CHAPTER FIVE

The Effects of Redistribution Policies on Growth and Employment

Casey B. Mulligan

I'll start with a two-sentence summary, so you can get right to the weaknesses of what I'm going to say. First sentence: the federal government has recently created or expanded a number of redistribution programs, and these programs have made the American economy smaller than it would have been. Second sentence: the effects of these programs are right in line with basic economics, right in line with basic price theory, but the opposite of what the program advocates have been telling us. So a natural reaction, I think, to those two sentences would be—and this is kind of an early Milton Friedman style of conclusion—would be to say, "Hey, these policies are bad ideas. We're not sure where they came from. And they could have been rectified by giving some combination of voters, politicians, and bureaucrats a better economic education." In short, if everybody just studied price theory, what a wonderful world it would be.

And I'm not sure I'm going to be able to tell you more than that today.

But I know that Gary Becker would have pushed back on that. And he did push back when we had working groups on these topics. He would push back and say, "Wait a second. Don't side with the guy on the left in this picture [Milton Friedman]. The guy on the right [George Stigler] had some things to say, too." And he would say, "You can do all the educating you want, and there are still going to be the fundamental economic and political forces pushing for these policies."

Milton Friedman (left) walking with fellow University of Chicago economist George Stigler.

I don't know what these fundamental forces are. I'm just going to tell you what the results are in terms of policy.

Now let's talk about redistribution policy. There's an excess of attention on the personal income tax. I'll start with figure 5.1 of marginal tax rates as calculated by NBER [National Bureau of Economic Research] for the personal income taxes at the federal and state levels. Each tick in this graph is two points, so the last several years here you don't see a lot of action. The moves in this tax are in the tenths of percentage points. Basically, this tax hasn't changed.

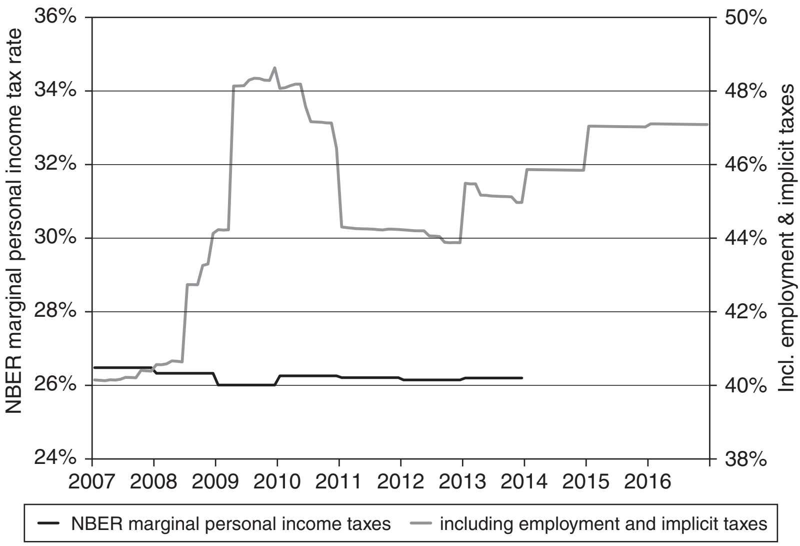

FIGURE 5.1. Statutory marginal labor tax rates
Source: National Bureau of Economic Research.

And if you focus on personal income taxes too much, then you say we haven't really changed the redistribution we've been doing.

Now, there are a couple problems with this graph the way I've drawn it here. It doesn't have employment taxes. And I think if you're interested in employment, of course income taxes are relevant. People have jobs to earn income. But also, employment taxes are relevant for employment.

The gray lines include those implicit income taxes into the picture. Each tick is still two points. The levels are different, but now we have a lot more happening. And I want to tell you some of the story behind what is happening.

I tried to organize some of the policy changes in table 5.1 by time period and by type of tax. Employment tax is the one that gets the least attention. That's in the first column. In the second column are the income taxes. In the interest of time, I'm going to jump to the middle period of 2007 to 2013, where there is a lot of legislative action

TABLE 5.1. New employment and income taxes in recent history

Explicit taxes are indicated in italics; all other taxes are implicit taxes

Time period	Employment taxes	Income Taxes
before 2007	Disability expansions esp., wider range of ailments	Medicaid expansions Eligibility, esp. children Growing market value of free health insurance
2007–2013	Work requirements dropped UI expansions more weeks of eligibility other eligibility expansions benefit increases Unemployment-tested assistance with health insurance 3 Federal minimum wage increases	Food stamps expansions eligibility benefit increases Means-tested loan forgiveness mortgages student loans
2014–2016	ACA HI assistance *ACA employer penalty*	ACA HI assistance ACA Medicaid expansions *AGA Medicare tax surcharges*

Source: Author's summary

in both employment and income taxes. You probably heard of the infamous ninety-nine weeks of unemployment insurance. That's one of the items here. But there are a bunch of items here that have little to do with ninety-nine weeks of unemployment insurance. There were a lot of new employment taxes that never made the newspaper.

Each one of these is a fascinating story. But I picked out two as a representative picture from the population. So I'll talk about some of the unemployment-tested health insurance and some of the food stamp expansions. The period from 2014–2016 is interesting in its own way, because these are all policies that come with the Affordable Care Act. There are a number of different aspects of that, and I'll tell you about some of these. And then in italics, I've indicated that only two of these taxes are explicit taxes that a politician would actually call a tax. The rest of them are implicit.

The first employment tax I will tell you about is the subsidy for

COBRA policies. COBRA refers to a long-standing law allowing people to continue participation in their former employer's health plan. Traditionally, that was an expensive proposition for the individual. You left your employer and stayed in the plan, but you had to pay for everything. Your employer probably wasn't going to be paying anymore. And you had to do it with after-tax dollars. So it was pretty expensive, and there were a lot of good reasons why people would avoid being laid off or try to avoid quitting. If they were laid off or quit, there was an incentive to hurry back to work. Well, the so-called stimulus law, the ARRA [American Recovery and Reinvestment Act of 2009], totally reversed that calculus. If you were laid off from your job and you liked your former employer health plan, you could keep it. And the federal government would pay about two-thirds. Now the scales were reversed, so that the cheaper way to get insurance would actually be to be off the job, rather than on the job. And this is a pretty big deal, not only because of the number of people—about two million workers plus dependents—who took part in this, but also it was kind of a preview to the real film that's coming, which was the Affordable Care Act. It was kind of a test run of the Affordable Care Act, as we will see.

The second one I want to tell you about is now called SNAP [Supplemental Nutrition Assistance Program], although it is known colloquially as food stamps. Food stamps are a combination of a tax on income, a tax on assets, and a subsidy from employment, all in the same bundle. Traditionally, that's the way it worked. One thing that happened in 2008 was that they cut the asset tax. So that put more people in a situation where they're paying an income tax rather than an asset tax. The other thing that happened was they got rid of the work requirement (or the employment subsidy if you think of it that way), so two things at the same time created a new income tax and a new employment tax for people, relative to the baseline.

Basically, SNAP has become a kind of unemployment insurance for unmarried people. There's no limit. You can be on there more than ninety-nine weeks. And really the only restriction, so to speak, is it's hard to be on there if you're married. Here's a statistic I have from fiscal year 2010. In a typical week, about 85 percent of unemployed, unmarried, non-elderly household heads were in food stamp households. And I'm not just picking some tiny little population with only a few people in it. The numerator of that 85 percent is over three million people. So this is a kind of new unemployment program, it is ongoing. The only temporary part was some benefit bonus they put on there, but all the rest continues, and there's no schedule to changing any of it.

That's the middle busy period from 2007 to 2013. The next period has to do with the Affordable Care Act. There are a lot of taxes in there and I don't have time to tell you all about them. But I'm going to tell you about my two favorites. And to introduce you to those, I need to tell you about some of the components in that big, complicated law that are related to health insurance coverage. The number one component is the market exchanges. They're exchanges where people can buy health insurance, and it is often subsidized in a couple of different ways. The second part is the employer mandate, that's enforced with the penalty that I'm going to tell you about. There are two other parts I'm not going to talk about much today, which are the individual mandate and the Medicaid expansions, but I'm going to focus on the first two.

In those marketplaces, there are two taxes that are large and many small ones. There are two that often get mixed together, but they are economically distinct. And the second part, the employer penalty, is actually a lot more significant than it first appears. I'll explain to you why—when you first look at it—you're only seeing a tip of the iceberg there.

Let's start with the employer penalty. That is a penalty that is important to understand. It only applies to full-time employees, and only when they are on the payroll. If you are unemployed, no one is penalizing you or penalizing an employer on your behalf. That is pretty important to the economics. It's indexed to health insurance costs, so it's probably going to grow faster than wages and faster than the economy into the future. It disproportionally hits low-skilled workers. Imagine that I kept talking to you guys today until dark, and then I kept going for a couple more hours. That's how many hours minimum-wage workers have to work so their employer can pay this penalty. That's a long time. Every week, they have to work eight hours to pay off that penalty. One reason why it's so many hours is that, unlike salaries, these penalties are not deductible from business taxes. So you've heard the penalty probably referred to as the $2,000 penalty, but in reality it is a $3,000 penalty if you look at it in terms of a salary equivalent. So for a minimum-wage worker, that is a lot of money on an annual basis. Also, it has anti-competitive aspects. I'm referring to competition in the labor market. Small employers don't pay this penalty. And you might hope, as a fan of markets, that there would be some competition, that the low-penalty players in the market could out-compete the high-penalty players. The problem is, if they try to out-compete the high-penalty players, they become high-penalty players themselves. There's a tremendous penalty—over $60,000 annually—for going over the threshold between small and large employers. So I think you're in a situation where you're going to have not only a penalty that's going to be paid by some employers, but you have the anti-competitive effects.

Now let's talk about the health insurance marketplaces. Figure 5.2 shows income on the horizontal axis and payments for health care on the vertical axis. The horizontal line represents paying full price for health care, which means it's independent of your income. Whatever your health care is, you pay, whether you're rich or you're poor. I've drawn another line for a discount, but the same discount for everybody. So that's why it's another horizontal line, but it's lower because it's a discount. What the Affordable Care Act

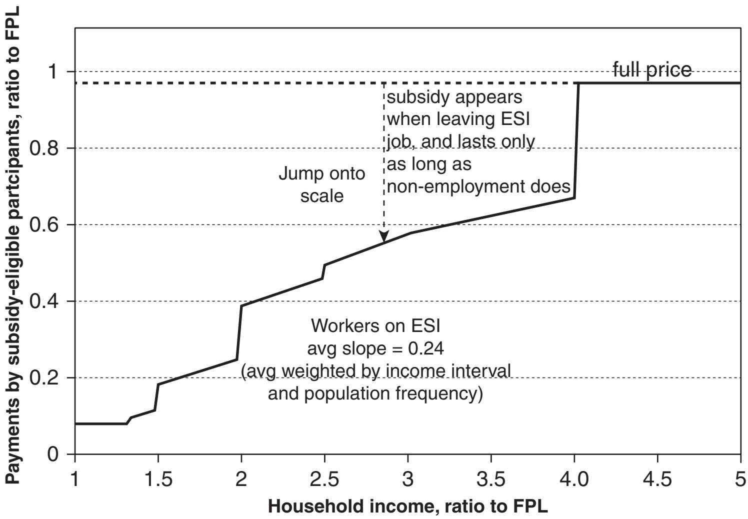

FIGURE 5.2. Health insurance marketplaces
Source: Author's calculations

says is, if you want to have the discount, you cannot be a full-time worker at an employer that offers coverage—which of course is most employees. This is a kind of full-time employment tax, and that's what the arrow is showing. You can't get that discount unless you leave that full-time position somehow, either to part-time work, or unemployment, or you're out of the labor force, making it a full-time employment tax.

I'm over-simplifying here, because the discount line is not really a horizontal line in the real law. It's an upward sloping line. And because it's an upward sloping line, it's also an income tax. But I want to emphasize that the full-time employment tax has not disappeared. When I've gone from my simple example to the real law, that arrow is still there. So not only is there a penalty on earning income as you move up and down the solid line, but there's also a penalty for being employed, and those are distinct economically, and you've got to look at them both. The slope, by the way, of the solid line . . . it's got a lot of slopes, but it averages about twentyfour. That's not a trivial thing. That's on top of all the other taxes that people pay.

Figure 5.3 is a summary of my three favorite taxes in the law. The black lines are telling us about the percentage of people who experience this tax. When I say "experience it," I don't mean pay it. I mean it's in their budget set. Whether they pay it or not is a choice, which is an analysis we do once we determine how large these taxes are. And then the gray bars are indicating how large the tax is, from the point of view of the people who are sitting in the black bars. And these are big numbers. Each tick on the side here is five percentage points. A number of these taxes look like almost doubling the payroll tax from employer and employee among the people who would be experiencing them.

Now I want to show you some behavioral analysis of these taxes. I'm going to start at an aggregate level. Having three groups is not aggregate enough for me, so I'm going to multiply the gray and the

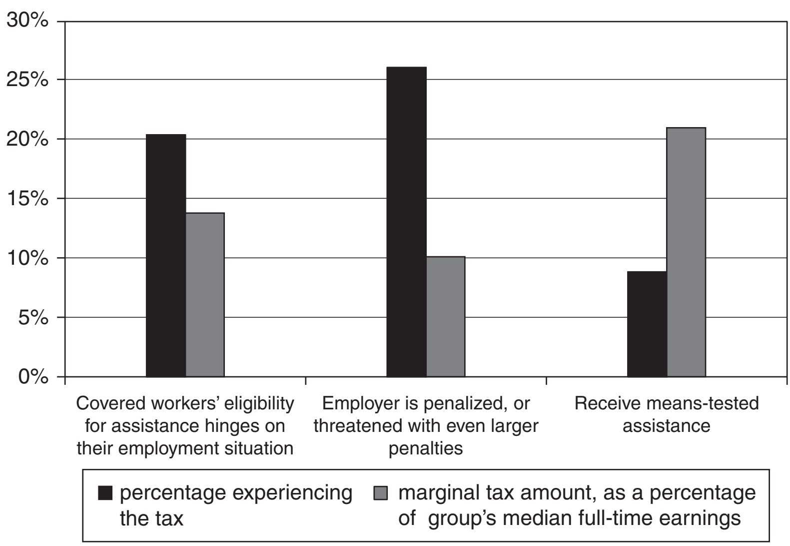

FIGURE 5.3. Taxes in Affordable Care Act

Source: Mulligan, Casey B., *Side Effects and Complications* (Chicago: University of Chicago Press, 2015.)

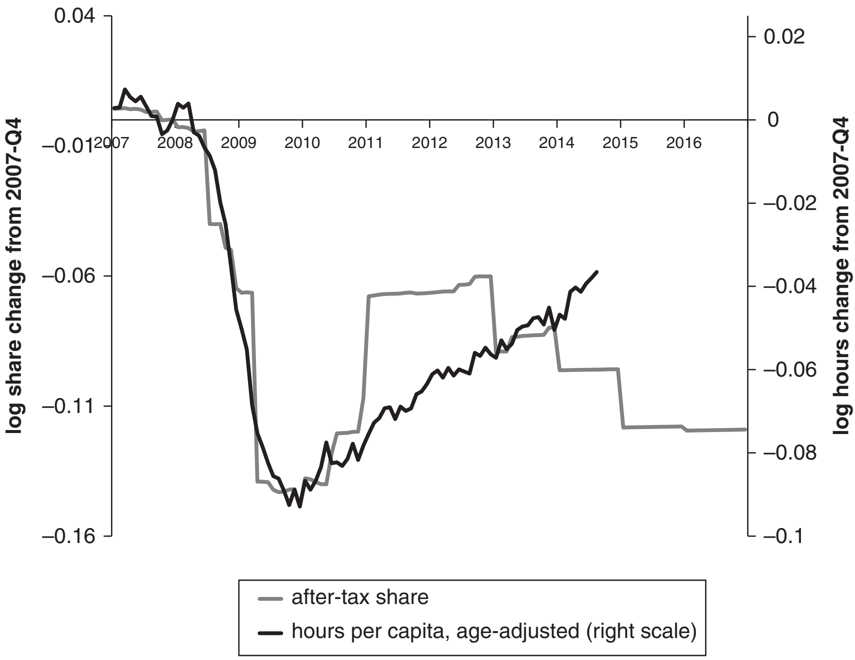

FIGURE 5.4. Safety net rules compared with work hours
Source: Author's calculations

black together, make an index, and use fixed population rates to redo that index every month. And I'm going to not only include the Affordable Care Act's new taxes, but all the new taxes that are displayed on table 5.1. I flipped it upside down to represent not what you pay when you earn more, but what you keep. And I've also put it on a log scale. That's the after-tax share. Here's where we are today. And then I'm going to plot labor market performance by measuring work hours per person, adjusted for the average age of the population. The work hours are in black. These are not exactly on the same scale. I'm not sure I'd want to use an elasticity of one to connect these two together, which is what you'd be doing if you put them on a common scale. Taxes went down, and the market went down. When the labor market came back somewhat, taxes came back somewhat.

Here's another way to look at what has happened. Figure 5.5 shows measures of wages. Of course, I think in terms of supply and demand. That's what Gary taught me. But there's a supply price and a demand price, and I'm showing you both in the labor market. I'm showing you employer costs, the demand price for labor in the black, and I'm showing you the supply price, the employee reward to working after all the taxes and subsidies. Starting with the black line, I think it went up somewhat. What's important to me is that you look at it on this scale. Namely, when you're looking at employer costs, look at it on the same scale that you use to look at the employee reward. You have room to fit the 12 percent drop in the employee reward to working that happened during this period. We can argue what has happened to employer costs, and maybe they went down, but it's nothing like what happened to the employee reward to work. It took a very big hit and remains quite low.

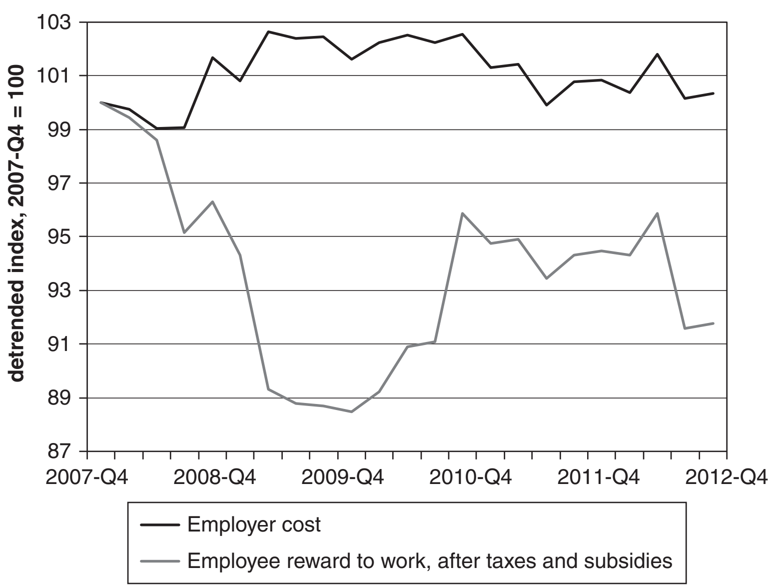

FIGURE 5.5. Measures of wages
Source: Author's calculations

Next I'll show you some cross-sectional behavioral patterns. I'm going to do this kind of tax rate analysis separately for ten groups. There are five groups based on skill, and each of the skill groups are broken into married and unmarried. I'm going to do a tax rate for each of the ten groups, and then I'm going to do an hours change. I'm going to do a gray series for each of the groups and a black series, and then I'm going to put them into a scatter plot.

The incentives will be on the bottom, and so farther to the right will mean a greater increase in incentives for working. Changes in hours worked from 2007 to 2010 are on the vertical axis.

Figure 5.6 shows married groups in black and unmarried groups in gray. The labels show you for these groups what they typically earn per month when they work full-time. Often you hear that in a recession, the low-skill groups are hit the hardest. You don't really see that among the married people. They all went down around 6 percent except for the most skilled group. Also, maybe it's just a coincidence that their incentives measured this way also went down about the same amount, about twelve log points.

Now let me show you the unmarried people. They don't all bunch together, either in their incentives or in their hours worked changes, except the bottom two groups. Those two have more or less the same hours changes and incentives changes. So maybe it is too naïve, but basic economics says, "Well, you'd expect the groups that have their incentives lowered the most would be the ones with hours that decline the most." And you see what you'd expect.

It's not true that taxes have been constant in these years. Broadly measured to include employment taxes and implicit taxes, they've gone up quite a bit. Incentives have been eroded because there's more redistribution than there was a few years ago. That redistribution has reduced the return to working quite a bit, and it should remain low if the laws on the books stay on the books.

The laws that created these new taxes were called stimulus laws, but by taxing employment and income, you get less employment

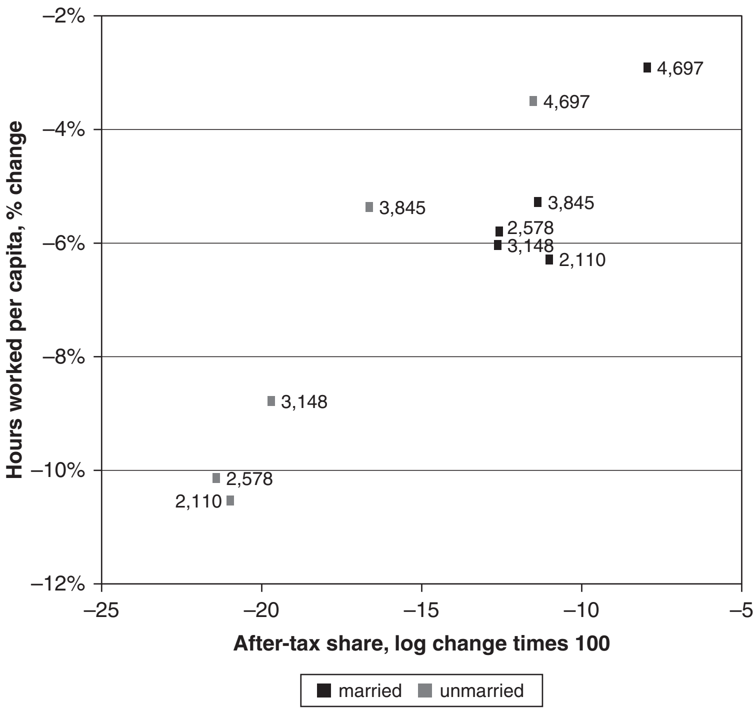

FIGURE 5.6. Full-time wages for married and unmarried workers

Source: Mulligan, Casey B., "Recent Marginal Labor Income Tax Rate Changes by Skill and Marital Status." *Tax Policy and the Economy* 27 (2013): 69–100

and less income. My estimates suggest it about doubled the size of the contraction measured in terms of average work hours. On a permanent basis, about half of potential workers will have a major new disincentive going forward in their budget set as a consequence of the health law. I estimate that employment and aggregate hours are going to be reduced by 3 percent due to the health law, and national income reduced by 2 percent due to the health law.

Let me go back and make the case for economic education versus politics. The first thing I would start with is so many of these taxes were implicit taxes. That, of course, allows politicians to say they didn't change taxes, because they use the word narrowly to their advantage. So the political economists might explain that. More surprising, I think, is that the experts, not the politicians, offer opinions about the employment situation without mentioning these new taxes. I'm talking about the Federal Reserve or the IMF (International Monetary Fund). Now maybe the students of George Stigler and Gary Becker would say, "Come on, we can use political economy theory to explain . . . those are government institutions. We'll use political economy to explain why they don't do the economics quite right."

I think Gary would push back, but I think maybe economic education does have something to do with public policy. I'm going to side with the younger Milton Friedman, and I think all of us who learned from Gary need to do our part to pass on the economic way of thinking, because it doesn't pass itself on.

Question and Answer Session

QUESTION: *I would just offer what I'm sure Gary's spirit (which was quite influential in my early work on taxation, including taxation of the family and taxation of human capital) that he'd appreciate or might support a friendly amendment which would say: this doesn't yet get into all the negative effects on skill accumulation on people who are not in the labor force. And that would make things even worse.*

CASEY MULLIGAN: We need to go through these laws and ask, "What are they doing to the tax rate, not just on work but on human capital accumulation, on the job training, certain types of schooling?" It's really important. I haven't done it yet. It's doable, but I haven't done it. I'm hoping these effects take longer to accumulate, so I have time to catch up with the new laws. But of course, human capital is ultimately the number one thing to study in these sorts of situations.

QUESTION: *You've identified the behavioral effects and they look like they're potentially large. So the question is, what about the consequences for income distribution? Have you looked at disability, food stamps, ACA, individually or together, and their effects on income distribution?*

MULLIGAN: Although human capital definitely creates inequality in earnings, I think of it as fairly constant over this time frame. As I showed in my cross-sectional analysis, these aren't random samples of people who are leaving work. So redistribution is raising inequality. I think in a full analysis, though, you would want to look at those returns to human capital. That's a big deal for inequality issues. People who earn more probably have more human capital, and if we want to understand the distribution of earnings, you've got to understand the distribution of human capital. I haven't offered much on that, I'm afraid.

QUESTION: *You had mentioned when you showed your hours of work and you made the point that it's usually stated that during recessions, the less educated get hit more than the more educated. And you showed with hours of work, that wasn't the case. Now I'm thinking back to unemployment rates, and my sense is that with unemployment rates, that is the case, but that may not be right. Is it because I'm thinking of absolute changes versus proportionate changes? And you did proportionate changes? Or is there a difference between the intensive and the extensive margin?*

MULLIGAN: From the very beginning of this project, I never emphasized the unemployment rate. I'm sorry. I know what it means to be employed. Unemployed, I'm not sure what it means, number one. Number two, the payments to calling yourself unemployed versus out of the labor force are changing over this very period. My brain's not big enough to analyze that type of data, so I never looked at it.

QUESTION: *You mentioned, if I understood this distinction between single and married. The bottom line: is this a huge disincentive to marriage?*

MULLIGAN: I put it below human capital on the list of projects, but yes, the Affordable Care Act has big taxes on being married. And that's going to matter for families. And I think you want to quantify the size of those taxes and start to understand what to expect from families going forward under these new incentives. And the basic problem is that the subsidies are based on household income. And you're not a household if you're unmarried for tax purposes, but you are if you're married. So you can go from being below poverty to above poverty just by getting a marriage certificate. And that kicks a lot of people off these various forms of assistance. I'm sure people are going to consider that in their marriage behavior.

QUESTION: *I had a question about whether we are headed toward a European-style labor market because of this, where eligible jobs with large companies are very rare, and most other employment is temporary. And also, what do your findings say about whether the US will be a 2 percent growth economy or a 3.5 percent growth economy?*

MULLIGAN: To the first question, one puzzle a lot of guys here worked on—I know Gary worked on it; he and I talked about it together and this is a conversation the profession had in the eighties and nineties—why is the United States' public policy different from Europe's? There was a lot of head-scratching on that problem. But we don't have to scratch our heads anymore because we're going to be more like them. Our taxes are more hidden, more implicit. Theirs are more aboveboard. They have a payroll tax, a big one. And we have more hidden stuff. But other than that, the basic economics of redistribution are starting to look more and more similar all the time.

QUESTION: *If you go to Singapore, you learn they are allergic to stuff being thrown around and distributed. So one day, I went to the races on Sunday. And what do you do at the races? You bet, you lose, you tear up your ticket, and you throw it on the ground. Well, in Singapore, after each race, there's an announcement. In the upper right-hand corner of each ticket there is a number. And on Monday morning, there will be a drawing. The winning number gets a thousand dollars. They have no problem. So people respond to incentives. And it seems to me in listening to your presentation, even if things are implicit, people somehow sense them and they respond. So let me put my question this way, is there any result that you got in your work that was surprising?*

MULLIGAN: To the guys who took Gary's class, I don't think so. It's not cutting-edge stuff that I'm doing. I'm just measuring.

QUESTION: *So I know your work is focused on 2007 or more recently, but there's lots of changes in policy over longer periods, which people studied and I actually think it's pretty consistent with what you have. But that also shows that policy can change. You can see, partly because of the knowledge of the economics, it could be that the Chicago School itself waved back and forth. And your poll of the [University of] Chicago Booth School [of Business] would suggest it's waving in another direction. So based on the longer history, could you add more to your findings about whether we might find something to be more optimistic about going down the road? Or are we sort of continuing in this mode for a while? You can sort of see changes from the seventies to eighties, for example. People documented that. But could you comment a little bit on that?*

MULLIGAN: I'm kind of stuck on that. Friedman thought the ideas were important, and Stigler thought there were more basic forces there. Both things will change. Basic forces don't stay constant, and ideas don't stay constant.

QUESTION: *Casey, I'm curious. I'm right with you, and I think most people in this room are, on the negative effects of unemployment insurance and the extension up to ninety-nine weeks. I think there was even some research by President Obama's chief economist that affirmed unemployment insurance causes an uptick in the unemployment rate. So it made that dissonance really interesting. Can you give us an update on what the status is of the program now? I know it phased out. And what you thought about good ideas for replacing or reforming the unemployment insurance system.*

MULLIGAN: I showed a number of programs related to unemployment. The ninety-nine weeks has expired. The COBRA assistance has expired. The food stamp expansions are not expired, may never be expired. But the Affordable Care Act is that COBRA program all over again but for a bigger population. You don't have to be unemployed anymore. To get COBRA assistance, you had to say, "I'm looking for work." To get Obamacare, you don't need to say, "I'm looking for work." Just don't be at a job where they offer coverage. So you could be early retired. You could be a housewife, a house-husband. Not working is a source of assistance there, and it's a lot of assistance that's being directed. So you had some unemployment programs replacing others. I don't think you've had a reduction in assistance for non-employment.

FOLLOW-UP: *I know your focus has been on the health care law. It's been amazing. But just thinking—even if we're just with twenty-six weeks at roughly 50 percent replacement rate, aren't there better ways to help people to create maybe automatic stabilizers, some of the benefits to restructure when the program starts? Just for example, right now you lose your job, and you're immediately eligible for UI, that very first week. And this is one of the* *frustrating things when I came out of the military, that you could file for unemployment insurance right away. And then we wonder why there's a veteran's unemployment problem. Maybe if you had to wait for a month or two, but you had a more generous compensation, would that be a good idea? I'm just wondering on that program, if you've done any thinking or if you could point to some other scholars who've done some good research.*

MULLIGAN: Let me say the health reform that (Massachusetts Governor Mitt) Romney had, one of the big differences was RomneyCare had assistance for unemployed, but you had to wait six months to get that assistance. And with the ACA, there's no wait. That's a difference, so you could study that difference. I'm not saying which policy is better or worse, but you could study that one. You know, I came to Chicago very interested in optimal tax and optimal policy, and Gary talked me out of that quickly. He said, "Try to figure out what people do and worry about the optimal policy later." And I've followed that.