and net exports.

[11] Aguiar and Hurst (2005). To the extent that it redistributed resources to low-income families, the 2011-12 payroll tax cut is an exception because it achieved its redistribution while increasing the reward to work.

Figure 1. Work Decisions, Resources, and Incentives

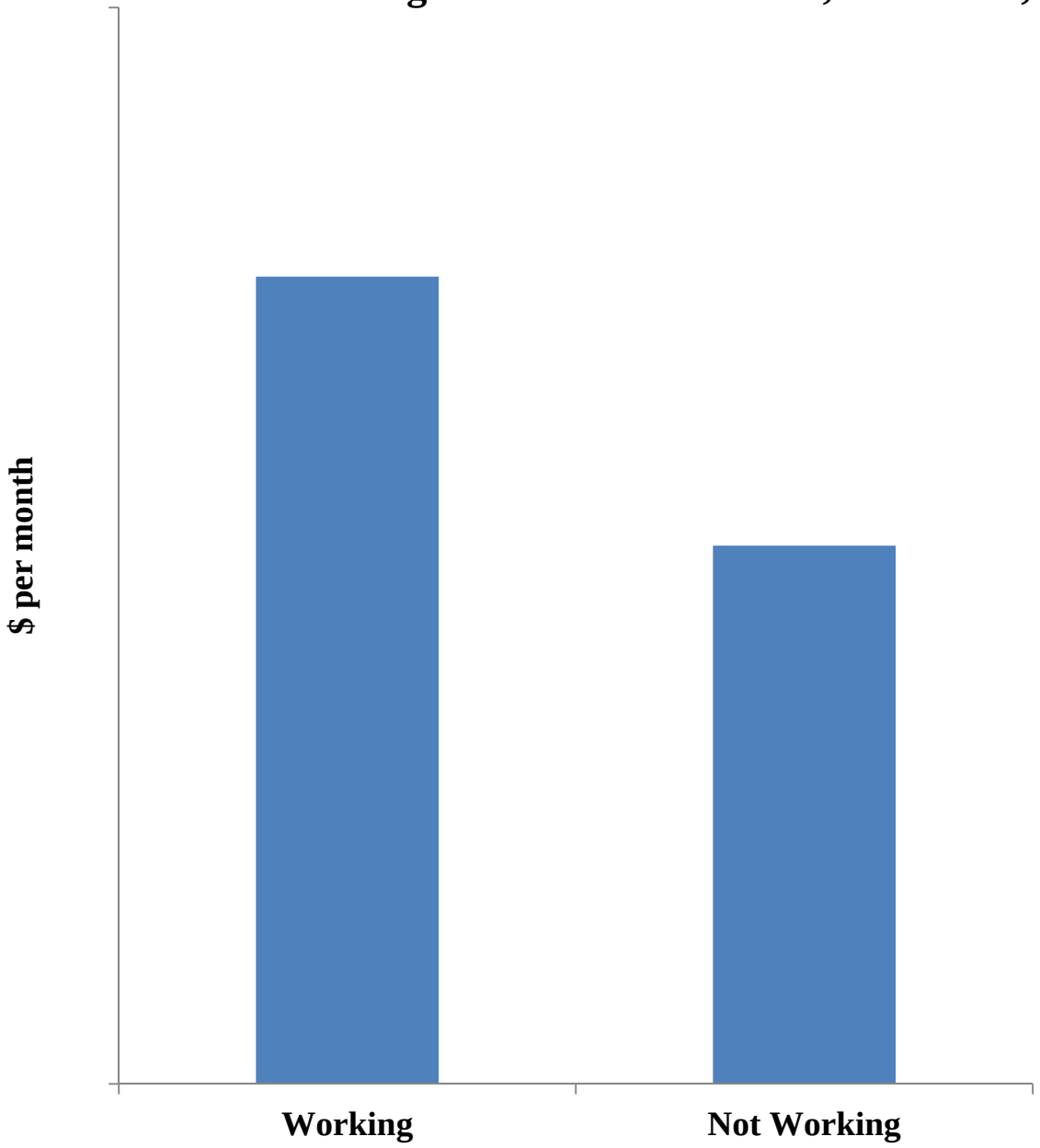


Figure 2. Statutory Marginal Labor Income Tax Rates over Time

average among non-elderly heads and spouses with median earnings potential. includes subsidies

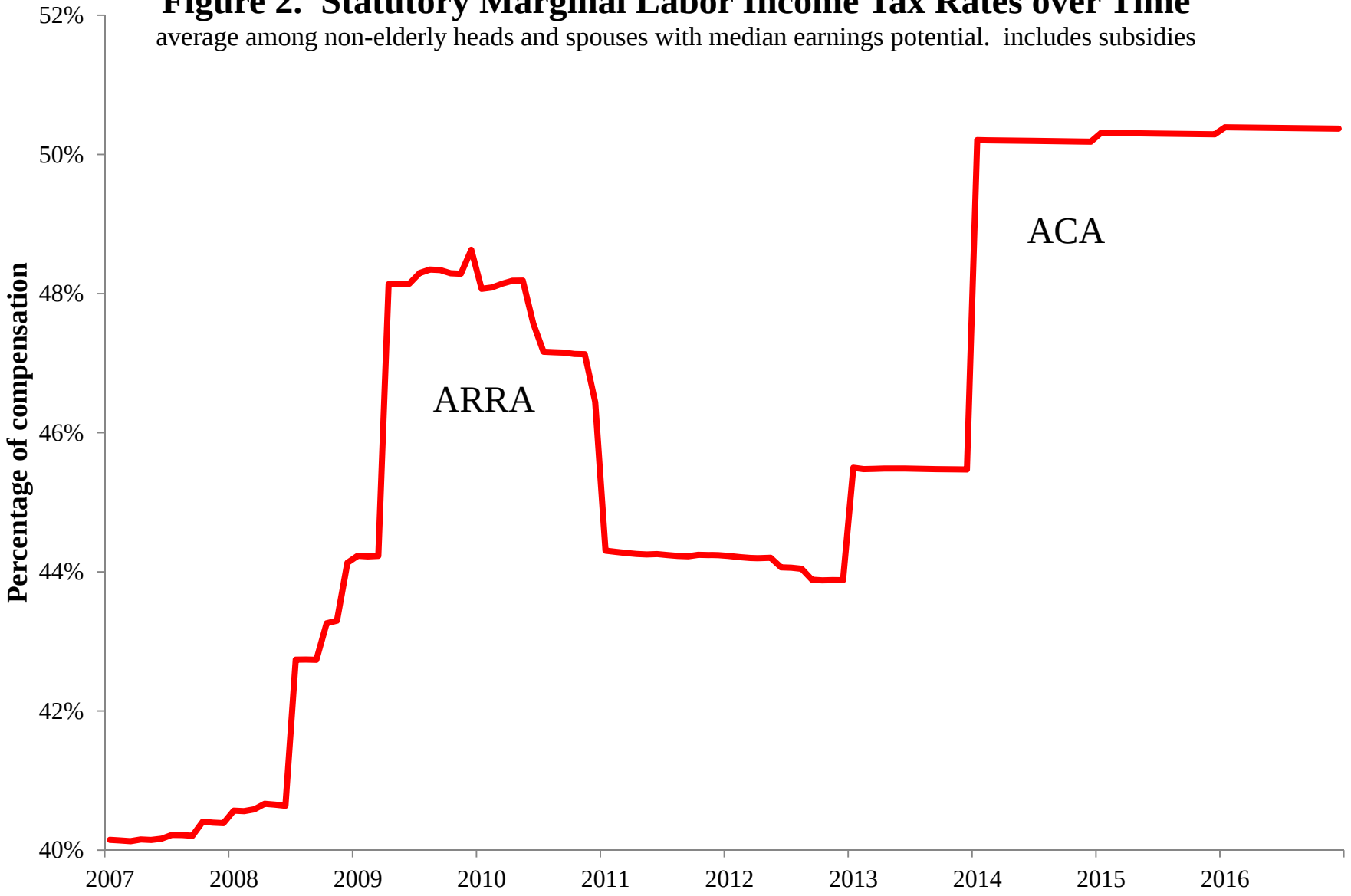
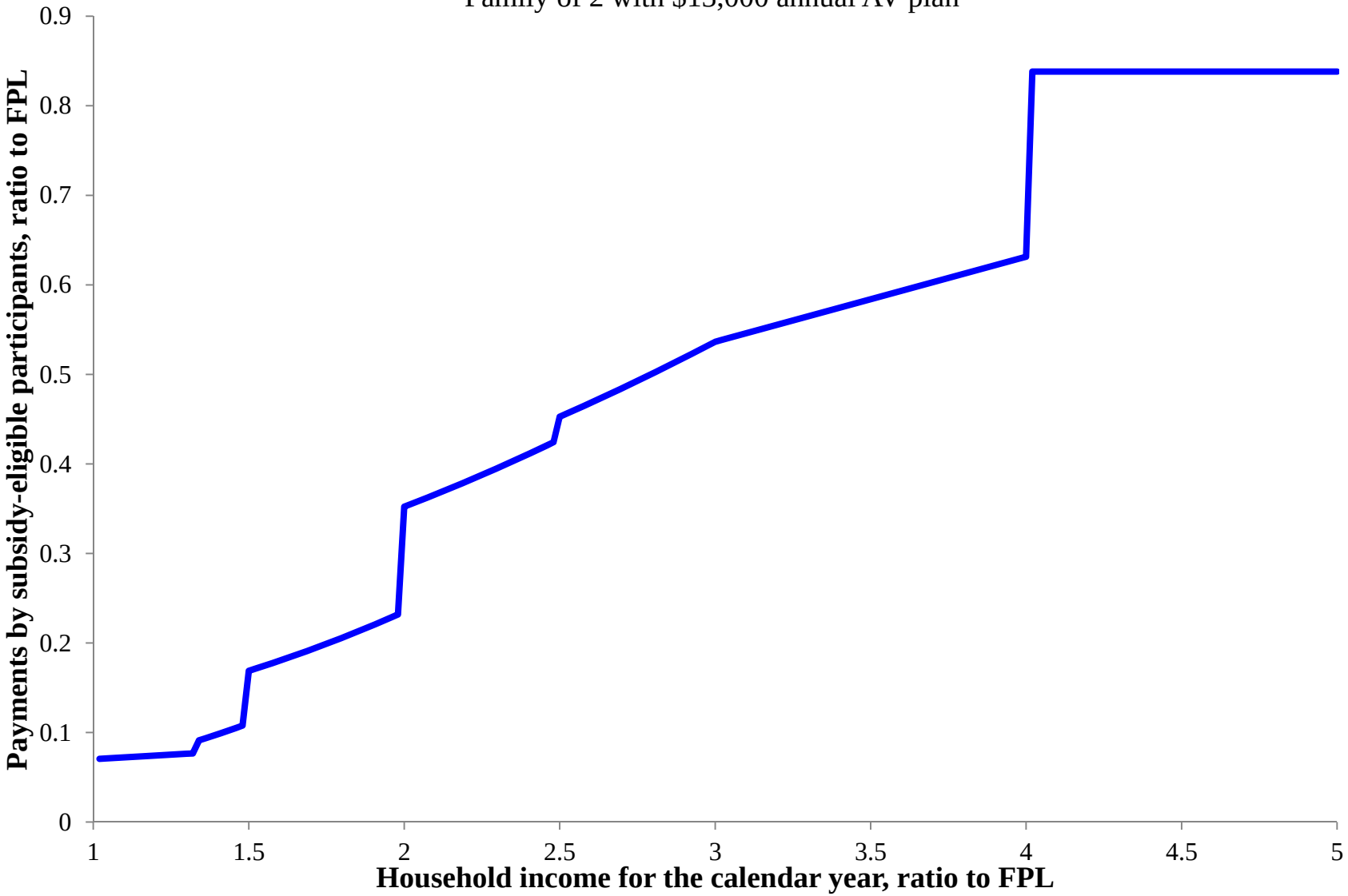


Figure 3. 2014 Health Payments as a Function of Household Income

Family of 2 with $13,000 annual AV plan



Committee on Ways and Means
Witness Disclosure Requirement – "Truth in Testimony"
Required by House Rule XI, Clause 2(g)

Your Name: Casey B. Mulligan		
1. Are you testifying on behalf of a Federal, State, or Local Government entity? a. Name of entity(ies). b. Briefly describe the capacity in which you represent this entity.	Yes ☐	No ☒
2. Are you testifying on behalf of any non-governmental entity(ies)? a. Name of entity(ies). b. Briefly describe the capacity in which you represent this entity.	Yes ☐	No ☒
3. Please list any Federal grants or contracts (including subgrants or subcontracts) which <u>you have received</u> during the current fiscal year or either of the two previous fiscal years: None.		
4. Please list any offices or elected positions you hold. None.		
5. Does the entity(ies) you represent, other than yourself, have parent organizations, subsidiaries, or partnerships you are not representing?	Yes ☐	No ☒
6. Please list any Federal grants or contracts (including subgrants or subcontracts) which were received by the entity(ies) you represent during the current fiscal year or either of the two previous fiscal years, which exceed 10 percent of entity(ies) revenues in the year received. Include the source and amount of each grant or contract. Attach a second page if necessary. **N.A.**		

Committee on Ways and Means
Witness Disclosure Requirement – "Truth in Testimony"
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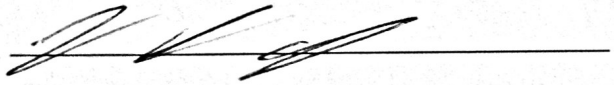
Name: _Casey B. Mulligan_____

Address: _233 E 13th #2105_____

_Chicago, IL 60605_____

_____

Signature: 

Date: _June 14, 2013_____