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Effects of the Affordable Care Act on Economic Productivity

Casey Mulligan

University of Chicago

CASEY MULLIGAN, a professor of economics at the University of Chicago, received his Ph.D. in economics from the University of Chicago in 1993. He has been a visiting professor at Harvard University and Clemson University, and is affiliated with the National Bureau of Economic Research, the George J. Stigler Center for the Study of the Economy and the State, and the Population Research Center. He has written for the *Chicago Tribune*, the *Chicago Sun-Times*, the *New York Times*, and the *Wall Street Journal*, and is the author of three books, including *Side Effects: The Economic Consequences of the Health Reform*.

The following is adapted from a speech delivered on October 24, 2014, at a Hillsdale College Free Market Forum in Indianapolis, Indiana.

The topic of my talk today is the economic side effects of the Affordable Care Act (ACA), sometimes referred to as Obamacare. Since most of the economy has to do with labor and work, that's where I'll start. But first a caveat. I'm an economist, and I'm going to talk about some parts of this complex law that have an impact on the labor market. Other parts of it relate to health and medicine, and because I'm not a doctor or a biologist, I'm not going to speak to those parts. From an economic or labor-market perspective, I'm going to explain how the costs of the ACA outweigh its benefits. But I can't measure or estimate its effects on health care. I leave that to others.

The key economic concept required to understand the labor market effects of the ACA is what economists call "tax distortions." Tax distortions are changes in behavior on the part of businesses or households for the purpose of reducing their taxes or increasing their subsidies. We call them distortions because they don't occur for real business or real personal reasons. They occur because of the tax code. A prime example of a tax policy that creates distortions is the ethanol subsidy—technically it is a credit, not a subsidy—whereby gasoline refiners are subsidized on the basis of how many gallons of gas they produce with ethanol. Because of this subsidy, businesses change the type of gas they produce and deliver, people change the type of gas they use—which affects engines—and corn is used for ethanol instead of as feed or food. Nor do the distortions stop there. Arguably, food prices are increased due to the reallocation of corn to different uses—and when food prices are higher, restaurants and households do things differently. There are distortions economy-wide, all for the chasing of a subsidy.

To be clear, just because taxes cause distortions doesn't mean that we should never have taxes. It just means that in order to get the full picture when it comes to policies like an ethanol subsidy or laws such as the ACA, we need to take into account the tax distortions in order to ensure that the benefits we are seeking exceed the costs.

The Employer Mandate/ Penalty/Tax

So what are the tax distortions that emanate from the ACA? Here let me simply focus on two aspects of the law: the employer mandate or employer penalty—the requirement that employers of a certain size either provide health insurance for full-time employees or pay a penalty for not doing so; and the exchanges—sometimes they're called marketplaces—where people can purchase health insurance separate from their employer. The mandate or penalty is intended, of course, to encourage employers to provide health insurance. And the exchanges are where the major government assistance is provided, since those who purchase insurance in an exchange typically receive a tax credit. As I'll explain, taken together, the penalty on employers and the subsidies in the exchanges add up to a tax on full-time employment—a tax that you pay if you work full time but not if you work part time or don't work at all. And the problem with that, of course, is that by taxing full-time work—which is the same as subsidizing part-time work and unemployment—you get less of the former and more of the latter two.

How does this full-time employment tax work with regard to the employer mandate? As I mentioned, the penalty applies only in the case of full-time employees and only to employers that don't offer health coverage, and it applies only in those months during which those full-time employees are on the payroll. If an employee cuts back to part-time work, the employer no longer has to pay the penalty. The dollar amount of the penalty doesn't depend on whether the employee is rich, poor, or middle class—if he works full time, the employer must either provide insurance or pay the penalty. And the penalty is indexed to health insurance costs, so every year those costs increase more than the economy and more than wages, the penalty will increase more than the economy and more than wages.

The current penalty is usually described as $2,000 per year per full-time employee. But it's really more than that, because the penalty, unlike wages, is

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[Latin]: in the first place

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not deductible from business taxes. So in terms of a salary equivalent, the penalty is closer to $3,000 a head. Needless to say, this penalty reduces competition in the labor market: It discourages employers from competing for full-time employees—which, if you're an employee, is a bad deal. Also there are a lot of employers who are not going to pay the penalty because they don't meet the size threshold of 50 or more employees, and employees are going to suffer because these small employers won't want to become large employers and therefore subject to the penalty.

Furthermore, this mandate or penalty—and by this time it should be clear that we can think of it as a tax on having a full-time employee—disproportionately harms low-skill workers. Think about it this way: How many hours does a worker have to work each week to produce the $3,000-per-year of value to justify keeping his job or being hired? For a minimum-wage worker, that comes to eight hours a week, all year round—one day of work a week for the government due to the ACA alone. Higher-skilled employees can obviously produce $3,000 worth of value in less time, so the penalty will have less of an impact on them.

Subsidized Health Insurance Exchanges

What of the tax distortions that come from the subsidized health insurance exchanges or marketplaces? To begin to think about this, imagine paying full price for your health care. How does full price work? Well, you pay the full price. The health care provider doesn't look at your tax return and adjust the bill accordingly. So we would never call paying full price for health care an income tax of any kind. Or imagine there is a discount on the full price—for instance, 30 percent off for everybody, regardless of income. In that case it's still not an income tax. No matter how much you earn, you pay the same price. But what if the discount (or subsidy) is tied to your employment situation? Not to your income, but to your employment situation. That's how the exchanges work. If you have a full-time job with an employer that offers coverage—which is the case for most employees in our economy—you don't get the subsidy offered through the exchanges. If you want to get the subsidy, you need to become a part-time worker or spend time off the job. In other words, this discount, too, is a tax on full-time employment. Of course, no politician ever calls it a tax. But when you are in a group of people that doesn't receive a subsidy that people in another group receive, that's a tax.

So far I have oversimplified things, because there isn't just one subsidy for everybody in the exchanges. The subsidy depends on your income. So there's also an income tax built in. The more you earn, the less of a discount you get. Indeed, if you earn enough, the discount disappears. The folks analyzing this law in Washington made the mistake of focusing only on the income-tax aspect of the subsidy. There will be only eight million people in the exchanges, they figured, so eight million people now have a new income tax. That's no big deal, they thought. They were oblivious to the fact that they were implementing a full-time employment tax on the majority of American workers. In all of the economic analyses of the ACA, there was no mention of this full-time employment tax—despite the fact that it's the single biggest tax in the law.

In describing the size of this tax, again I find it useful to think in terms of how many hours per week somebody has to work to create enough value to replace the government subsidy he is losing because of his full-time status. There are a number of full-time workers who may have to work ten, 20, or even 30 hours a week to create the value they would get for free if they worked part time or didn't work under the ACA. In the old days, working part time meant you earned less, and your family had less to spend than if you worked full time. Under this new system, on the other hand, if you have a family of four and make $26 an hour, dropping to part time can actually improve your financial condition by qualifying you for well over $1,000 per month in subsidies through the health care exchanges—an amount that exceeds what you would make by working the extra eleven hours per week. This is an economically perverse situation.

We have decades of research showing that when you tax something, you get less of it. So if you tax labor, you get less labor. By that I mean on average—I don't mean that every worker responds to every labor tax. That's obviously not the case. But on average, if you tax labor you get less labor. As a result of the ACA, then, we are going to have fewer people working and less value created overall.

Nor will the loss of productivity end there. As with the ethanol example, there will be more and more tax distortions from the ACA as it continues to roll out. Businesses will change the way they do business, whether it's by bending over backwards to stay below 50 employees or by having more part-time employees and fewer full-time employees—not because these policies create value or satisfy customers, but because they avoid penalties or enhance subsidies. The Chicago Cubs baseball team changed over to more part-time employees this past summer, and as a result there was a day when the grounds crew couldn't handle the weather—reducing the value of the game for the fans in general. Incentives and disincentives in the tax code ripple through the economy in unimaginable ways.

This has not been well understood. Some analysts, for instance, have argued that not many employers, relatively speaking, are going to end up paying the penalty, so the harm of the penalty will be limited. And that's just wrong. Adam Smith pointed out in *The Wealth of Nations* that if there's a type of employment that's evidently either more advantageous or less advantageous than other types of employment, so many people would crowd into it in the former case, or desert it in the latter case, that its advantages would soon return to the level of the other types. In terms of the ACA, whereas only some workers will experience the penalty directly, it will be felt across the economy because workers will move out of the penalized businesses—and customers will do the same, since those penalties are passed on to them in the form of higher costs. We'll all experience it. Economists and politicians who looked at this law made the mistake of basing their analyses on models in which nothing matters except what happens directly to the individual worker and his employer. That is not how economics works.

* * *

In summary, the ACA has three major taxes in it. Two are taxes on full-time employment and the other is a tax on income. They may be implicit, they may be hidden, politicians may not call them taxes, but that's what they are. Their economic impact on workers varies widely, affecting low-skill workers the most. They create all kinds of productivity problems and will have visible and permanent effects on the economy. I have estimated that employment will be three percent less over the long term because of the ACA, and that national income—or GDP, if you like to think of it that way—will be two percent less. If you look at the productivity costs alone—forgetting the fact that there will be a number of people not working anymore—they come to $6,000 per person who gets health insurance because of the law. And I'm not beginning to count the payments needed for health care providers.

In conclusion, I can make you this promise: If you like your weak economy, you can keep your weak economy. ■