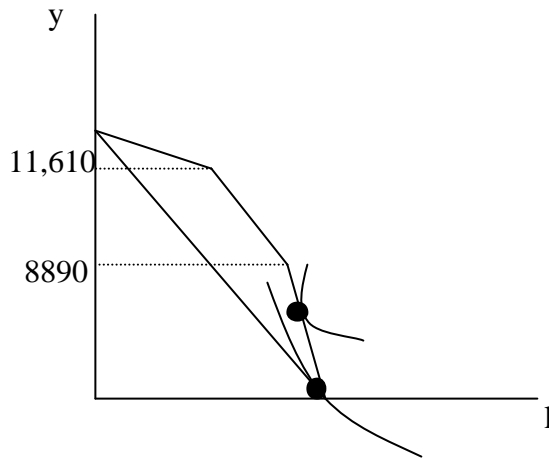


Earned Income Tax Credit: (EITC)

- began on small scale in 1975
- spending on EITC is about 10 times spending on welfare
- idea is to reward work instead of rewarding not working
- have to have children to qualify, but *can* also be married, unlike welfare
- example: in 1996- single parent with 2 children
 - earnings up to \$8,890/year: tax credit of 40% (max. of \$3,356)
 - earnings between \$8,890-11,610: no additional credit, but keep \$3,356
 - earnings above \$11,610: credit reduced by 21.06¢ per dollar earned
 - earnings above \$28,495: program phased out
 - *there are different schedules for more kids, if married, etc.

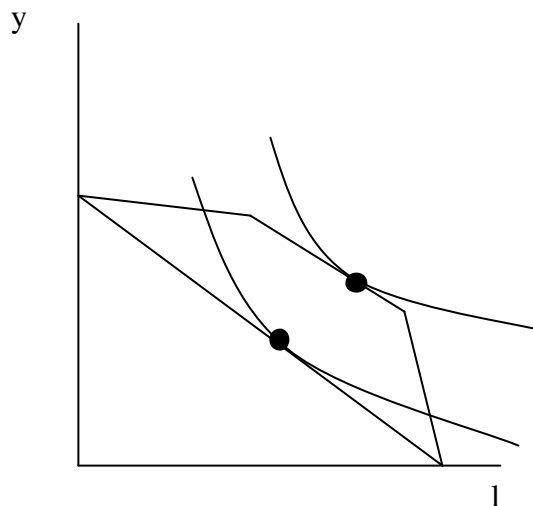
Predicted effects on labor supply:

a) low or zero initial work hours:



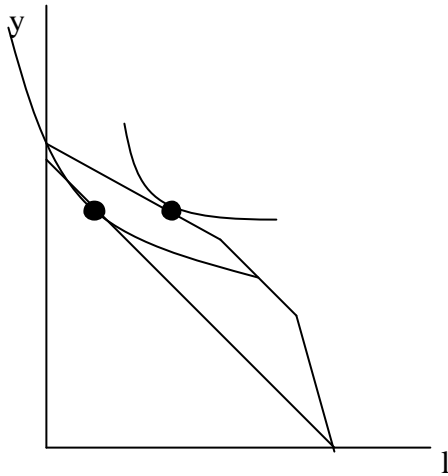
- increase in labor force participation
- on higher indiff curve with EITC

b) medium level of work hours:



- decrease in labor supply due to an income effect

c) high level of initial hours:



- decrease in labor supply due to income effect *and* substitution effect

Putting all these cases together: Depending on initial hours, EITC can either increase or reduce total hours worked. But even when it reduces hours, EITC will never induce anyone to stop working altogether. Thus it is predicted to increase the fraction of people working unambiguously.

Evidence:

- Eissa and Liebman (1995) studied the effects of the EITC on the labor force participation of unmarried women.
- Looked at behavior before and after the large increase in EITC in 1986.
- Compared LS changes of unmarried women with children (who are eligible for EITC) to those of unmarried women without children (who are not eligible: serve as control group).
- for unmarried women with no kids, the fraction working remained unchanged at 95.2% before and after 1986.
- for unmarried women with kids, the fraction working increased from 72.9% to 75.3%. Thus it looks like making EITC more generous raises labor force participation, as predicted. (This contrasts with welfare, which has the opposite effect).

Comment:

-Things are a bit different for married couples with children, who are also eligible for EITC. If they make joint decisions on *total family labor supply*, you can interpret the horizontal axis in the above diagrams as total leisure (of husband and wife together). In cases 2 and 3, the reduction in labor supply now could take the form of the wife stopping work altogether (because the couple is still supplying some labor after the wife stops working). Thus EITC could reduce the fraction of low-income *married* women who work. In a follow-up paper, Eissa and Liebman find exactly that.

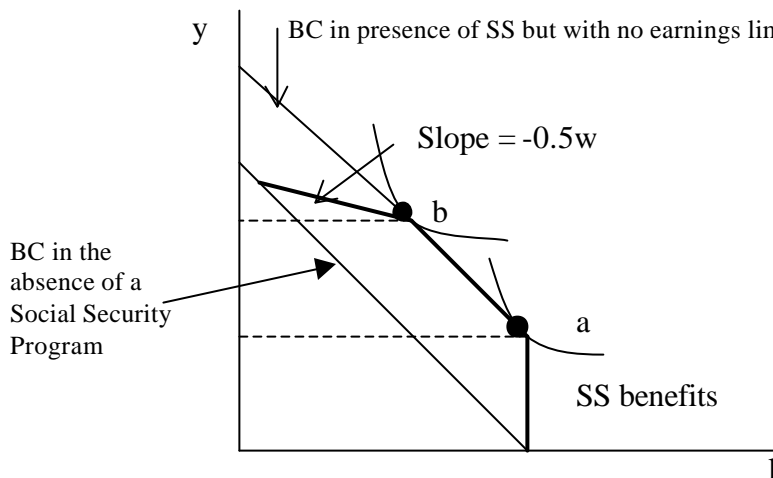
Social Security Earnings Limit:

- Social Security has been around since 1930's
- originally money came from general taxes
- goal was to provide a basic level of income for retired people
- to prevent non-retired people from claiming benefits, people earning more than a specified amount per year were not allowed to get benefits.
- this is the **social security earnings limit** – the amount that you are allowed to earn before your benefits begin to be revoked
- in 1998, for 62-65 year olds:
 - annual earnings up to \$9,120 were exempt
 - earnings above this, social security benefits were “taxed back” by 50 cents per dollar
- for 65-69 year olds:
 - annual earnings up to \$14,500 were exempt
 - beyond that there was a 33% tax back
- on March 22, 2000, social security earnings limit for people over 65 was eliminated by a unanimous vote in Congress

Predicted effects of Social Security and the Earnings Limit:

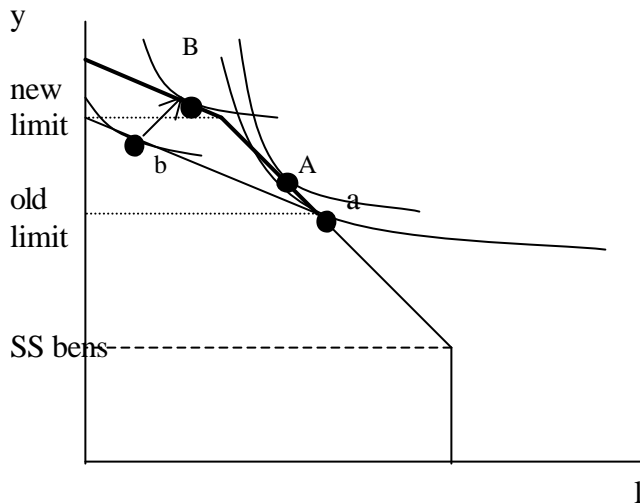
(case of a 62-65 year-old)

(dark line gives BC in the Presence of a Social Security Program that has an Earnings Limit and a 50% tax-back of earnings above the limit)



- people tend to bunch up at the kinks
 - a) total labor force withdrawal
 - b) max. earnings limit

- effects of raising the exempt amount:



- a) individuals initially at the kink will respond by working more (**a** to **A**)
- b) individuals initially above the kink are likely to work less (**b** to **B**: income effects) With more money left over, people no longer need to work as much to supplement their SS benefits.

Evidence on the effects of the Social Security Earnings Limit (Friedberg 1999):

Looks at the effects of an increase in the exempt amount in 1978 for 65-69 year olds

- people really do “pile up” at the old kinks before the policy change, and at the new kinks afterwards, just as theory predicts: an unusual fraction of population has annual earnings *just below* (i.e. within \$1000 of) the earnings limit

Friedberg’s findings however suggest that the net effect of an increase in the exempt amount to \$30,000 would be to reduce total labor supply by the elderly (effect **bB** dominates). A complete elimination of the exempt amount is however predicted to raise total labor supply.

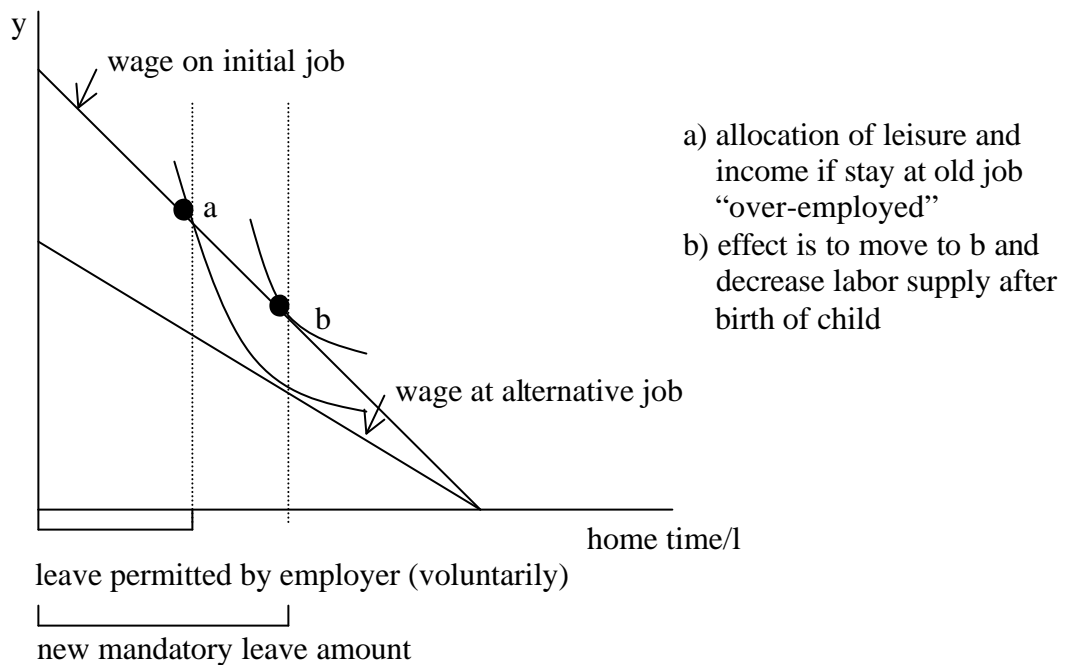
Family and Medical Leave Act (FMLA):

- not an income support program
- just a law that went into effect in 1993
- requires firms to give leave to women who give birth – 16 weeks minimum
- pay is not required, but have to give job back after 16 weeks
- can also apply to taking care of sick/elderly parents
- in comparison to other countries, US is quite stingy

Predicted Effects of FMLA:

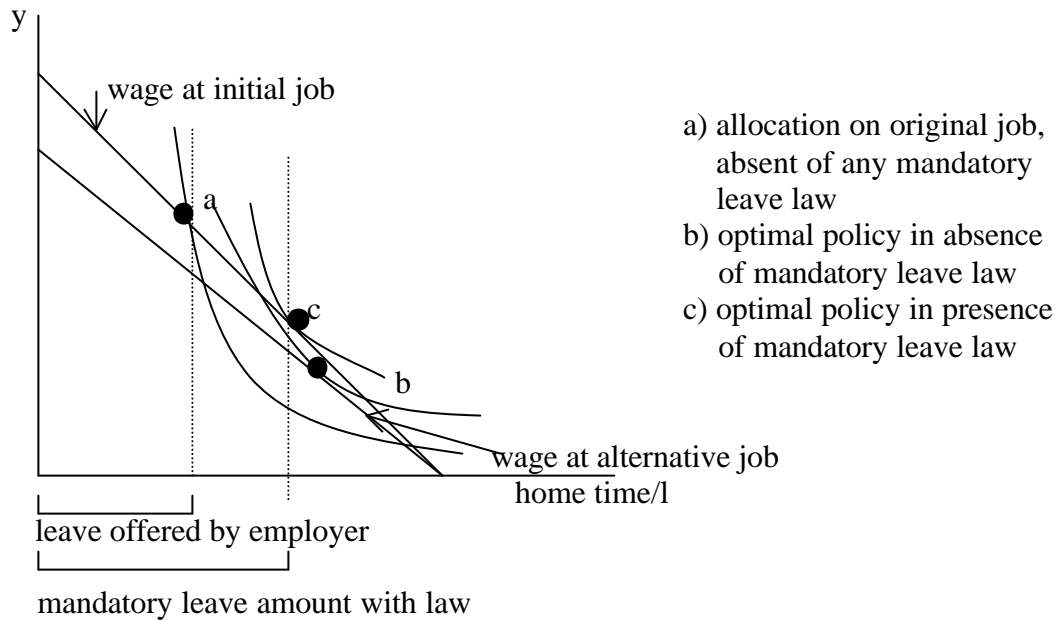
- two cases:

Case 1: alternative employment hard to find



In this case, quitting the old job is not a viable option, either in the presence or in the absence of the mandatory leave law.

Case 2: alternative employment more easily available



- mandatory leave laws can increase employment for women after child birth
- in this case, mandatory leave laws prevent quits: the employee stays with her former employer instead of quitting
- thus the laws increase continuity of women's employment, and raise women's wages as well as their employment after childbirth.

Evidence on the Labor Market Effects of FMLA:

Klerman and Leibowitz article – used Current Population Survey

- data from 1993 – before and after FMLA was introduced
- control group used was mothers of 1-2 year olds
- found that FMLA reduced frequency of work among mothers of 0-4 month olds (roughly about 16 weeks)
- also more reported to be on leave for childbirth
- *but* increased fraction of mothers of 4-12 month olds who worked ? more mothers going back to work earlier
- however, don't know if women are going back to the same firm after maternity leave