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The Affordable Care Act Negatively Impacts the Supply of Labor

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Labor market distortions are common within the Patient Protection and Affordable Care Act (PPACA/Obamacare). Employers are faced with uncertainty at every turn. As observed from the recently released Federal Reserve beige book, this uncertainty restrains hiring.[1]

While substantial attention has been given to the employer side, the employee side also experiences many distortionary effects. Some of these distortions include incentives to reduce hours, not seek work, drop insurance coverage, drop dependent coverage, become divorced, or avoid marriage. It is apparent that Obamacare's effects extend far past the number of employees a business will employ, or how many hours a week an employee will be allowed to work.

Obamacare Taxes and the Supply of Labor. Obamacare will negatively affect the reward to work for many workers, as noted by University of Chicago economist, Casey Mulligan. According to Mulligan, "The net result of all of this will be to reduce employment, especially among less skilled people."[2] Many individuals will be left facing tough decisions on whether or not to take a higher paying job or losing thousands of dollars in health care subsidies.[3]

When an individual faces higher tax rates, if they currently have a job, they may roll back on hours worked. Subsidies also have this sort of effect. According to Mulligan, "The [Affordable Care Act's] subsidies will sharply reduce the financial reward to working because they will be phased out with household income."

The Congressional Budget Office (CBO) also agrees, stating, "The expansion of Medicaid and the availability of subsidies through the exchanges will effective increases beneficiaries' financial resources. Those additional resources will encourage some people to work fewer hours or to withdraw from the labor market." The CBO found that the legislation would reduce amount of labor by half a percent.[4]

Under the Affordable Care Act's system of subsidies, as an individual makes more money, they are *rewarded* by losing subsidies. This creates a calculation that each person must make—whether or not to strive to increase their personal household income through working more or getting a better job, or choosing to stay in a similar place in life in order to keep the benefits.

In November 2012, the CBO estimated the increase in marginal tax rates due to Obamacare, adding evidence to Mulligan's claim. According to the CBO, the introduction of the Medicaid expansion and the exchange subsidies would increase marginal tax rates for more individuals. Populations that have Medicaid face marginal tax rates above 75 percent in many instances. In terms of exchange subsides, for income between 100 percent and 133 percent of the poverty level, tax rates increase by 2 percent. For income between 133 percent and 400 percent of the poverty level, increases vary between 9.5 percent and 18 percent.[5]

Compared to previous law, individuals now experience even higher marginal tax rates from the ability to garnish health care subsidies at lower income. Obamacare ultimately discourages low income individuals from trying to move into higher paying jobs on the margin.

This paper, in its entirety, can be found at **http://report.heritage.org/ib3873**

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Low-wage workers are especially affected, because they are most responsive to higher tax rates or lower subsidies. The CBO believes that low-income workers have higher labor elasticies.[6] Low income workers will respond to changes in tax rates more intensely on the margin than individuals with higher incomes. Not only are marginal rates higher, but lower income individuals are expected to respond more vigorously to the changes. This effect could be further exasperated through the incentives for employers to drop coverage to lowering income employees.[7]

Dependent Coverage and Obamacare's Treatment of Marriage. Several analysts point out that Obamacare develops a marriage penalty.[8] Simply put, individuals lose subsidies if they choose to marry without any change to earnings. Representative Darrel Issa (R–CA) points out a simple explanation and example: "The result of linking the tax credit to the federal poverty level is that two individuals who make between $61,600 and $91,200 in 2014 will not benefit from the tax credit if they decide to marry."

While this example only shows one case, it is true that most individuals that previously obtained exchange subsidies would lose some subsidies when becoming married. For a couple that has two individual earners between 100 percent and 400 percent of the Federal Poverty Level, choosing to get married would experience further increases in effective marginal tax rates—between 10 percent and 24 percent.[9]

The extension of dependent coverage in Obamacare attacks the labor market from several angles. First, young adults are discouraged from entering the labor force due to the law's implementation. Heritage analysis shows that individuals can be as much as 15 percent more unlikely to be part of the labor force after the dependent coverage provision went into effect.[10]

This behavior makes the most sense for low-income earners where the benefit will be relatively large compared to the wage earned. While it is not necessarily true that a young adult would lose their dependent coverage upon getting a job of their own, this consideration could be coming into play, as well as a general decision to utilize the benefit to stay in school, or pursue other activities.

A second effect, as outlined in a previous Heritage Issue Brief, outlines the incentive for individuals dropping their own name coverage for dependent coverage.[11] Ultimately, this leads to increased incentives for employers to drop coverage, either by pushing employees to the exchanges indirectly or paying the penalty and adjusting benefits accordingly.

Labor Market Distortions Still to Come. Obamacare distorts incentives for employees to make positive changes in the labor market. Employees are encouraged to keep lower paying jobs in order to preserve subsidies, while also being encouraged to remain single, leave

1. Federal Reserve District "Current Economic Conditions," February 2013, http://www.federalreserve.gov/monetarypolicy/beigebook/files/Beigebook_20130306.pdf (accessed March 7, 2013).
2. Casey B. Mulligan, "Health Reform, the Reward to Work and Massachusetts," *The New York Times*, March 6 2013, http://economix.blogs.nytimes.com/2013/03/06/health-reform-the-reward-to-work-and-massachusetts/ (accessed March 7, 2013).
3. David Gamage, "Obamacare's Costs to the Working Class," *The Wall Street Journal*, October 30, 2012, http://online.wsj.com/article/SB100014240529702033 35504578086702676417058.html (accessed March 8, 2013).
4. Congressional Budget Office, "The Budget and Economic Outlook: An Update," August 18, 2010, http://www.cbo.gov/publication/21670 (accessed March 8, 2013).
5. Congressional Budget Office, "Effective Marginal Tax Rates for Low – and Moderate- Income Workers," November 2012, http://www.cbo.gov/sites/default/files/cbofiles/attachments/11-15-2012-MarginalTaxRates.pdf (accessed March 7, 2012).
6. Robert McClelland and Shannon Mok, "A review of Recent Research on Labor Supply Elasticities," October 2012, http://www.cbo.gov/sites/default/files/cbofiles/attachments/10-25-2012-Recent_Research_on_Labor_Supply_Elasticities.pdf (accessed March 8, 2013).
7. Casey B. Mulligan, "In Massachusetts We Trust," *The New York Times*, February 27, 2013, http://economix.blogs.nytimes.com/2013/02/27/in-massachusetts-we-trust/ (accessed March 7, 2013).
8. Oversight Committee, "Examining Obamacare's Hidden Marriage Penalty and its Impact on the Deficit," October 27, 2011, http://oversight.house.gov/wp-content/uploads/2012/04/10-27-11-Subcommittee-on-Health-Care-District-of-Columbia-Census-and-the-National-Archives-Hearing-Transcript.pdf (accessed March 8, 2013).
9. Calculations by Author.
10. Analysis Conducted by Author in Forthcoming Brief.
11. Drew Gonshorowski, "Health Reform and the Impact of Extending Dependent Coverage to Age 26," Heritage Foundation *Issue Brief* No. 3645, June 21, 2012 http://www.heritage.org/research/reports/2012/06/health-reform-and-the-impact-of-extending-dependent-coverage-to-age-26.

the labor force, or even not participate in the labor force.

While many economists and officials suggest that the Affordable Care Act will not result in drastic labor market distortions when it is fully implemented, basic economic evaluation of the situation shows that these distortions will occur. If the most recent Federal Reserve beige book's further revelations about slow labor market recovery is any foreshadowing to what is to come, the United States labor market is in for rude surprise in the coming years.[12]

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12. Federal Reserve District, "Current Economic Conditions."