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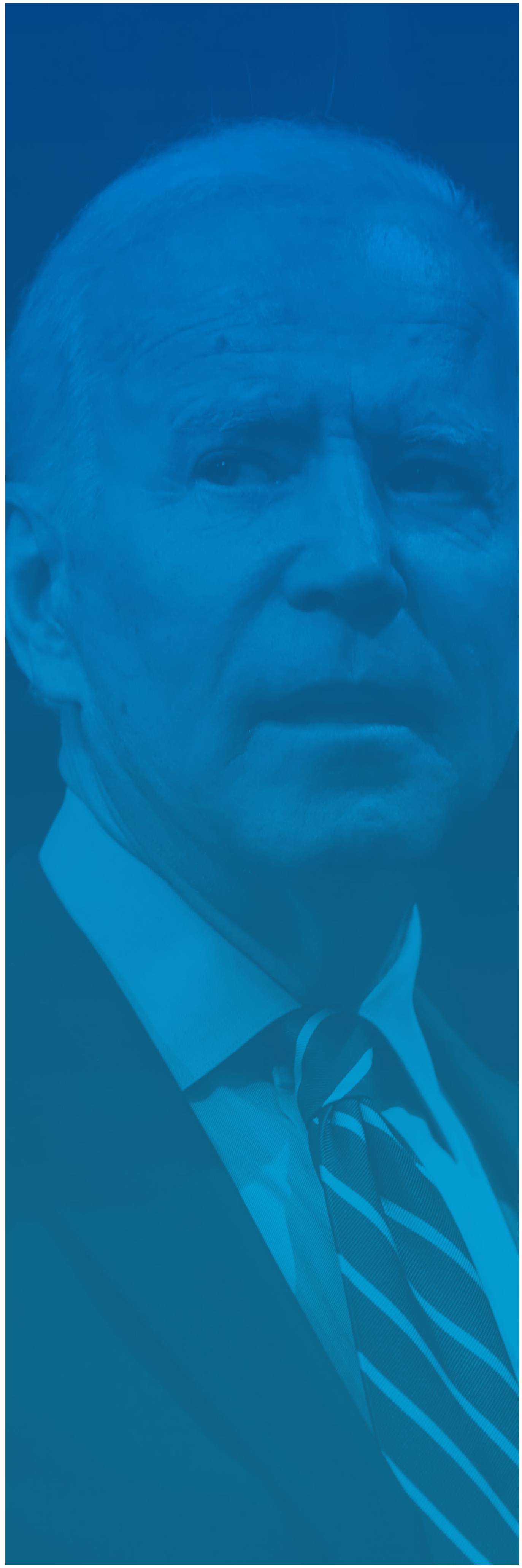
Build Back Better's Hidden But Hefty Penalties on Work

Casey B. Mulligan



Casey B. Mulligan is a professor of economics at the
University of Chicago, who served as chief economist
at the White House Council of Economic Advisers.

As the Build Back Better (BBB) bill seeks to redistribute resources, it would unintentionally reduce U.S. living standards by depressing the supply of goods and services. Especially, the bill would implement the single largest permanent increase in work disincentives since the income tax came into its own during World War II.

The bill would also reduce work by limiting competition in the labor market, imposing employer mandates, distorting childcare markets, and increasing consumer prices for telecommunications, energy, and other products. All of these disincentives go on top of those already in the baseline due to a continuing portfolio of federal, state, and local tax, spending, and regulatory policies.

The implicit employment and income taxes in BBB would increase marginal tax rates on work by about 8 percentage points. I expect that such a change in the disincentive would reduce full-time equivalent employment by about 6%, or almost 9 million jobs, over 10 years. Any economic effect of financing BBB – with current or future personal or business income taxes – would go on top of this estimate. The table that follows decomposes the 9 million projection into the individual contributions of 13 distinct parts of BBB.

Penalizing Work and Hiring

The disincentives are delivered through two fundamental economic mechanisms. First and foremost is the creation and expansion of employment-tested benefits.

Full-time employment is a major barrier to participating in the programs, even if that employment does not produce much income (Mulligan 2015a). BBB allows even America's highest-income households to participate in subsidized "Obamacare" insurance plans as long as they are not engaged in any job that offers health insurance.[1] For most full-time workers, their employment status by itself excludes them and their family from the additional Obamacare subsidies delivered through BBB, especially its sections 137501 and 137502 (see also Blase 2021).

Family medical leave is another benefit tied to not working. Section 130001 is quite explicit that eligibility requires a caregiving activity "in lieu of work, other than for monetary compensation." Family medical leave is a cash benefit paid in proportion to the number of hours of such caregiving. (Presumably the beneficiary could not both engage in a normal work schedule and claim such caregiving activities, but the details would be the subject of future executive-branch rulemaking. If double-dipping were rampant, this would raise expenditure on the program thereby requiring additional taxation that would itself discourage work.)

[1] Some employers will respond to BBB by dropping their coverage, but from an employment-incentive perspective this only changes the form of the full-time employment tax to the Affordable Care Act's (ACA's) employer penalty for not offering coverage. The salary equivalent of that penalty is almost $4,000 per full-time employee per year (Mulligan 2020).

Hidden Work Disincentives in "Build Back Better"

BBB Program	Percentage points added to average marginal tax rate	Employment impact, FTEs
ACA & Medicaid expansions	4.01	-4.5 million
Family Medical Leave	0.90	-1.0 million
Phaseout new childcare subsidies	0.78	-0.9 million
Remove CTC phase-in (ages 0-16) and reduce childcare/ PreK costs (ages 0-4) for those < 150% median household income	0	0.0 million
Phase out expanded Child Tax Credit	0.24	-0.3 million
Increase childcare costs at higher incomes	0.22	-0.2 million
Expand Child and Dependent Care Tax Credit	0	0.0 million
Phase out new affordable housing subsidies	0.56	-0.6 million
20% of Green New Deal	0.11	-0.1 million
Mandate employers to provide and auto enroll retirement accounts	0.51	-0.6 million
Various increase unionization	0.29	-0.3 million
FTC privacy regulation	0.13	-0.1 million
New excises taxes on tobacco	0.08	-0.1 million
All additions to implicit employment and income taxes	**7.84**	**-8.7 million**

Notes: Work is discouraged by removing the CTC phase-in, which applies to low-income parents of children aged 0-16. Holding other policies constant, work is encouraged for those families experiencing by reducing childcare costs (children aged 0-4). These two effects are assumed to offset. Employment impacts are for five years after all programs are in place.

Acronyms: ACA = Affordable Care Act. CTC = Child Tax Credit. FTC = Federal Trade Commission. FTE = full-time equivalent employment.

Several childcare provisions are in the bill, including “universal pre-K,” a new federal program for childcare subsidies modeled after the Affordable Care Act (ACA), and expanding two major tax credits for parents. While some of the provisions encourage work in pockets of the population, others discourage work with a net national effect that is readily quantified as shown in the next section of this report. Especially, the child care subsidies are clawed back with income, which would affect millions of parents in households earning less than $200,000 or so annually as well as many above that. Also disturbing is that the new subsidies would create large financial marriage penalties and significantly distort the quality of care.[2] For each year that a couple has children under age 5, being unmarried could easily save them $15,000 annually in childcare costs compared to being married because the new program would base the subsidy on household income, without combining the incomes of unmarried parents.

BBB also creates and expands employer mandates, with compliance enforced through penalties that are proportional to employment, regardless of how rich or poor the employees may be. An example of a proportional employer-penalty scheme is BBB's new requirement to administer individual retirement account (IRA) deductions from employee paychecks, with all employees enrolled by default. The penalty for non-compliance is $10 per employee per day (Section 131101), which is similar in magnitude to the ACA's penalty for failing to provide health insurance.

Section 21004 increases penalties on employers for failure to comply with federal occupational safety, health, and labor-standards requirements. The increases are tenfold or more. For example, the penalty for a large (100+) employer to employ an unvaccinated person is between $50,000 and $700,000 per violation and an additional $70,000 per day. This could amount to $26 million for every year that each unvaccinated person remains on the payroll.

These and other parts of BBB further reduce employment by suppressing competition in the labor market. Such provisions seek to prevent non-union workplaces, which are almost 95 percent of all private employment, from distinguishing themselves from unionized workplaces. Others put nonunion workplaces at an outright disadvantage.[3] Section 138514 would allow union dues to be deductible from federal income tax, putting about $400 million per year on the union side of the economic scale.[4] Other sections, such as 132002, target "infrastructure grants" to "labor unions and other employers … that pay the prevailing wage." Section 136401 creates a credit for the purchase of an electric vehicle that "satisfies the domestic assembly qualifications" (that is, unionized).

Penalizing Income

The second mechanism is income-tested benefits, which discourage the earning of income by withholding benefits as a household's income rises. For example, Section 136407 creates a tax credit for 15 percent of the price of the purchase of an electric bicycle, but the credit is reduced $0.20 per additional dollar earned by the household. More important, from an aggregate perspective, are a massive new federal childcare program and various additions to major income-tested programs such as Medicaid, "affordable housing" and the Child Tax Credit. By my count, the various new affordable housing subsidies in BBB exceed $220 billion over ten years.

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2 BBB includes heavy-handed childcare quality regulation, which Quebec tried in 1997 without the income phaseout. The results for Quebec children included "increases in early childhood anxiety and aggression," "a large, significant, negative shock to the preschool, noncognitive development and health of children exposed to the new program, with little measured impact on cognitive skills" and "worse health, lower life satisfaction, and higher crime rates later in life" (Baker, Gruber and Milligan 2019).

3 The labor union movement, of course, is an attempt to restrict or monopolize the supply of labor in order to extract higher employee compensation.

4 https://www.ntu.org/foundation/detail/house-dem-bill-would-add-42-billion-tax-break-for-union-dues

All of this means that as one's income from working goes up, the amount offered by these benefit programs go down. The means testing creates high marginal tax rates on workers for working an extra hour, day or week or for undertaking the kinds of skill upgrades that would get them a promotion.

Other provisions are, legally or economically, new excise taxes. These discourage work by reducing real wages, especially to the extent these policies raise consumer prices by protecting incumbent producers. A major example is section 31501, which directs the FTC to further enforce "privacy" rules that are effectively prohibitions on lower cost internet plans. When President Trump and the 115th Congress repealed such prohibitions, the cost of internet service dropped so sharply and immediately that the consumer savings drew the attention of then Federal Reserve Chair Janet Yellen due to its visible effect on the overall Consumer Price Index.[5] This shows why we can expect higher prices for internet plans under BBB.

A plethora of "green policies" have a similar effect on prices of transportation and energy, such as rural-utilities programs (Section 12007), taxes on methane emissions (Section 30114), and green electricity programs (Sections 30411, 136101).

Quantitative Analysis of Childcare Programs

While some of BBB's childcare provisions encourage work in pockets of the population, others discourage work with a net national effect that is readily quantified. Previous law included a child tax credit (CTC, for all children up to age 16) that was phased in with household income during the year, which has been found to encourage work especially among single mothers. Eliminating that phase in, as BBB would do, would do the opposite (Corinth, et al. 2021). On the other hand, childcare tends to complement working and two BBB provisions would reduce childcare costs for some families with children aged 0 to 4. Those provisions are a new federal childcare program (Section 23001) and a new "universal pre-K" program (Section 23002). Although this second effect is experienced by a smaller population, I assume that the two effects cancel.

In addition, the new assistance delivered through the new subsidies and the CTC expansion are phased out with income. Built in the ACA mold, the childcare subsidy phaseout begins at about 75% of median household income (75% is about $51,000 annually) and ends above $400,000 annually, depending on the number of children and the unsubsidized price of childcare. The subsidy phase-out rates are 7-14 percent and potentially would apply to the incomes of 9 percent of adults aged 21-65. However, I assume that a significant number of families will not experience the phaseout because they eschew the subsidies due to the heavy-handed regulation.[6] Therefore the contribution of the subsidy phaseout to the national average marginal tax rate on labor income is estimated to be 0.78 percentage points.

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5 https://www.federalreserve.gov/mediacenter/files/fomcpresconf20170614.pdf

6 Specifically, I assume that 20 percent of subsidy-eligible families stay out of the program, which is about twice the rate that kindergarten-aged children are not enrolled in "free" public schools (National Center for Education Statistics 2020). Recall that many families turned down ACA health insurance plans, despite being eligible for large subsidies.

The phase-out range of the expanded CTC is a subset of the subsidy-phaseout range, and occurs at a five percent rate. My estimates from the Current Population Survey suggest that less than five percent of nonelderly persons aged 21-64 are in a household with 2019 incomes that would be in that range. The table above therefore shows the expanded CTC-phaseout's contribution to the marginal tax rate increase to be "only" 0.24 percentage points.

Also reminiscent of the ACA, BBB would prohibit low-cost (a.k.a., "low quality") childcare unless the provider were to forgo all federal dollars, which would involve something like having zero children from a family at or below $200K annual income. Childcare workers would have to be paid as much as elementary-school teachers. According to the Bureau of Labor Statistics (2020), elementary school teachers earned an average of $63,930 annually in 2019, as compared to an average of $25,510 for childcare workers. That is, under BBB childcare would have to pay them 151% more.[7]

See also Sections 132002 and following promulgating many more rules and certifications, not to mention the agency rules that would be implementing them. All of this detail will add administrative costs to childcare. Just as physicians today complain about paperwork taking precious hours away from their real job, so will childcare providers under BBB. Therefore, families without subsidies may find themselves paying twice as much for childcare than they were before BBB. In this population, work is discouraged: akin to 0.22 additional percentage points on the marginal tax rate on labor income (see the table above).

Projected Employment Effects

Even beyond the childcare programs, the magnitude of BBB's disincentives for work and hiring varies across households and firms. They also vary by margin of response, such as adjusting work schedules, the duration of employment, or the duration of nonemployment. Properly measured disincentives also reflect the reality that benefit takeup (the percentage of eligible households that actually sign up for the program) is typically well below one hundred percent (Gallen and Mulligan 2018). I estimate that, on average, BBB implicit employment and income taxes would add about eight percentage points to the marginal tax rate on labor income. At least another two percentage points would someday be required to finance its projected $220 billion contribution to the annual deficit.

These disincentives are on top of the many other taxes on income, payroll, and sales; other implicit and explicit employment taxes; and longstanding income-tested benefits. Even ignoring the additional financing, the disincentives would reduce the share of marginal product kept by the average worker from about 0.52 to 0.44, which is a reduction of about 15 percent. I expect that such a change in the disincentive would reduce full-time equivalent employment by about 6%, or almost 9 million jobs. Perhaps employment would prove to be more sensitive to incentives, as it did during the 1990s welfare reform, or less sensitive, but 9 million is a good point estimate.

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7 A 151% increase is similar to the increase in individual health insurance premiums that occurred when the ACA came into effect (Council of Economic Advisers 2019a).

I estimate the 8 percentage points by aggregating the disincentives in the various sections of BBB. The program-specific employment impacts in the table's final column come from allocating the 9 million total among the thirteen programs in proportion to their addition to average marginal tax rates (second-to-last column).

The largest is the expansion of subsidies for Obamacare exchange plans. Using the same methods as Mulligan (2015b), I estimate that these subsidies by themselves add almost three percentage points. Another percentage point comes from Medicaid expansions, bringing the ACA-plus-Medicaid total to the 4.01 percentage points shown in the table.

For the employer IRA mandate, I estimate 0.5 percentage points, which is the average result from two methods. One method is from Council of Economic Advisers (2019a) analysis of the removal of an IRA mandate. The second method is, based on the Harberger triangle method, to take half of the penalty and apply it to the 33 percent of workers who do not currently have pension coverage through an employer (United States Bureau of Labor Statistics 2021).

For several other provisions, such as the Medicaid expansion in states that opted out of the original ACA expansion, the new Medicaid home and community-based programs (included in the table's 4.01 in the first row), and affordable housing, I assume that each dollar budgeted in BBB translates into the same contribution to disincentives as each dollar expected to be spent on the expanded subsidies for exchange plans.

I assume that the effects on restraining competition in labor markets are the same as Council of Economic Advisers (2019b) found for four Obama-era regulations intended to bolster unions (the Fiduciary rule, the Persuader rule, and two joint-employer rules). I assume that the green energy components of BBB contribute one-fifth to the labor wedge of what Fitzgerald, Hassett, Kallen, and Mulligan (2020) estimated for Biden's campaign promises regarding renewable energy.

These estimates are based on the House version of the BBB. Many of the details of the BBB programs will remain unknown until it becomes law and executive agencies issue their rules for administering them. The large new childcare programs are particularly uncertain because they are not expansions of extant programs.

Although I assume that benefit takeup is well under 100 percent, I may still have overestimated it, in which case BBB would be more of an adverse productivity shock and less of a work disincentive. In other words, an alternative scenario is that the spending is largely wasteful so that fewer households and business change their behavior in order to participate in the new and expanded programs.

Conclusion

We saw the severe negative employment effects from the expansion of unemployment benefits, health insurance and food stamps, and the relaxation of work requirements during the first 18 months of the pandemic. I estimate that some two to five million fewer Americans were in jobs as a result. Based on the comparative performance of red- and blue-state economies during 2021, I previously estimated that the blue states would have had some 800,000 more workers on the job by August, if they had stopped the $300 weekly UI bonuses in June, as the red states did.

Biden's policies would permanently and more significantly expand programs for the unemployed and those with low incomes, without restarting any work or training requirements as a condition of receiving the new benefits. As such, the policies repudiate the bipartisan welfare reforms of 1996 – signed into law by a Democratic president, Bill Clinton. The result of "Build Back Better" would be as many as nine million fewer Americans working and instead collecting government benefits. This seems especially unwise at a time when the Labor Department reports more than 10 million unfilled jobs and our labor market remains well short of pre-pandemic employment levels. As European countries learned the hard way, job losses will tend to accumulate over time as businesses and households further adjust to the fact that work is no longer customary behavior in significant segments of the population (Lindbeck 1995, Sargent and Ljungqvist 1998).

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