

Comments on the Swedish EITC

Conference on Earned Income Tax
Credit – Jobs and Employment

Ministry of Finance, Stockholm

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Three questions

- Are the methods used by the Ministry of Finance in line with established research practice?
- How good is established research practice?
- What policy conclusions can be drawn?

The Ministry's methods

- Comparisons of treated and non-treated groups not possible
- One has to rely on micro simulations
- Reasonable results
 - EITC at lower end of income scale has substantial effects on participation rate
 - EITC and reductions in state income tax higher up have their main effects on working time

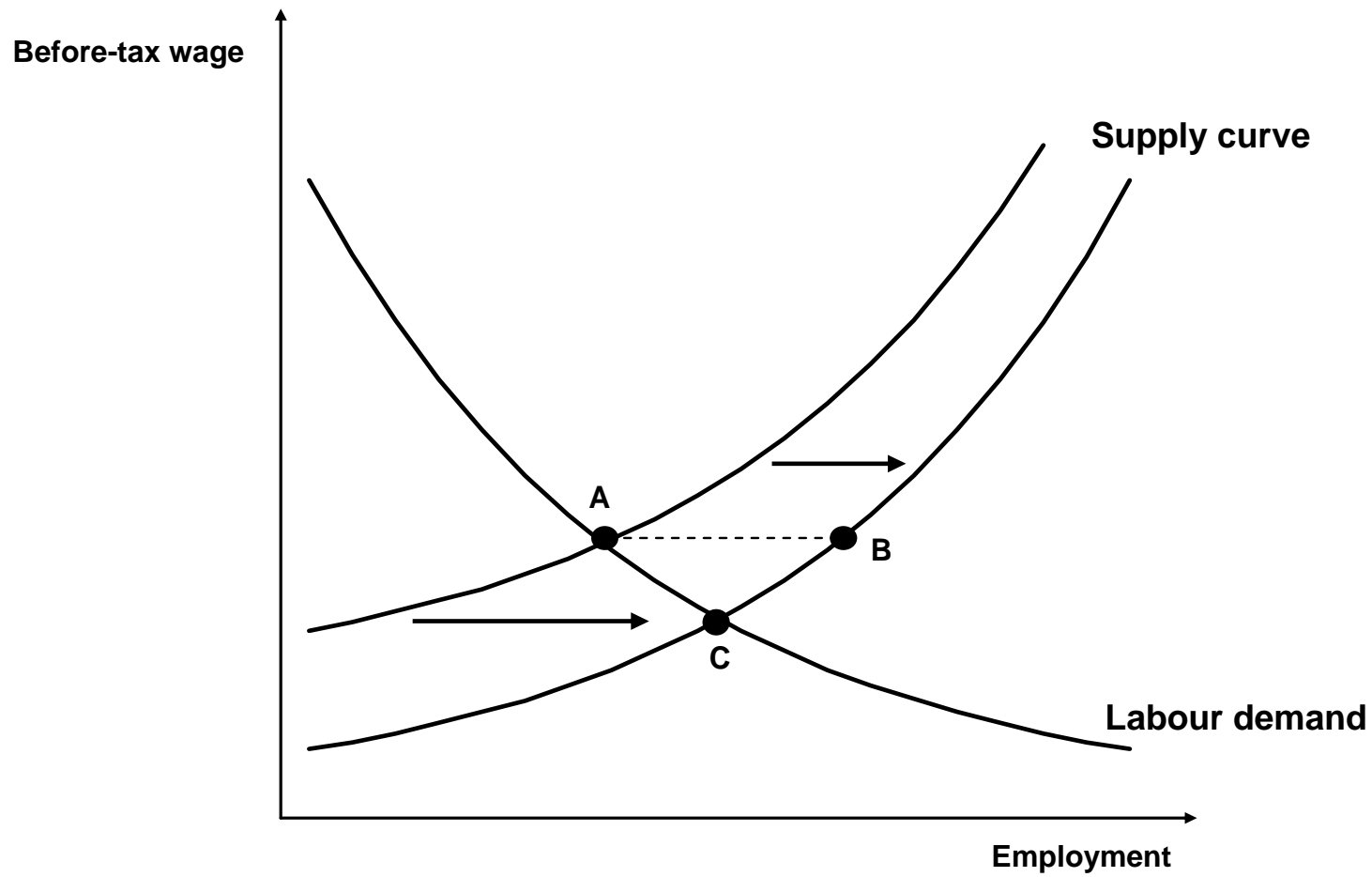
No evidence of decreasing marginal returns

- No compelling theoretical case for decreasing marginal returns
- It depends on the distribution of **reservation wages** in the population
- This is an empirical question
- How much can one back out from the model and the underlying data?

Conclusions so far

- The Ministry's analysis conforms to the state of art
- But how good is the state of art?

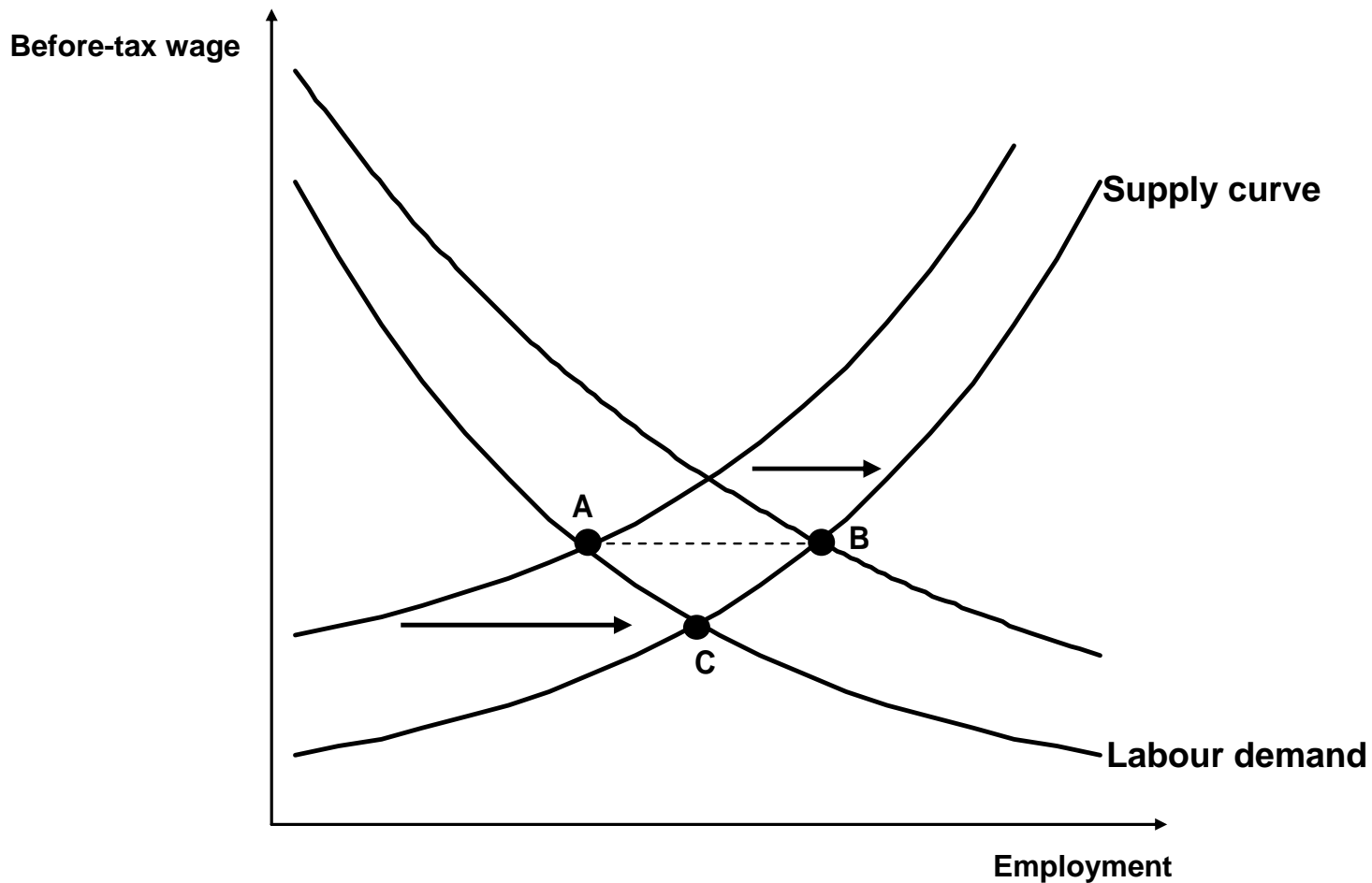
Labour supply and demand



Possible responses to the criticism

- Only partial-equilibrium analysis
 - true but still a problem
- When estimating effects on labour-market participation one is in practice looking at employment
 - true but one does not capture general-equilibrium effects
- Internationally determined return to capital

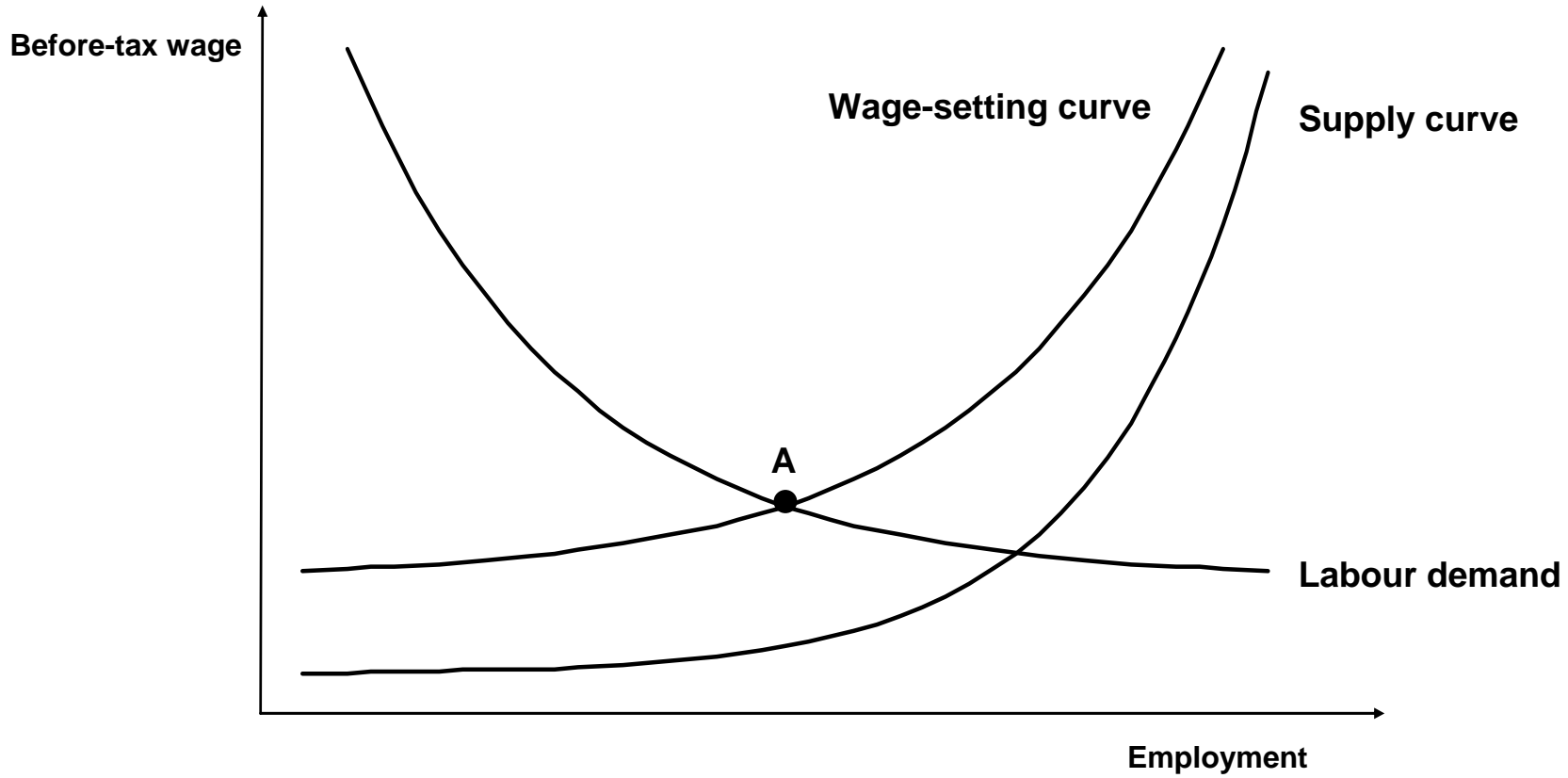
Internationally given return to capital



Internationally given return to capital

- Strong assumptions necessary
 - constant returns to scale in production
 - investment at home and abroad are perfect substitutes
 - domestic and foreign goods are perfect substitutes
- Even in this case adjustment takes very long time

The Layard-Nickel model



Policy conclusions

- Large uncertainty on the results concerning the magnitude of **absolute** employment effects
- One can have more faith in results concerning **relative** employment effects
- Calculations ignore the crucial **political-economy effect** that EITCs may trigger also tax cuts for retired people as well
- Wrong to claim that EITCs helps fiscal sustainability
 - the effect is the reverse one
- EITCs either for reasons of **social efficiency** or **employment**
- The ultimate **political** trade-off is between incentives and insurance

Procentuell förändring: Sysselsatta, arbetstid och årsarbetstimmar. Självfinansieringsgrad i procent

Alternativ	Sysselsatta	Medelarbetstid för sysselsatta	Årsarbets-timmar	Självfinansieringsgrad
1 Gränsvärde 1	0,10	-0,02	0,09	15
2 Luntning 1	0,10	-0,01	0,09	16
3 Gränsvärde 2	0,10	0,06	0,17	23
4 Lutning 2	0,09	0,11	0,20	24
5 Gränsvärde 3	0,03	0,21	0,23	43
6 Höjd skiktgräns	0,00	0,16	0,15	36
7 Sänkt statlig skatt	-0,02	0,17	0,16	45
8 Slopade värnskatt	0,01	0,09	0,10	56

Replacement rate after tax in 2006 and 2010 at one calendar year's unemployment according to monthly income

Monthly pay	15 000	20 000	25 000	35 000	50 000
Replacement rate 2006	82.3	81.8	71.3	51.8	39.9
Replacement rate 2010	73.1	68.7	56.5	42.6	33.4
Change	-9.2	-13.1	-14.8	-9.2	-6.5
From 80 to 70 per cent	-1.9	-0.7	-	-	-
Reduced ceiling for 100 days	-	-1.7	-1.5	-1.1	-0.8
Earned income tax credit	-7.0	-6.5	-5.4	-3.2	-1.9
Raised income threshold for state tax	-	-	-	-0.6	-0.3
Price and wage increases	-0.1	-4.0	-7.0	-4.2	-2.9

Replacement rate after tax for the long-term unemployed with activity support according to monthly income

Monthly pay	15 000	20 000	25 000	35 000	50 000
Replacement rate 2006	82.3	81.8	69.5	50.5	38.9
Replacement rate 2010	62.5	62.0	56.5	42.6	33.4
Change	-19.8	-19.8	-13.0	-7.9	-5.5
From 80 to 65 per cent	-12.5	-7.4	-	-	-
Reduced ceiling for 100 days.	-	-	-	-	-
Earned income tax credit	-6.0	-6.0	-5.4	-3.2	-1.9
Raised income threshold for state tax	-	-	-	-0.6	-0.3
Price and wage increases	+0.3	-0.2	-5.2	-4.2	-2.9