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## Married Women Work Less Because of the EITC

After a decade in near total obscurity, the Earned Income Tax Credit (EITC) was expanded in the tax acts of 1986, 1990, and 1993 to become the largest cash-transfer program for lower-income families with children. Introduced in 1975 as a modest program to offset the Social Security payroll tax, the EITC is expected to benefit 19 million taxpayers and cost the federal government 25 billion dollars (including tax expenditures and outlays) in 1998. Just one decade earlier, in 1986, only seven million families received two billion dollars in federal income tax refunds through the EITC.

In **The Earned Income Tax Credit and the Labor Supply of Married Couples** (NBER Working Paper No. 6856), NBER Faculty Research Fellows **Nada Eissa** and **Hilary Hoynes** examine the effect of expansions of the EITC program between 1984 and 1996 on married couples with children. They find that the EITC increased married men's

employment only slightly (0.2 percentage points), but reduced married women's employment by more than a full percentage point (out of a base of about 50 percent). Overall, family labor supply and pretax family earnings fell among married couples eligible for the EITC. Eissa and Hoynes conclude that the EITC effectively subsidizes married mothers to stay at home.

Advocates of the EITC argue that, unlike traditional welfare, the credit helps "promote both the values of family and work." Indeed, the evidence suggests that the EITC promotes employment among eligible unmarried women with children.

However, to target benefits to lower-income families, the EITC is based on *family* income, which leads to a very different set of incen-

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"Women in the phase-out of the EITC are more than 5 percent less likely to work, and if they are already working, work as much as 20 percent fewer hours per year."

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The EITC is a *refundable* tax credit, so that any amount of the credit exceeding the family's tax liability is returned either as a lump sum payment or as part of the worker's regular paycheck. Virtually all recipients, however, choose the lump sum payment. In 1997, the maximum credit amount was \$3,656 for a family with two or more children, and \$2,210 for a family with one child.

tives for married taxpayers. In fact, the EITC sets up the same type of disincentives to work for EITC-eligible married women as traditional welfare does. In cases where the husband's earnings place the family at the beginning of the phase-out portion of the EITC (\$11,650 in 1997), the family's credit is reduced by 21 cents if the couple has two children (or 18 cents if one child).

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Combined with federal, state, and Social Security payroll taxes, the EITC substantially lowers the likelihood of work and the number of hours worked by secondary earners.

Eissa and Hoynes find that the modest overall labor supply distortions mask substantial differences among married EITC-eligible families. The expansion of the EITC has led to higher employment rates and hours worked by women in the

phase-in region (of family income), and lower employment rates and hours worked beyond the phase-in. Women in the phase-out of the EITC are more than 5 percent less likely to work, and if they are already working, work as much as 20 percent fewer hours per year.

Eissa and Hoynes use data from the Current Population Survey for 1984 through 1996 and base their estimates on a subset of married

couples with less than 12 years of schooling, who are disproportionately more likely to be eligible for the EITC than more educated couples. They examine labor force participation and hours worked, taking into account changes in the family budget constraint induced by tax policy, wages, income, and family size.

—Lester A. Picker

## True Price of Depression Treatment is Declining

**A**fter health expenditures rose at an alarming pace for much of the post World War II period, the increases in the 1990s have been relatively anemic, much to the relief of policymakers, business managers, and health professionals. But what accounts for this welcome trend?

Economists typically start delving into the forces driving trend change by dividing nominal spending by an official price index. Longstanding difficulties in the construction of price indexes in the health sector

tutional innovations.

In a recent NBER Working Paper, **Price Indexes for Acute Phase Treatment of Depression** (NBER Working Paper No. 6799), authors **Ernst Berndt, Susan Busch, and Richard Frank** have created a price measure for the treatment of one major illness: depression. One in ten American suffers from major depression. The authors identify therapeutically similar treatment bundles, based on an intensive review of the clinical literature. They also tap into a medical claims database of almost half a million lives, annually from

medical treatment from both the insurer and patient. Their demand-side index, like the CPI, incorporates the out-of-pocket payments by consumers or patients.

The results are striking. All the supply-side indexes are flat or decreasing over the 1991 to 1995 period. In sharp contrast, the BLS producer price indexes point to sharply rising prices. The authors' demand-side index shows annual increases of about 10 percent between 1991 and 1994, and then a 20 percent surge in 1995. The reason: the impact of higher co-payments and deductibles.

Taken altogether, the real price of care has fallen: more could be done to treat major depression in 1995 than in 1991 for a given budget. But contrary to both public and expert perception, increases in spending on mental health care have not been driven by more low-benefit services and higher payments to providers. "Our results point to a different story where spending increases are due to a larger number of 'effective' treatments being provided," the authors write.

—Chris Farrell

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"...more could be done to treat major depression in 1995 than in 1991 for a given budget."

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have been an impediment to gaining a deeper understanding of health care productivity and spending. For example, the CPI only deals with consumers' direct out-of-pocket payments; it doesn't include any money paid by employers to insurers. The BLS's medical price indexes also are based on the repricing over time of a fixed basket of goods or services, rather than capturing the entire treatment of an illness and condition and the impact of technological and insti-

1991 to 1995. The price indexes they calculate are based on transactions prices rather than list prices; they take into account treatment episodes, quality, and expected outcomes; and, finally, they use time-varying expenditure weights.

The researchers also distinguish between a supply-side index and a demand-side index. Their supply-side measures, like the BLS's producer price index, represent the total receipts received by providers of

## Past International Rescues were More Successful than Recent Ones

The specter of the International Monetary Fund or some other international institution riding to the “rescue” of a country in financial distress has become such a routine event in the 1990s that, increasingly, it invites only the cursory scrutiny that accompanies the common place. But in **Under What Circumstances, Past and Present, Have International Rescues of Countries in Financial Distress Been Successful?** (NBER Working Paper No. 6824) NBER Research Associates **Michael Bordo** and **Anna Schwartz** conclude that since 1973—and especially in the 1990s—rescues have presented more problems than solutions to the effort to stabilize emerging economies.

They note that, for more than 100 years, financial rescues mainly involved provisioning countries with “relatively small amounts of money” at “commercial market interest rates” with the goal of “staving off” actions that could cause currency problems “while remedial policies were put in place.” By contrast, Bordo and Schwartz point out that rescues today usually involve large amounts of money provided at below market rates, occur *after* a currency crisis is already in full bloom, and contain conditions for policy reforms that are “easily evaded.”

The result, they claim, is that bailouts provide investors and countries with an excuse to ignore the potential pitfalls of market conditions and

macroeconomic policies. Bordo and Schwartz observe that foreign lenders now often assume that any losses on their loans will be covered by international lending agencies, while “emerging countries may believe that they have an implicit contract with the IMF to be saved from their own folly.”

They note that recent recipients of high profile rescue packages—Mexico, Russia, Thailand, Indonesia, and South Korea—still have failed to

ble because of their own home-grown problems.” As for the safety net, Bordo and Schwartz observe that the need to “cover investors’ foreign holdings, such as large investment firms, presumes that the national welfare depends on their welfare.” “It is far from clear that protection of any sector or industry benefits the whole economy,” they write.

Bordo and Schwartz believe policymakers should look to the successful (and modest) financial

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“...it was not contagion from Thailand that made other countries vulnerable to financial crisis. They were vulnerable because of their own home-grown problems.”

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make changes in fundamental problems that required the bailouts in the first place. “By contrast, in earlier times, presumably borrowers and lenders learned the hard lesson that caution paid,” the authors write.

Bordo and Schwartz dismiss as “fallacies” two of the central preconceptions that drive 1990s style bailouts: contagion and investors’ need for “a safety net.” Implicit in the notion of contagion, they write, is the flawed assumption that other countries will be infected with a neighbor’s troubles largely by virtue of proximity, not because they share “the same problems as were present in the first country.” For example, they note that when the Thai currency, the baht, collapsed, “it was not contagion from Thailand that made other countries vulnerable to financial crisis. They were vulnera-

rescues of the past—such as the initiatives directed at Canada in 1962 and Italy in 1964—for lessons on how to proceed in the future. They observe that past successes demonstrate how the IMF could “rescue a monetary authority that has a temporary liquidity problem, is adopting remedial policies, and has a good chance of timely repayment.”

“Were today’s (international) monetary authorities, including the IMF, to lend at short term at a penalty rate on good collateral that exceeds the value of the loan, they would be following (time-honored) principles,” conclude Bordo and Schwartz. “However, in a world of deep capital markets, such as prevails today, there are few good reasons why the private markets cannot perform this role.”

—Matthew Davis

## Immigrants Tend to Live in High Welfare Benefit States

In **Immigration and Welfare Magnets** (NBER Working Paper No. 6813), NBER Research Associate **George Borjas** concludes that “the generous welfare benefits offered by

some states have magnetic effects and alter the geographic sorting of immigrants in the United States.” He finds that there is a “striking and easily observable” clustering of immigrants in high-benefit states, such as California. This is especially true for

immigrants receiving welfare as opposed to those who are not. Natives do not cluster in the same way, perhaps because they find it expensive or costly in other ways to move from one state to another. Immigrants have already decided to make

the costly move to the United States, and then must only decide which state is most advantageous to them. The extra cost of reaching that state may be small.

To reach his conclusion, Borjas uses data from the 1980 and 1990 censuses, looking at where immigrant households (those whose heads are resident aliens or naturalized citizens born outside the United States) have settled and making comparisons with native households (those with heads born in the United

welfare provisions. In 1970, California benefits were at the median, with as many states giving more as those giving less. By 1990, California's AFDC benefit package was almost the most generous in the nation. It was 20 percent larger than that provided by New York; 89 percent larger than the one in Illinois, and almost 280 percent greater than that offered by Texas. The increasing relative generosity of California's welfare system appears to have had an impact.

"...there is a 'striking and easily observable' clustering of immigrants in high-benefit states."

States). In classifying households, Borjas determines if a household received Aid to Families with Dependent Children (AFDC), Supplemental Security Income, and general assistance in the year prior to the census. The census data does not include information on Medicaid and Food Stamps. His calculations take account of the general trends in welfare.

California, Borjas notes, has become relatively more generous in its

In 1990, California was home to 9.6 percent of U.S. natives who did not receive welfare and 11.5 percent of U.S. natives who did. It was also home to 27.6 percent of the nation's immigrant households that did not receive welfare and 37.6 percent of immigrant households that did.

If only those immigrant households whose head has arrived in the United States five years prior to the census are included, the clustering

becomes even clearer. Some 45.4 percent of recent immigrants receiving welfare live in California, as compared to only 28.9 percent of those recent immigrants who do not receive welfare. Much of this clustering is because less-educated immigrants are more likely to live in California than less-educated natives. This is true even within groups of immigrants from a specific nation.

The same clustering is shown in the numbers for recent female-headed immigrant households with children. Borjas also determines that the clustering in California holds if immigrants from countries sending large numbers of refugees to the United States are excluded and if immigrants of Mexican origin are excluded. So the clustering in California can't be said to be entirely the result of California being adjacent to Mexico, or merely a favorite location for refugees. Further, his analysis indicates that clustering is not attributable to ethnic enclaves in California that often help new immigrants get settled.

—David R. Francis

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