

# 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

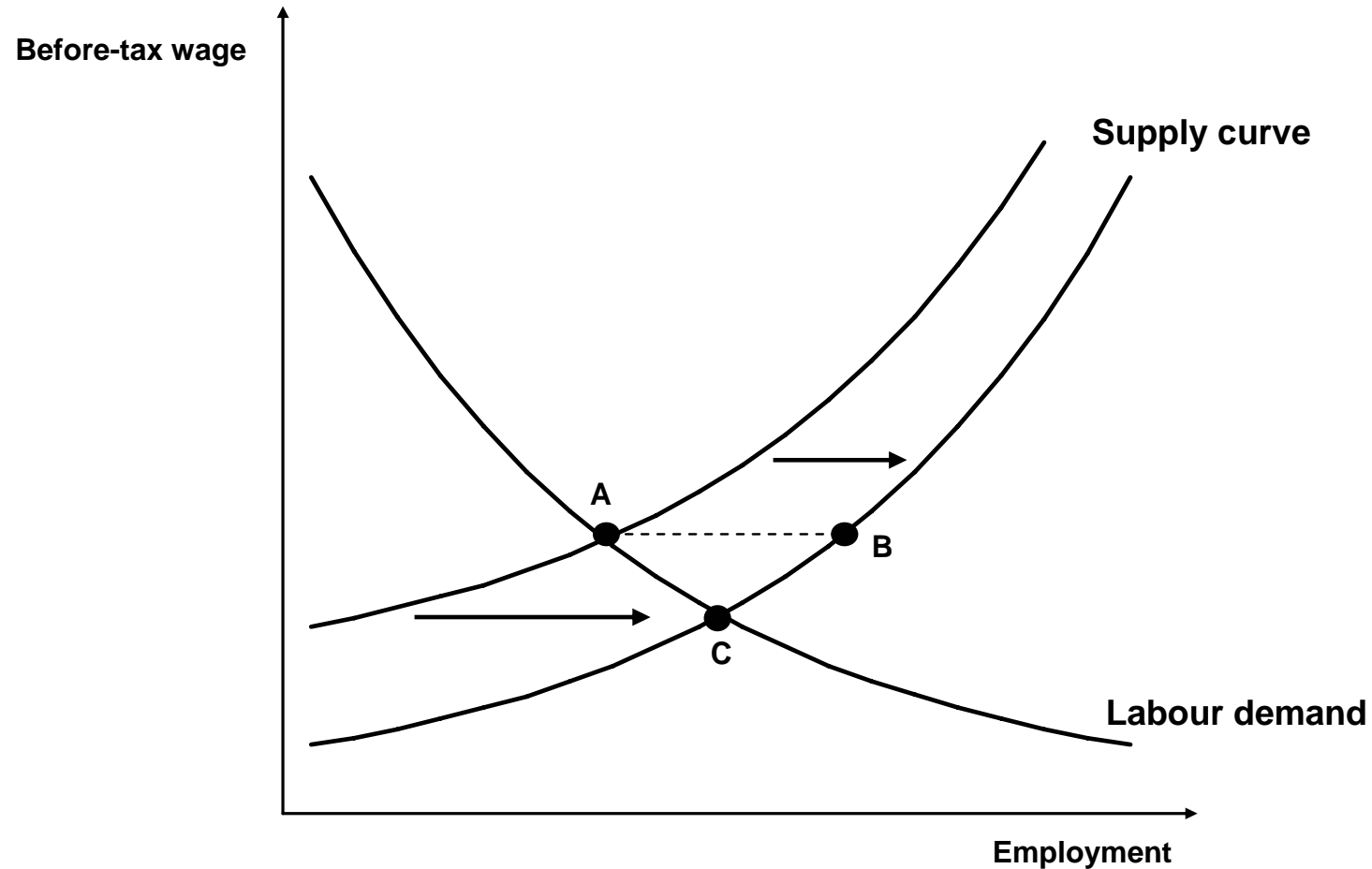
# No evidence of decreasing marginal returns

- 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?

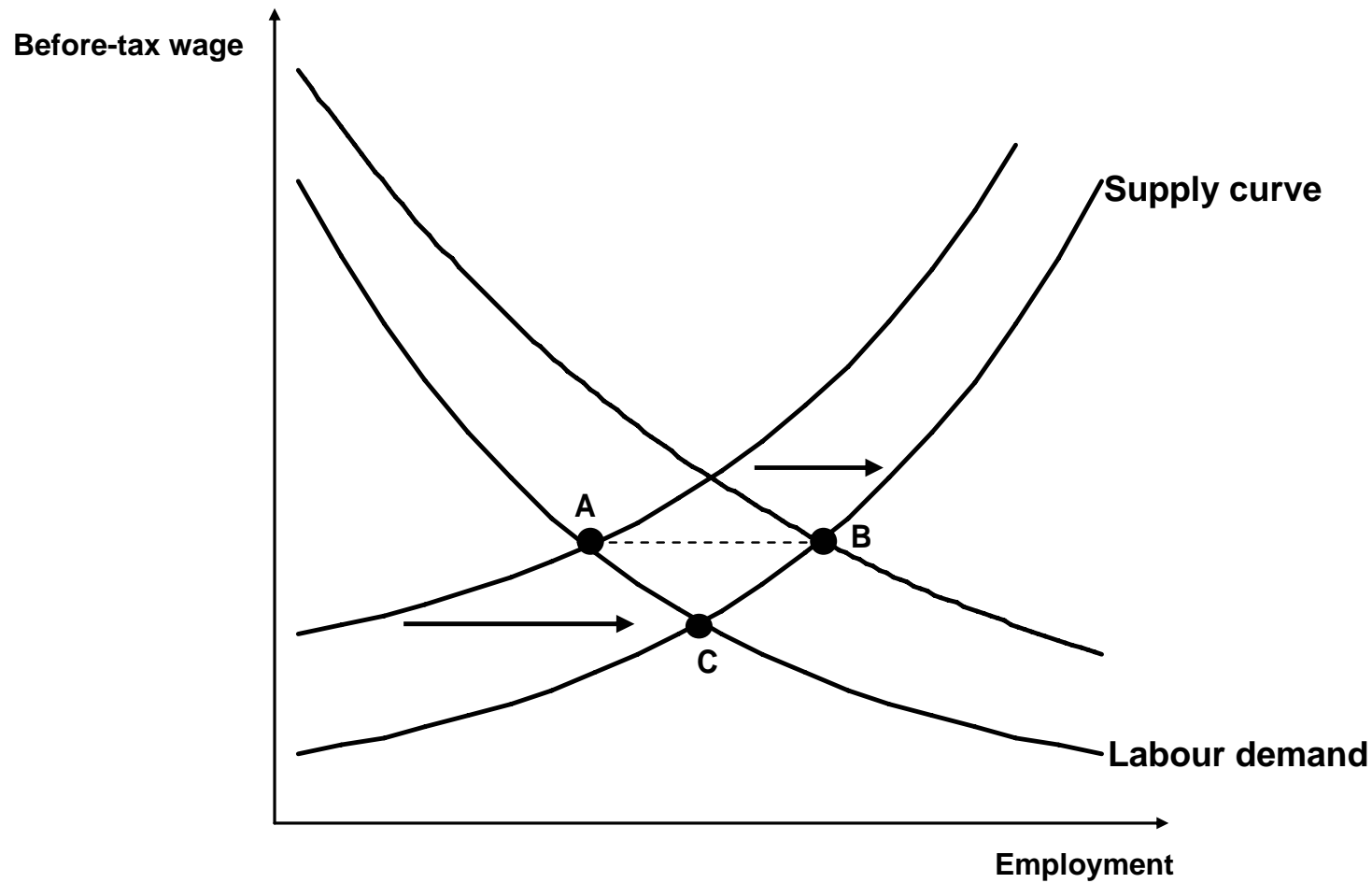
# Labour supply and demand



# 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

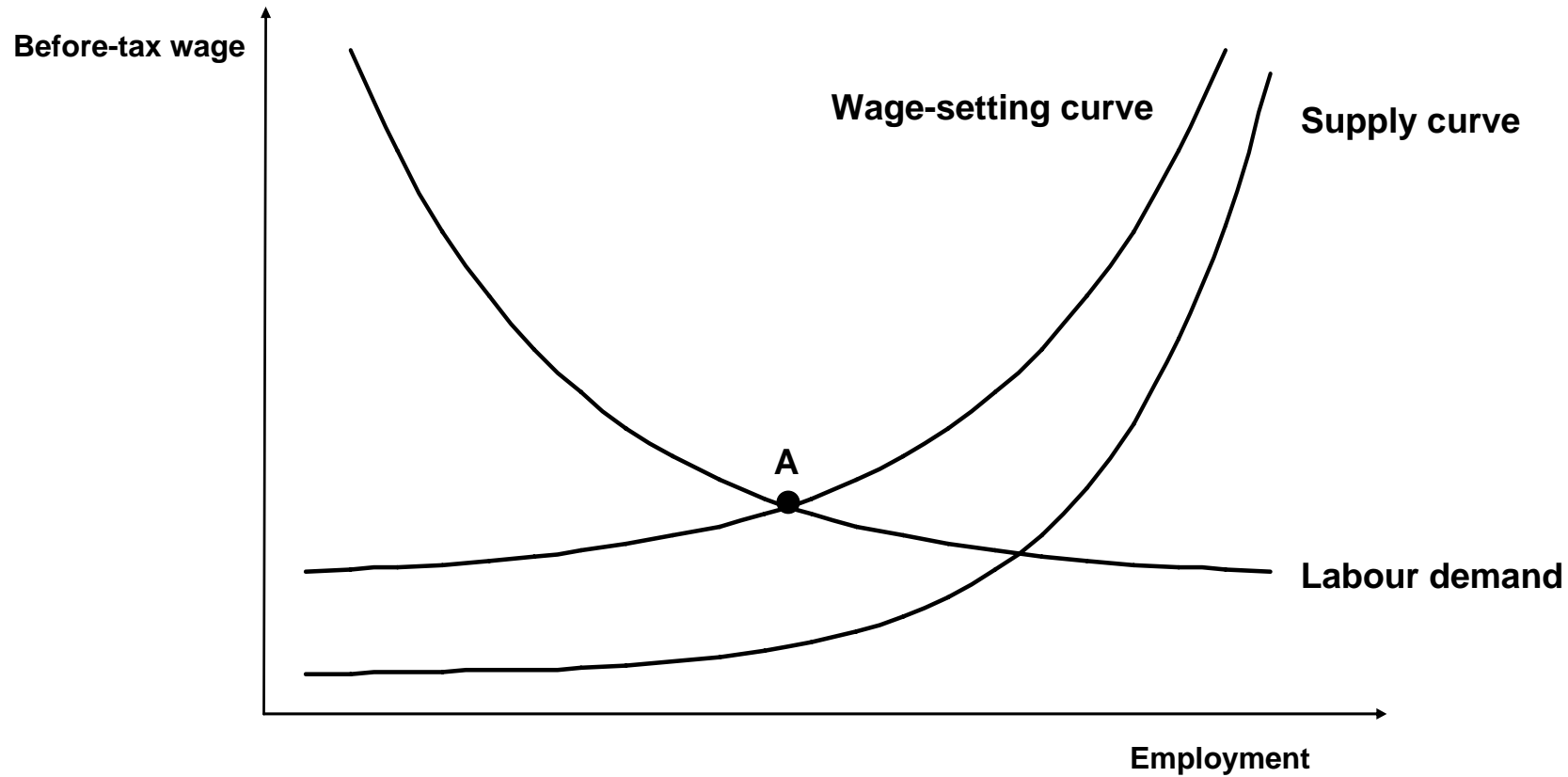
# Internationally given return to capital



# 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	Självfinansie-ringsgrad
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 Slopad värnsskatt	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
<b>Replacement rate 2006</b>	<b>82.3</b>	<b>81.8</b>	<b>71.3</b>	<b>51.8</b>	<b>39.9</b>
<b>Replacement rate 2010</b>	<b>73.1</b>	<b>68.7</b>	<b>56.5</b>	<b>42.6</b>	<b>33.4</b>
<b>Change</b>	<b>-9.2</b>	<b>-13.1</b>	<b>-14.8</b>	<b>-9.2</b>	<b>-6.5</b>
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
<b>Replacement rate 2006</b>	<b>82.3</b>	<b>81.8</b>	<b>69.5</b>	<b>50.5</b>	<b>38.9</b>
<b>Replacement rate 2010</b>	<b>62.5</b>	<b>62.0</b>	<b>56.5</b>	<b>42.6</b>	<b>33.4</b>
<b>Change</b>	<b>-19.8</b>	<b>-19.8</b>	<b>-13.0</b>	<b>-7.9</b>	<b>-5.5</b>
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