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How CBO Estimated the Effects of the 2025 Reconciliation Act on the Labor Supply

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Abstract

Fiscal policies can affect incentives to work by changing the resources available to people who are not working and the compensation for an additional hour of work (after accounting for taxes paid and benefits received) for people who are working. How much labor people supply in response to the work incentives under current law is reflected in the economic projections that underlie the Congressional Budget Office's baseline projections of revenues and outlays.

Provisions in Public Law 119-21, referred to here as the 2025 reconciliation act, affected the way individuals and businesses are taxed and modified federal programs. In this paper, CBO describes how the agency estimated the effects on the labor supply (or labor supply response) of provisions related to individual income taxes and the Medicaid program. To estimate the labor supply response to changes to taxes, CBO used its microsimulation tax model and estimates of labor supply elasticities from the research literature. To estimate the labor supply response to work requirements and other policies that would change enrollment in Medicaid, CBO assessed the research literature about previous Medicaid expansions and extrapolated the results to apply to people affected by the relevant policy changes in the reconciliation act. Those estimates are reflected in the agency's economic forecast that underlies its February 2026 baseline projections. In the final section of this paper, CBO outlines the types of research that could improve the way the agency models labor supply responses.

Keywords: labor supply, federal taxes, Medicaid, work requirements

JEL Classification: H2, H3, H51, I1, J2

Notes

Unless this paper indicates otherwise, all years referred to are federal fiscal years, which run from October 1 to September 30 and are designated by the calendar year in which they end.

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Introduction

Fiscal policy can affect incentives to work by changing the resources available to people who are not working and the compensation for an additional hour of work (after accounting for taxes paid and benefits received) for people who are working. The amount of labor that people supply in response to incentives stemming from fiscal policy is reflected in the economic forecast that underlies the Congressional Budget Office's baseline projections of federal revenues and outlays.

Public Law 119-21 was enacted on July 4, 2025. Referred to here as the 2025 reconciliation act, that law affected the federal tax code and spending on certain federal programs. The law's effects on projected revenues and outlays are reflected in the most recent edition of *The Budget and Economic Outlook*, published this past February.[1] On net, CBO estimated that the 2025 reconciliation act would increase work incentives, mainly by extending tax provisions that were scheduled to expire at the end of calendar year 2025 and, to a lesser extent, changing eligibility and financing for Medicaid and the Supplemental Nutrition Assistance Program (SNAP).[2]

In this paper, CBO describes how the agency estimated the effects on the labor supply from provisions in the 2025 reconciliation act that affect individual income taxes and Medicaid. Also described are the ways those effects are reflected in the agency's February 2026 baseline projections. CBO's methods for estimating the law's effects on the labor supply varied because of several factors, including the following:

- The different characteristics of people affected by each of the law's provisions,
- Whether the provisions change financial resources or in-kind benefits,
- CBO's existing modeling infrastructure, and
- The availability of relevant research.

To estimate how changes to taxes would affect the labor supply, CBO used its microsimulation tax model and estimates of labor supply elasticities from economic research. To estimate the effects of community engagement requirements (referred to here as work requirements to better reflect this paper's focus on analyzing the labor supply) and other policies that would change enrollment in Medicaid, CBO assessed the research literature on previous Medicaid expansions and extrapolated the results to apply to people affected by the relevant provisions in the 2025

[1] See Appendix A in CBO (2026b) for more discussion of the economic and budgetary effects of the 2025 reconciliation act on CBO's baseline projections.

[2] For details about how CBO modeled the effect on the labor supply from changes to SNAP and other programs, see CBO (2026a) and CBO (2025d).

reconciliation act.[3] The agency applied that same general approach to estimate how changes to SNAP would affect the labor supply.

CBO's estimates of many of the effects of the 2025 reconciliation act are subject to considerable uncertainty. Areas in which additional research could improve the agency's modeling of effects on the labor supply are discussed in the final section of this paper.

How Fiscal Policy Affects Work Incentives

Policies related to revenues and spending can affect work incentives by changing the economic returns from various activities. CBO considers how work incentives are affected by changes to fiscal policy, including changes to taxes, means-tested programs (that is, programs such as Medicaid or SNAP, for which eligibility depends on a person's income or assets), and social insurance programs (such as Social Security or Unemployment Insurance, which help financially protect people from economic risks).

Changes to policies that affect tax liability (the amount owed in taxes), such as tax rates, tax credits, and how taxable income is computed, can alter people's incentives to work by changing the net compensation they receive for an additional hour of work. Working can thus become more attractive or less attractive than other uses of time, and the amount of work needed to maintain a certain standard of living can change.

Work incentives can be affected by changes to means-tested programs in much the same way they are affected by changes to tax policy.[4] For example, if benefits are phased out as a recipient's income increases, the returns from additional work will be reduced, making work less attractive than other uses of time. In addition, means-tested programs can increase the resources available to workers and reduce the amount of work needed to maintain a certain standard of living.

Changes to social insurance programs also can affect work incentives because people's decisions about working and the amount they work in the present can affect their *future* benefits. Thus, the models used to analyze how changes to social insurance programs affect the labor supply differ from the models used to analyze the effects from changes to taxes or means-tested programs.

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[3] The community engagement requirement directs states to require that certain Medicaid enrollees spend a fixed number of hours each month performing certain activities—such as work, job training, education, or community service—as a condition of eligibility.

[4] Some means-tested programs, such as Medicaid and SNAP, provide in-kind transfers. Others, including Temporary Assistance for Needy Families (TANF) and Supplemental Security Income, provide cash transfers. Often, means-tested benefits could either be provided through the tax code or through a transfer program. For example, the government can provide assistance to parents through a tax credit for children or through TANF.

(Because the 2025 reconciliation act did not substantially change social insurance programs, the methods used to analyze such changes are not described in this paper.)

All those types of fiscal policy can change individuals' income after taxes and transfers (income after accounting for taxes owed and benefits received). Changes in income after taxes and transfers can create two countervailing pressures on people's willingness to work: a substitution effect and an income effect. The substitution effect comes from changes in the value of work in relation to other uses of time. The income effect arises from changes in the amount of work necessary to maintain a certain standard of living.

Some policies have substitution effects and income effects that push the labor supply in opposite directions. For example, an increase in statutory tax rates raises marginal tax rates, which decreases the after-tax compensation for an additional hour of work and (if the number of working hours is unchanged) reduces a person's income. (The marginal tax rate is the percentage of an additional dollar of income that is paid in taxes.) The substitution effect suggests that in response, people would reduce the number of hours they work because work had become less valuable than other uses of time. The income effect suggests that people would increase the number of hours they work to maintain their standard of living from before the increase in statutory tax rates. The net effect of such a policy on the number of hours worked would thus depend on the relative sizes of the two effects.

Other policies, such as the introduction of SNAP, which phases out as income increases, have substitution effects and income effects that push the labor supply in the same direction. SNAP increases the resources available to workers, thus reducing the amount of work needed to maintain a given standard of living (the income effect). The benefit amount phases out as income rises, reducing the return from additional work (the substitution effect).

The overall effects of a policy change on the labor supply can be specified as an elasticity, which is the change in the labor supply (expressed as a percentage) that results from a 1 percent change in income after accounting for taxes and transfers. People can change the amount of labor they supply by changing whether they work (a response on the participation margin, measured as a participation elasticity) or the number of hours they work (a response on the hours margin, measured as an hours elasticity). Elasticities can also be specified for the substitution effect (that is, a substitution elasticity) and the income effect (an income elasticity). In general, to allow estimates of fiscal policies' effects on the labor supply to inform its economic projections, CBO must translate those estimates into aggregate hours worked, weighted by earnings.[5]

[5] For details about how CBO accounts for changes in the labor supply when developing its economic projections, see the subsequent section titled "How Effects Are Reflected in CBO's Economic Forecast."

CBO typically relies on economic research to determine the relevant elasticities for various types of policy changes. Elasticities derived from one policy are generally not appropriate for estimating the effect of changes to other policies. Recent evidence suggests that labor supply responses vary among people on the basis of their age, income, marital status, and attachment to the labor force. Furthermore, how people respond to a policy change depends on its salience, time horizon, and how easily they can change their work hours. Economic theory indicates that people's labor supply response to changes in in-kind programs depends on how much they value the program. When proposed policy changes have effects that differ in those ways from effects of policies analyzed in the research literature, CBO adjusts the estimates of labor supply responses in the literature to account for those differences.

The 2025 Reconciliation Act's Effects on the Labor Supply

The 2025 reconciliation act affected federal income taxes and spending on some programs and thus changed the demand for and supply of labor.[6] In CBO's estimates, that law increases potential hours worked by 0.6 percent, on average, over the 2025–2034 period in relation to the agency's January 2025 baseline projections.[7] That increase in potential hours worked reflects greater aggregate demand for labor from expanded economic activity, increased labor supply from changes in incentives to work, and reductions in population size from increased immigration enforcement and detention. Accounting only for changes in incentives to work, the reconciliation act is projected to increase potential hours worked by 0.6 percent, on average, over the 2025–2034 period because the effects of greater aggregate demand for labor and changes in population size largely offset each other. Most of the increase in potential hours worked is attributable to greater work incentives stemming from reduced marginal tax rates on labor income.

Several changes to the individual income tax stemming from the reconciliation act lowered tax rates for most households.[8] The law permanently extended tax provisions that affect individual income taxes and that were scheduled to expire at the end of calendar year 2025. Some provisions, such as the one that maintained the lower statutory tax rates on individual income that were put in place in the December 2017 reconciliation act, reduced marginal tax rates in

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[6] See CBO (2025c) for a list of the reconciliation act's provisions.

[7] That estimated effect does not include the effects of other changes since January 2025, such as changes to tariff rates and immigration policies, or the interactions between those policies and the 2025 reconciliation act; see CBO (2026b). Potential hours worked is a combination of potential average hours worked per worker and the potential labor force, which are, respectively, CBO's estimates of how much the average worker would work if economic output and other key variables were at their maximum sustainable amounts and how big the labor force would be under those same conditions.

[8] For more discussion about the law's effects on the tax code, see Appendix A in CBO (2026b).

relation to CBO's January 2025 baseline. (That baseline reflected the higher rates that would have resulted from those provisions' scheduled expiration.) Other provisions, such as the one that increased the standard deduction, reduced average tax rates (the share of total income paid in taxes) in relation to CBO's January 2025 baseline. The law also created temporary measures to exempt tip income and overtime pay from taxation. By contrast, the phaseout of some tax provisions for higher-income taxpayers increased their marginal tax rate. CBO estimated that, all told, the incentives created by the law's changes to the tax code would increase the labor supply by 0.56 percent, on average, over the 2025–2034 period in relation to the agency's January 2025 baseline.[9]

The reconciliation act affected the labor supply by changing some federal spending programs. The law made several changes to Medicaid, including implementing work requirements, prescribing more frequent eligibility redeterminations for some enrollees, preventing states from increasing taxes on health care providers, and lowering the amount of tax revenues that can be collected from certain providers in most states.[10] CBO estimated the labor supply response to work requirements and to other policies that reduced Medicaid enrollment, including, but not limited to, those mentioned above. In CBO's estimates, the changes to Medicaid in the 2025 reconciliation act decrease the number of people enrolled in the program and the benefits it provides, which reduces the resources available to households. The increased work incentives from changes to Medicaid increase the labor supply by 0.02 percent, on average, over the 2025–2034 period in relation to CBO's January 2025 baseline projections.

The reconciliation act also changed other federal programs, including SNAP, student loan programs, and immigration enforcement.[11] The increase in the potential labor supply stemming from changes to SNAP and student loan programs is partially offset by reductions in the population size that are attributable to increased immigration enforcement and detention. On net, those changes increase labor supply by 0.02 percent, on average, over the 2025–2034 period in relation to CBO's January 2025 baseline projections. In this paper, in addition to changes in the tax code, CBO focuses on how it estimated the change in labor supply in response to changes to Medicaid.

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[9] For proposed legislation, the staff of the Joint Committee on Taxation provides estimates of the effects on the labor supply from tax provisions; see, for example, Joint Committee on Taxation (2025).

[10] For more information about the changes to Medicaid in the 2025 reconciliation act, see CBO (2025a).

[11] CBO's analysis of how changes to SNAP would affect the labor supply followed a similar approach to the one described in this paper, which has been discussed in other publications. For more discussion about how changes to SNAP would affect the labor supply, see CBO (2026a) and CBO (2025d).

Effects From Individual Income Tax Provisions

To analyze how changes to individual income taxes in the 2025 reconciliation act would affect the labor supply, CBO used its microsimulation tax model to estimate how the law would affect tax rates.[12] For each record in its representative sample of taxpayers, CBO estimated the change in average and marginal tax rates. In the agency's tax modeling, the average tax rate is federal individual income tax liability divided by total income. The marginal tax rate is the change in federal individual income tax liability from adding $1,000 of labor income divided by the additional income. The change in the tax rate is the difference between the tax rate under the 2025 reconciliation act and the tax rate under previous law (that is, if the individual income tax provisions had expired at the end of calendar year 2025).

In CBO's estimates, the reconciliation act reduces average and marginal tax rates on most earned income in 2026 (see Figure 1). On an earnings-weighted basis, the law reduces average tax rates by 2 percentage points and marginal tax rates by 2.7 percentage points.[13]

Next, CBO applied income and substitution elasticities to the estimated change in the after-tax wage rate to estimate the change in earnings for each taxpayer. For its analysis of the 2025 reconciliation act, CBO used elasticities from studies that examined tax changes that affect the broad population because tax changes in that law affect most taxpayers.[14]

CBO used elasticities that vary by a worker's earnings in relation to others within a household and by a worker's income in relation to that of other workers (see Table 1).[15] For primary earners (taxpayers who do not file joint tax returns, or the higher earner of those who do), CBO's central estimate of the substitution effect is 0.25. The substitution elasticity varies among primary earners by income group: Lower-earning workers are more responsive to changes in the relative cost of working than higher-earning workers. In CBO's assessment, the substitution elasticity is

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[12] For more information about CBO's tax model, see CBO (2018). That model relies mainly on information from individual income tax returns and uses earnings to measure the labor supply.

[13] That reduction in marginal tax rates differs from the 2.3 percentage-point reduction reported in CBO (2026b), Table A-3. That earlier measure reflects the marginal rate on different forms of compensation, weighted by each component's share of total compensation in the economy (including income that is unreported on tax returns), whereas the measure reported here reflects the change in the marginal tax rate, faced by each taxpayer, on labor income reported on tax returns.

[14] For more details, see McClelland and Mok (2012). The elasticities are drawn from studies that measure changes in hours worked or employment. Although some research has examined how income reported on tax returns responds to changes in tax rates, estimates of elasticity of income are not used, because those responses include changes in reporting or the use of deductions to reduce taxable income.

[15] For more details, see CBO (2012).

0.32 for secondary earners, who are thus more responsive than primary earners to those changes. CBO's central estimate for the income elasticity is −0.05, which is applied to both primary and secondary earners. The elasticities that CBO uses do not vary over time: They reflect people's responses after they fully adjust to a change in after-tax income. They also reflect the combined effects from decisions that workers make about the number of hours to work and whether to work.

The change in the labor supply for each worker is the sum of each elasticity multiplied by the percentage change in its corresponding after-tax wage rate. For example, consider a primary earner who initially faces an average tax rate of 10 percent and a marginal tax rate of 20 percent. If the reconciliation act reduced that earner's average tax rate by 2 percentage points and their marginal tax rate by 4 percentage points, the substitution effect would increase the labor supply by 1.25 percent (= 0.25 × 0.04 ÷ (1-0.20)), and the income effect would decrease the labor supply by 0.11 percent (= −0.05 × 0.02 ÷ (1-0.10)), thus resulting in a net increase in the labor supply of 1.14 percent.

The aggregate change in the labor supply is the sum of each taxpayer's labor supply response weighted by the taxpayer's earnings. In CBO's assessment, people take time to adjust to changes to tax policy; thus, the labor supply effect for each year is calculated as the three-year moving average of estimated contemporaneous effects.[16] In CBO's estimates, an increase in work incentives stemming from the 2025 reconciliation act's individual income tax provisions boosts the labor supply by 0.56 percent, on average, over the 2025–2034 period in relation to the agency's January 2025 baseline.

Effects From Medicaid Provisions

To estimate the labor supply response to provisions in the 2025 reconciliation act that altered Medicaid, CBO used empirical evidence to estimate the percentage change in the earnings of adults affected by the provisions. In this section, CBO's review of the empirical literature is summarized. Then, the way the agency adjusted the estimates in the literature to apply to the different populations affected by the law's changes to Medicaid is described. Those populations include people expected to lose Medicaid coverage as a result of the changes and people subject to Medicaid work requirements. CBO estimated separate earnings responses to losing Medicaid coverage for different groups of people—namely, the elderly, disabled, children, adults, or adults in the Affordable Care Act (ACA) expansion population. Moreover, the agency estimated separate earnings responses to Medicaid work requirements for childless adults and parents.

[16] Because of that averaging, the effect of the individual income tax provisions on the labor supply gradually increases from 2025 to 2028.

Estimating labor supply responses to changes in Medicaid on the basis of evidence regarding changes in other types of fiscal policy can be challenging. That is because of certain characteristics of the Medicaid program:

- Many Medicaid recipients have mental or physical health conditions that make employment difficult. Because such recipients may thus be less responsive to policy changes than the broader population, using elasticities derived from research on changes to fiscal policies that affect the broader population would not be appropriate.
- People may be less responsive to Medicaid-driven changes to income after federal taxes and transfers than they are to changes in cash income because they value the former less than the latter.
- Some changes to Medicaid, particularly those involving work requirements, probably affect the participation margin the most. Responses to policies that affect both the hours margin and the participation margin, such as the tax changes described above, may not be as informative about the magnitude of that response.
- Policies such as work requirements have a discontinuous effect on work incentives. Evidence drawn from policies that have a smoother effect on work incentives, such as the tax changes described above, may not be as informative about the magnitude of the response to work requirements.

For those reasons, rather than using estimates of labor supply responses to a variety of fiscal policies, CBO instead focused on studies analyzing previous policies that changed Medicaid eligibility and then adjusted those results to estimate how the Medicaid provisions of the reconciliation act would affect earnings. In CBO's estimates, an increase in work incentives stemming from the provisions that affect Medicaid enrollment and establish work requirements boosts the labor supply by 0.02 percent, on average, over the 2025–2034 period in relation to the agency's January 2025 baseline.

Estimates From Studies of Changes to Medicaid Eligibility. Several studies that analyzed effects of changes to Medicaid eligibility examined the expansion of Medicaid under the ACA. Those studies mainly used a difference-in-differences approach to compare labor market outcomes among childless adults in states that expanded Medicaid with outcomes in states that did not. (See Lavender and Johnston 2024; Aslim 2022; Peng, Guo, and Meyerhoefer 2020; Duggan, Goda, and Jackson 2019; Frisvold and Jung 2018; Leung and Mas 2018; and Kaestner and others 2017). The estimates vary greatly: One of the studies found an increase in employment or labor force participation after the Medicaid expansion, whereas others found a decrease (see Table 2, which summarizes CBO's review of the relevant research). Moreover, the estimated effects are usually imprecise and not statistically significant.

Some studies examined changes in Medicaid coverage before the ACA became law. Those studies were generally limited to a single state and resulted in estimates that range widely—from

effectively no change in employment from Medicaid coverage (Baicker and others 2014) to a 77 percent increase in employment following Medicaid disenrollment (Garthwaite, Gross, and Notowidigdo 2014).

In addition to studies of how changes in Medicaid eligibility affect the labor supply, a handful of studies examined the effects of implementing a Medicaid work requirement in Arkansas in 2018. They compared employment among adults in that state with employment in other states without Medicaid work requirements (Gangopadhyaya and Karpman 2025, Sommers and others 2020, Sommers and others 2019). However, those studies' estimated effects on employment are not statistically significant and are imprecise.

After reviewing the relevant research literature, CBO used a 2 percent increase in earnings among people who lose Medicaid coverage as the starting point for estimating the labor supply response to changes in Medicaid.[17] To arrive at that 2 percent summary measure, CBO averaged the estimates from various studies, mostly relying on studies that examined the expansion of Medicaid under the ACA. Because providing subsidized coverage through the marketplaces established under the ACA gives people an option for health insurance coverage that did not previously exist, people's responses to changes in Medicaid coverage before the ACA became law are less relevant to current policy changes.

Therefore, to give less weight to results from the pre-ACA studies, CBO included the *median* of the estimates from those studies when averaging the estimates from the ACA expansion studies. Insignificant estimates were treated as zeros; for studies with estimates by subgroup, CBO focused on the estimates for childless adults.[18] When a study reported more than one estimate for different groups of childless adults (for example, men and women), CBO used the average of the estimates.

Adjustments for Policies That Disenroll People From Medicaid. The 2025 reconciliation act included provisions that changed Medicaid enrollment for people other than nonelderly, able-bodied, childless adults—the population studied in the existing literature. When analyzing policies that changed enrollment for those other people, such as those who are elderly, disabled, parents, or children, CBO adjusted the 2 percent increase in employment gleaned from the research literature to account for differences in the value of Medicaid as a share of family income

[17] That 2 percent increase in earnings is based on evidence that people who lose Medicaid coverage would increase their employment by 1 percentage point, which amounts to a 2 percent increase in their employment over an implied baseline employment rate of roughly 50 percent. In the estimates, there is a direct correspondence between the percentage increase in employment and earnings.

[18] When deriving a central estimate from a group of studies, statistically insignificant estimates can be treated in various ways; CBO continues to consider alternative treatments for such estimates.

and differences in how Medicaid enrollment affects work incentives depending on family size.[19] In general, receiving Medicaid benefits reduces work incentives because it increases the resources available to families (holding the amount of work fixed) and because increases in earnings above the income limit for eligibility lead to loss of coverage.

CBO expects that policies that disenroll people from Medicaid will have a larger effect on employment and earnings among people for whom receiving Medicaid benefits reduces the incentive to work the most. In general, those are people who value Medicaid more or have smaller households. Different types of Medicaid enrollees value Medicaid differently depending on how much care they use, how much they would pay for that care if Medicaid did not cover it, and the share of their family income that the program's benefits represent.[20]

Additionally, the change in work incentives stemming from alterations to Medicaid policy will vary depending on the number of an enrollee's dependents because the income thresholds for eligibility increase with household size. Thus, among people who lose Medicaid coverage, those with more dependents will have a smaller labor supply response than those with fewer dependents because working more was less likely to push their income above the eligibility threshold when they were covered.

Table 3 shows the estimated, adjusted labor supply effects that CBO applied to policies that change Medicaid enrollment, causing people to lose coverage. Those estimates represent the average percentage change in earnings expected for adults in the health insurance unit (the set of household members whose incomes are used to determine eligibility) in response to losing Medicaid coverage. That change in earnings reflects increases in average earnings, among all affected adults, stemming from increases in employment and changes in hours worked.

For example, the estimate of a 1.1 percent increase in earnings for disabled Medicaid enrollees who lose coverage reflects the combined increase in employment and earnings from all adults in health insurance units with disabled family members—not the increase in employment and earnings associated specifically with the disabled enrollees. Similarly, the 0.8 percent increase in earnings in response to a loss of Medicaid coverage among children reflects the increase in employment and earnings of their parents or other adults in the health insurance unit, not of the children themselves.

CBO's estimate of the earnings response of adults in the expansion population (that is, able-bodied adults who gained Medicaid coverage through the expansion enacted in the ACA) is slightly lower than the central estimate of 2 percent from the research literature. That is because

[19] In this analysis, CBO held the value of Medicaid as a share of family income constant over time.

[20] For more information, see CBO (2025b).

children are present in some households in the expansion population. Larger households have higher income thresholds for Medicaid eligibility; therefore, adults with children are more likely to remain eligible for Medicaid while working. That implies that removing the income threshold through disenrollment would have a smaller effect on their labor supply than it would for adults without children, for whom the income threshold is lower. Because studies that examine the ACA Medicaid expansion typically focus on a population of childless adults, the employment responses in those studies are larger than for the overall expansion population that includes households with children.

In CBO's assessment, health insurance units with adults age 65 or older have, on net, no employment or earnings response to Medicaid provisions affecting the elderly in the 2025 reconciliation act. The elderly, their spouses, or their adult children might work more to help cover the increase in their health care costs. But if the loss of Medicaid meant the loss of home- and community-based services (HCBS) or nursing home care, they might instead work less and spend more time providing care.[21] CBO estimated the net effect of those countervailing forces to be zero.

Adjustments for Work Requirements. Given the small number of studies on Medicaid work requirements and the imprecision of those studies' estimates, CBO extrapolated the labor supply response to establishing work requirements from the effect of policies that change Medicaid eligibility for reasons not related to work status. An important way in which the two types of policies differ is that work requirements only incentivize work for people who are not exempt or already in compliance, whereas eligibility policies change work incentives for everyone whose eligibility status is affected. For people who are not already complying but could comply without earning above the income eligibility thresholds, work requirements can create larger incentives to work than policies that end eligibility. That is because receiving Medicaid coverage can act as an incentive to work when there is a work requirement, whereas the potential to maintain Medicaid coverage does not exist when that coverage is eliminated.

The differences in work incentives imply that the magnitude of the labor supply response to Medicaid work requirements will differ from the magnitude of the response to losing Medicaid coverage. Those differences also depend on the distribution of actual and potential wages and of hours worked of people affected by the policies. Using data from recent cross-sections of the Annual Social and Economic Supplement of the Current Population Survey, CBO estimated the actual and potential wages and hours worked of adults who reported receiving Medicaid. On the basis of those estimates, 20 percent of nonelderly, able-bodied, nonexempt childless adults who are eligible for Medicaid under current law worked enough to satisfy work requirements and so

[21] Shen (2024) found that providing HCBS to the elderly through Medicaid increases the labor supply of the enrollees' daughters.

would have no incentive to work more hours.[22] CBO estimated that of those not already working enough hours to satisfy the work requirement, the combined income and substitution effects from establishing a work requirement would be 5 percent larger than the average household effect of nonelderly, able-bodied, childless adults' losing Medicaid coverage.

A weighted average of those estimates implies that establishing a work requirement for nonelderly, able-bodied, childless adults would generate an incentive to work that is 84 percent as large as the work incentive created by losing Medicaid coverage. Thus, CBO estimated that nonelderly, able-bodied, childless adults would increase their average earnings by 1.7 percent in response to a Medicaid work requirement.[23]

The value of Medicaid differs for parents of children age 14 or older for whom the reconciliation act also introduced a work requirement, and the distributions of their actual and potential wages and hours worked differ as well. Forty-six percent of parents who are not exempt from the work requirement worked enough to satisfy that requirement and would thus have no incentive to work more hours. The other differences in work incentives between parents and childless adults would mostly offset each other.[24]

Those estimates imply that a work requirement for parents of children age 14 or older would create an incentive to work that is 66 percent as large as the incentive from a requirement applied to nonelderly, able-bodied, childless adults. CBO thus estimated that parents would increase their average earnings by 1.1 percent in response to Medicaid work requirements.

How Effects Are Reflected in CBO's Economic Forecast

CBO incorporated the 2025 reconciliation act's effects on the labor supply into the economic forecast included in the agency's February 2026 baseline projections. One of the main tools that CBO uses to incorporate the economic effects of fiscal policies in its baseline projections is a Solow-type growth model, called the policy growth model (PGM; CBO 2021). That model accounts for how changes in potential total hours worked, capital services, and total factor

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[22] People who reported being enrolled in Medicaid but whose income appeared to be above the eligibility threshold are excluded from this analysis because the effects of additional earnings on their eligibility were unclear. If such people had been included (as they are in some of CBO's analyses), CBO would have estimated that about 50 percent of nonelderly, able-bodied, nonexempt childless adults were already working enough to meet the requirement. Most of the people who appear to have income above the eligibility threshold were working full time and thus would be unlikely to substantially increase their labor supply under a work requirement or if they lost eligibility.

[23] CBO applies the 84 percent to the 2 percent estimate from the literature, not the 1.9 percent response used for adults in the expansion population who lose Medicaid coverage. That is because the work requirement is applied to childless adults, which is the population used in studies of the effects of the ACA expansion.

[24] That is, the average effect of establishing a work requirement for parents who are not exempt and do not already meet the requirement is about the same as the average effect for childless adults who are not exempt and do not already meet the requirement.

productivity affect real potential output (the maximum sustainable level of output in the economy), which is a key measure of economic activity in the medium term and long term. An increase in the labor supply is reflected in CBO's economic forecast as greater output, relative to the absence of such policies.[25]

After estimating the effects on the labor supply from the reconciliation act's individual income tax and Medicaid provisions as described above, CBO applied those effects to the PGM as a 0.58 percent exogenous increase in aggregate earnings-weighted hours worked. That increase affects CBO's projections of potential labor force participation and potential average hours worked. Other factors that affect potential hours worked, such as immigration, changes to the noncyclical rate of unemployment, and productivity, are modeled within the PGM. Together, population, potential labor force participation, unemployment, and average hours worked create the labor input—potential total hours worked—that is used to produce CBO's projections of real potential output.

Areas in Which Additional Research Could Be Useful to CBO

CBO's modeling of labor supply responses could benefit from two types of research. The first type could help answer specific questions about the effects on the labor supply from changes to individual income taxes and Medicaid:

- To what degree is the labor supply response to tax changes on the participation margin or the hours margin—and how does that vary across the income distribution?
- How do Medicaid eligibility and work requirements affect people other than nonelderly, able-bodied, childless adults, who tend to be the focus of the current research literature?
- How does the value of in-kind benefits, such as Medicaid, vary for different groups of people?

The second type could improve how CBO applies and extrapolates the results of research in its analyses:

- Studies are more useful to CBO if they include estimates of elasticities that are representative of the people affected by the policy that CBO is analyzing. Some studies have instead focused on groups that are most likely to be responsive to the policy; those results, in isolation, are less useful to CBO for analyzing the aggregate effect of policies on the economy. If studies included supplemental information about the representativeness of the sample used or how the estimates could be scaled to apply to broader groups, they would be more useful to CBO.

[25] For more information about CBO's economic forecasts, see Arnold (2018) and Shackleton (2018).

- Studies that measure labor supply elasticities as the percentage change in work in response to a 1 percent change in the return from work most directly inform CBO's analyses. The return from work is typically measured as the increase in income after transfers and taxes from working full-time compared with not working at all. Studies of the effect of tax policies on the labor supply often measure elasticities in that way (for example, Goldin and others 2024), but other studies, especially those that focus on means-tested programs, often do not. Because small changes in policy design can affect the return from work, elasticities presented in this way are more useful for extrapolating to similar policies.
- When extrapolating results from the research literature, CBO considers the context of the policy that was studied and how it differs from the context of the policy at hand—including the difference in the salience of the change or contemporaneous policy changes. Estimates of changes in employment in response to changes in the earned income tax credit in the 1990s, for example, may differ from responses to tax policy changes currently considered because of the salience of the previous changes and reductions to means-tested transfers during the previous period. Further research on how the design of a benefit affects salience and how salience contributes to labor supply responses could be useful to CBO.
- CBO's budget baseline typically spans 10 years. Greater insight into how long people take to respond to changes in work incentives and the factors that contribute to the transition time would be useful.
- The effective marginal tax rate on labor income has fluctuated in recent decades. Applying labor supply elasticities implies corresponding changes in hours worked. However, those changes have not been observed in measures of aggregate labor supply. Studies that help reconcile the macroeconomic evidence with results from microeconomic research could especially benefit CBO's efforts to incorporate responses to fiscal policy into its economic projections.

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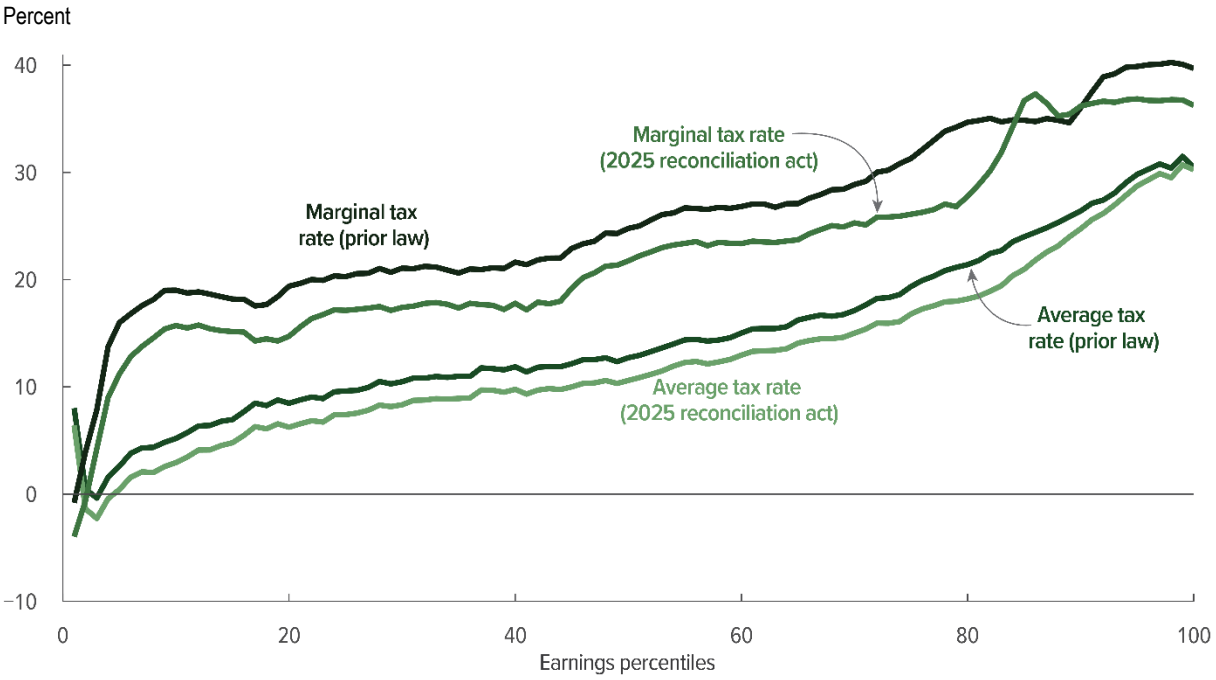
Figure

Figure 1. [Return to Text]

Federal Income Tax Rates in 2026 Under the 2025 Reconciliation Act and Prior Law, by Earnings Percentile



Data source: Congressional Budget Office.

The average tax rate is federal income tax liability divided by total income. The marginal tax rate is the change in federal income tax liability from adding $1,000 to earnings.

Each percentile represents equal amounts of earnings.

Tables

Table 1. [Return to Text]

Substitution and Income Elasticities Used in CBO's Policy (Solow-Type) Growth Model

	Lower estimate	Central estimate	Higher estimate
Substitution elasticity			
Primary earners	0.15	0.25	0.35
1st (lowest) decile (or tenth)	0.15	0.31	0.47
2nd decile	0.15	0.28	0.42
3rd and 4th deciles	0.15	0.27	0.38
5th and 6th deciles	0.15	0.25	0.35
7th to 10th (highest) deciles	0.15	0.22	0.29
Secondary earners	0.22	0.32	0.42
Income elasticity (all earners)	-0.10	-0.05	0

Data source: Congressional Budget Office, *How the Supply of Labor Responds to Changes in Fiscal Policy* (October 2012), www.cbo.gov/publication/43674.

Table 2. [Return to Text]

Estimated Elasticities From Recent Studies of Medicaid

Percent

	Outcome variable	Percentage change
		Pre-ACA Medicaid changes
Baicker and others (2014)	Employment	-3
Dague, DeLeire, and Leininger (2017)	Employment	-13[a]
DeLeire (2019)	Employment	0.2
Garthwaite, Gross, and Notowidigdo (2014)	Employment	-77[a]
		ACA Medicaid expansion
Aslim (2022)	Labor force participation	-25
Duggan, Goda, and Jackson (2019)	Labor force participation	6
Frisvold and Jung (2018)	Labor force participation	-5
Kaestner and others (2017)	Employment	-7 to 11
Lavender and Johnston (2024)	Labor force participation	-7 (men), -14[a] (women)
Leung and Mas (2018)	Employment	-7 to 25
Peng, Guo, and Meyerhoefer (2020)	Employment	Not enough information
		Medicaid work requirements
Sommers and others (2019)	Employment	-10
Sommers and others (2020)	Weekly hours worked	12
Gangopadhyaya and Karpman (2025)	Employment	Not enough information

Data source: Congressional Budget Office.

For pre-ACA Medicaid changes and ACA Medicaid expansion studies, to obtain comparable estimates of the employment effect among people gaining coverage, CBO rescaled estimates reported for the broader group (for example, all childless adults in expansion states) by the estimated increase in Medicaid coverage. For Medicaid work requirements, CBO rescaled estimates reported for the broader group by the estimated share of the sample that was enrolled in Medicaid and not exempt from the requirement. Results from studies without enough information to rescale the estimates are noted as "not enough information." To arrive at the 2 percent summary measure, CBO mostly relied on research literature about the expansion of Medicaid under the ACA and gave less weight to results from the pre-ACA studies. To do that, CBO included the median of the estimates from the pre-ACA studies when averaging the estimates from the ACA expansion studies. Insignificant estimates were treated as zeros; for studies with estimates by subgroup, CBO focused on the estimates for childless adults. When a study reported more than one estimate for different groups of childless adults (for example, men and women), CBO used the average of the estimates.

a. statistically significant

Table 3. [Return to Text]

Change in Earnings Applied to Changes in Medicaid Policies

Percent

	Change in earnings
	Policies that disenroll people from Medicaid
Disabled	1.1
Adults age 65 or older	0
Children	0.8
Previously eligible adults	1.9
Newly eligible adults	1.9
	Work requirements
Able-bodied adults without dependents	1.7
Parents of children age 14 or older	1.1

Data source: Congressional Budget Office.

Estimates for policies that disenroll people from Medicaid represent the average percentage change in earnings expected from adults in health insurance units (HIU) containing people eligible for Medicaid through a given pathway in response to all individuals of that eligibility type within the HIU losing Medicaid coverage. For example, CBO expects that if all children in an HIU lost Medicaid coverage, the adults in the HIU would increase their earnings so that HIU earnings are 0.8 percent higher than they would have been if the children had retained coverage.

In CBO's estimates, most of the changes in Medicaid enrollment from the 2025 reconciliation act are driven by enrollment changes among nonelderly, able-bodied adults, and work requirements mainly affect able-bodied adults without dependents.

Estimates for work requirements represent the average percentage change in earnings expected from adults who would be subject to the requirement.