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The Role of Policy in the Employment Growth of Single Mothers

A Report Prepared by the Council of Economic Advisers and the Department of the Treasury

ROUGH DRAFT
February 28, 2000

Introduction

One of the important recent trends in the labor market has been a notable increase in employment among several demographic groups that have traditionally played a marginal role in the labor market. This trend has garnered little attention in an economy in which the unemployment rate has declined to its lowest level in 30 years, more than 20 million jobs have been created in just seven years, and labor productivity surged to a 2.9 percent growth rate over the past four years.

The focus of this paper is explaining increased employment rates of demographic groups that have had generally been outside the economic mainstream, especially single women with children. Over the past seven years, employment has increased dramatically for these individuals. The general strength of the U.S. economy has contributed to this growth. But because employment rates for single mothers has increased relative to other groups of individuals that have also benefited from the strong economy, it appears that overall economic growth alone cannot be the explanation.

We present persuasive evidence that the growth in employment among single mothers is not merely a by-product of a strong labor market, but is also the result of conscious policies that have been implemented over the past decade. The Earned Income Tax Credit (EITC), for example, is an important program that has been effective in increasing the well-being of the working poor and their families. By increasing the rewards to labor market activity among workers in low-income households, an expanded EITC has also increased incentives to work for many people who previously did not work. Similarly, the 1996 Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA), as President Clinton said, "provides an historic opportunity to end welfare as we know it and transform our broken welfare system by promoting the fundamental values of work, responsibility, and family." The provisions of the legislation were intended to increase the relative returns to work for former recipients, and in so doing resulted in an expansion of employment for these individuals.

The evidence supports the notion that the EITC, work-related provisions of PRWORA, funding of child care, Medicaid expansion for families, and other related policies are not merely tools for raising the living standard of economically disadvantaged families. These policies are also a demonstrably effective means of bringing them into the economic mainstream and increasing the nation's labor force.

The policies we discuss and a strong overall economy are best viewed as complimentary, not competing explanations of the remarkable growth in employment among groups that have too often been out of the economic mainstream. Labor market policies have increased the incentive individuals have to work and the strong economy has provided the opportunity for them to work. And by increasing the nation's labor force, these labor market policies have contributed to the remarkable growth in the U.S. economy during this expansion.

We begin by presenting, in the next section, general trends in the labor force over the past several decades. We then evaluate the EITC, PRWORA, and a small number of other policies potentially relevant to labor supply, and provide concluding remarks.

Recent Trends in Employment

In January 2000, there were almost 141 million Americans in the labor force, a new record. The labor force participation rate was 67.5 percent, also a new record. Employment was at the highest level ever, 135 million, and the employment to population ratio of 64.8 percent was also the highest rate on record. Labor force growth, along with productivity growth, is an important factor in overall economic growth; as more individuals flow into the labor force Gross Domestic Product (GDP) rises. The Council of Economic Advisers estimates that about one-third of the growth in real GDP during the current economic expansion came from the increase in the labor force. Labor force growth will continue to be an important component of economic growth in the future—through the current expansion and beyond.

Since 1975, more than 70 percent of the growth in U.S. employment has come from groups that had previously been underrepresented. For example, the white male employment rate, which traditionally exceed that of other groups, has fallen by about 10 percentage points over the past 45 years. At the same time the employment to population ratios have been rising for women, blacks, and Hispanics. All of these groups had record-high employment rates in January 2000 (Chart 1). In fact, the employment to population ratios for these groups are approaching the national ratio.

Chart 2 shows the employment to population ratios for single women with children and single women without children since 1984. The gap in employment for single women with children compared to single women without children generally increased modestly over the late 1980s and early 1990s, but widened rapidly after 1993. This paper will discuss policies that appear to have contributed to the rapid growth in employment for single mothers.

The Earned Income Tax Credit

The earned income tax credit is a refundable tax credit aimed at raising the after-tax income of low- and middle-income working families. Because it is refundable, families whose credit exceeds their federal tax liability receive a refund from the Internal Revenue Service.

EITC benefits rise with a worker's income until a specified maximum benefit level is reached. The maximum benefit level and the size of the supplement depend on the number of children the worker is supporting. In 1999 (tax return filed in 2000), workers with no children receive 7.65 percent of their labor income up to a maximum benefit of $347 (reached at an income level of $4,500). Those with one child receive a supplement of 34 percent up to a maximum benefit of $2,312 (reached at an income level of $6,800). Those with two or more children receive a supplement of 40 percent up to a maximum benefit of $3,816 (reached at an income level of $9,550).

Once the maximum credit is reached, the size of the credit remains constant as income rises until a phase-out point is reached. In 1999, the credit begins phasing out at income levels of $5,700 for workers with no children, and $12,500 for workers with children. Once the phase-out point is reached, the size of the credit declines by about 8 cents for each additional dollar of income for childless workers, 16 cents for workers with one child, and 21 cents for workers with two or more children. The credit is fully phased out at income levels of $10,200 for workers with no children, $26,900 for workers with one child, and $30,580 for workers with two or more children. (See Chart 3.)

The EITC is now among the largest Federal programs benefiting low- and moderate-income families. EITC credits were received by almost 19.5 million households and amounted to more than $30.6 billion in 1997. Single mothers received more than two-thirds of these dollars, with the bulk of the remaining one-third going to married taxpayers.

The earned income tax credit was first enacted in 1975 as part of a tax package aimed at stimulating the economy. It gave taxpayers with children a 10 percent refundable credit on the first $4000 of income (a maximum credit of $400), which was then phased out over the next $4000 of income. Over the next 10 years, the EITC remained a relatively small Federal program, and despite small expansions in 1979 and 1985 the real value of the credit eroded slowly.

The Tax Reform Act of 1986 significantly expanded the credit and indexed it to inflation. Credit rates, phase-in ranges, and phase-out ranges were expanded considerably. The budget act of 1990 (OBRA90) increased credit amounts for families with two or more children and expanded eligibility. And starting January 1991, the EITC was not counted as income in most means-tested programs, a change that increased its value to low-income families.

President Clinton proposed a substantial expansion of the EITC in 1993 to meet his goal that no family with a full-time worker should fall below the poverty line. The 1993 expansion in credit rates and the maximum credit were phased in between 1994 and 1996. The maximum credit for families with two or more children was raised by 69 percent. In addition, childless workers with incomes below $9500 became eligible for a small credit. The cumulative effect of the expansions in the EITC has been remarkable: credits in real dollars increased by twelve-fold between 1984 and 1997. Chart 4 shows how the number of households receiving the EITC and the total value of EITC benefits (in constant 1999 dollars) have increased over time.

Effects of EITC on Labor Supply

The EITC, by raising the after-tax return to work, unambiguously encourages work by single parents. In this regard, the EITC is unlike other means-tested programs. The work incentives provided by the EITC have been associated with a significant increase in labor force participation.

Chart 5 compares the maximum benefit received under the EITC and the difference in employment to population ratios of single mothers and single women without children.[1] This comparison, similar to one by Berkley economist Nada Eissa and Harvard economist Jeffrey Liebman (1996), is instructive because the EITC substantially affects the first group but not the

[1] Since 1990, the maximum benefit is the average of the maximum for families with one child and those with two or more.

second. Prior to the expansions of the EITC following 1986, the employment to population ratios of these two groups moved roughly in parallel. Since then, and especially since 1993, employment among single mothers has risen dramatically while that of single women without children has been roughly unchanged. As Chart 5 demonstrates, the degree to which relative employment by single mothers and the maximum EITC benefit have moved together is striking.

A number of studies have examined labor force participation and employment by unmarried mothers and EITC benefits in order to determine if the close association exhibited in Chart 5 might be due to other factors. In a 2000 study, Bruce Meyer of Northwestern University and Dan Rosenbaum of UNC-Greensboro show that employment rates for single mothers rose during periods of EITC expansion not just relative to single women without children but also relative to two other groups less affected by changes in the EITC, black men and married mothers. In addition, they find that employment increases were especially large for high-school dropout single mothers (a group likely to be disproportionately affected by the EITC) during periods of EITC expansion. Perhaps most strikingly, they find that employment rates among single mothers with two or more children relative to single mothers with one child was steady or falling until 1993 and then rose sharply when EITC benefits were increased for those with more than one child.

Meyer and Rosenbaum (1999) supplement a comparison of employment rates with detailed structural models that allow them to control for characteristics (such as age, education, and wages) that may differ across groups and lead to different labor force behavior. They find that the relative employment rate of single mothers increased even more when controlling for these characteristics than without controls. In addition, they consider the labor supply impact of changes in a number of social policies in addition the EITC (including AFDC waivers prior to the 1996 Personal Responsibility and Work Opportunity Reconciliation Act, Food Stamps, and Medicaid expansions). Using individual data from the Current Population Survey for 13 years, they conclude that the EITC accounts for more than 60 percent of the increase in employment of single mothers between 1984 and 1996.

Harvard economist David Ellwood (1999) also looks at a number of controls to determine if policy changes, especially the EITC, are responsible for the dramatic change in employment of single mothers. His results showing that the rise in relative employment rates is especially dramatic for those most affected by the EITC increases—the lowest skill/lowest wage workers—are consistent with those of Meyer and Rosenbaum (1999, 2000) and Eissa and Liebman (1996). In addition, he finds that employment rates for single mothers increased especially rapidly in states aggressively pursing welfare reform.

Table 1 summarizes results of several academic studies on the effect of the EITC on employment and labor force participation.

Table 1 Studies of Effects of EITC on Employment/Labor Force Participation				
Study	**Data**	**Time Period Studied**	**Groups Studied**	**Effect of EITC**
Dickert, Houser, and Scholz (1995)	Simulation based on after-tax wages and labor supply parameters	1993 expansion	Single parents	+182,000 in employment
			Primary earners	+30,250 in employment
			Secondary earners	-26,000 in employment
Liebman and Eissa (1996)	CPS	1986 expansion	Single mothers (Relative to single childless women)	+2 percentage point in labor force participation
Eissa and Hoynes (1999)	CPS	1986, 1990, and 1993 expansions	Married men (Less than HS education)	+0.2 percentage point in labor force participation
			Married women (Less than HS education)	-1 percentage point in labor force participation
Meyer and Rosenbaum (1999)	CPS	1984-1996	Single mothers	EITC responsible for 60 percent of increase in employment
Ellwood (1999)	CPS	1980-1998	Low-income single mothers	EITC responsible for 20-30 percent of increase in employment
			Low-income married mothers	4-8 percentage point decline in employment

The effects of the EITC on hours worked by those who would chose to work without the EITC and on the hours and labor force participation of married workers with working spouses is less clear. For workers in the phase-in range of the EITC, the "substitution effect" is positive—the EITC raises after-tax return to working an additional hour and induces a worker to substitute from non-work activity into additional work. But for these workers and for those in the flat range of the EITC, the "income effect" is negative; these workers now have higher incomes, and this may weaken work incentives at the margin. (Notice that there is no substitution effect for workers in the flat range.) And for workers in the phase-out range, both the income and substitution effects are negative. Thus, in theory, the effect of the EITC on hours for those in the phase-in range is ambiguous while the effect those in the flat and phase-out ranges is negative.[2]

Married workers can face a disincentive to work as a result of the EITC. When the primary earner receives EITC credits, the income effect discourages labor force participation by secondary household earners. In addition, earnings by a secondary earner can place the family in the phase-out range of the EITC, thus providing a further disincentive for a secondary earner to work. But, for some very low-income families, the primary earner's income is so low that the secondary earner can actually raise the family's EITC benefits. The President has proposed changes in the EITC that would alleviate some of these effects; they are discussed in the final section of this paper.

How large are the various work incentive effects of the EITC? The empirical literature on labor supply suggests that participation is more responsive to wage and income changes than are hours worked for those in the labor market.[3] Stacy Dickert, Scott Houser, and Karl Scholz (1995) use estimates of labor supply elasticities to simulate the effect of the 1993 EITC expansion on both participation and hours. As is consistent with the results discussed above, they find that the EITC expansion should raise participation by single parents. Their simulations show a smaller increase in participation by primary earners in two-parent families (because most primary earners in these families were already working). Berkley economists Eissa and Hillary Hoynes (1999) find a small increase in the labor force participation of married men with less than 12 years of education from the EITC. Secondary earners in two-parent families reduce participation in their simulations, but that decline is smaller than the increase for primary earners. Ellwood (1999) presents evidence that the EITC results in lower participation among married women. Eissa and Hoynes (1999) also find that participation by married women is reduced by the EITC, but only by about one percentage point.

The predicted impact of the EITC on hours worked for those already in the labor force shows up in the simulations carried out by Dickert, Houser, and Scholz (1995). But the impact on hours is relatively small. On net, their simulations predict a positive effect of the EITC on labor supply – the positive effect on participation outweighs the negative effect on hours. Although the main focus of their work is on participation, Meyer and Rosenbaum (1999) look at the impact of EITC changes from 1984 to 1996 on hours and find that the net effect of EITC changes on hours worked is positive.

Other evidence also suggests that the impact of the EITC on hours for those already in the labor force is small. Eissa and Liebman (1996) examine taxpayers already in the labor force when the 1987 extension of the EITC expanded the phase-out range to additional workers and observe no decline in hours worked. In addition, Liebman (1998) argues that if workers respond to EITC phase out, there should be a bunching of taxpayers near the beginning of the phase-out range and few workers near the end of the range. He presents evidence from 1992 tax returns that shows little or no bunching at the beginning of the phase-out range and no sign of the predicted

[2] Finally, even workers initially outside the range of the EITC could at least theoretically be affected. For example, a worker whose income was marginally higher than the range for which EITC holds might reduce work effort if the EITC expands so as to benefit from the higher EITC credits.

[3] See, for example, James Heckman (1993).

shortage of workers at the break-even point. Eissa and Hoynes (1999) find a 2 percent decline in annual hours worked (45 hours) for married men because of the 1986-1993 EITC expansions, and a decline of 1-6 percent in annual hours (13 to 93 hours) for married women, depending on the specification. Again, all of these effects are for workers *already in the labor force.* The large net increases in employment from the EITC greatly outweigh the small declines in hours worked. Table 2 summarizes the effect of the EITC on hours worked for those already employed (or in the labor force).

Table 2
Studies of Effects of EITC on Hours Worked for Labor Force Participants/Workers

Study	Data	Time Period Studied	Groups Studied	Effect of EITC
Dickert, Houser, and Scholz (1995)	Simulation based on after-tax wages and labor supply parameters	1993 expansion	Single parents	-10 hours annually
			Primary earners	-8 hours annually
			Secondary earners	-30 hours annually
Liebman and Eissa (1996)	CPS	1986 expansion	Single mothers (Relative to single childless women)	No change
Eissa and Hoynes (1999)	CPS	1986, 1990, and 1993 expansions	Married men (Less than HS education)	-45 hours annually
			Married women (Less than HS education)	-13 to -93 hours annually
Meyer and Rosenbaum (1999)	CPS	1984-1996	Single mothers	Increase in EITC increases hours worked

The Personal Responsibility and Work Opportunity Reconciliation Act

In 1996, the President signed the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA), changing the nation's welfare system into one that requires work in exchange for time-limited assistance. The law contains strong work requirements, and provides performance bonuses to states that effectively move welfare recipients into jobs. Even before PRWORA became law, many states were well on their way to changing their welfare programs to jobs programs. By granting federal waivers, the Administration allowed 43 states to establish work requirements, time-limit assistance, or improve child support.

These policy changes appear to have dramatically affected welfare caseloads. As of June 1999 the number of welfare recipients—adults and children combined—was 6.9 million, 51 percent less than in 1993. (See Chart 6.) This 1999 figure represents 2.5 percent of the total population, the lowest proportion in more than three decades. A 1999 report by the Council of Economic Advisers examining the welfare caseload from 1996 to 1998 indicated that the single largest identified factor in the decline in repiciency was welfare reform—the change in state welfare programs implemented under the Temporary Assistance for Needy Families (TANF) block grant. Specifically, the report estimates that TANF accounted for 35-36 percent of the decline in recipiency. By way of comparison, the strong economy accounted for 8-10 percent of the decline.

Given the strong emphasis on work requirements, it is perhaps not surprising that the drop in welfare use has been accompanied by an increase in the number of welfare recipients finding employment. One compelling piece of evidence on this trend comes from the Current Population Survey (CPS). These data provide information on individuals' employment status in the month of the survey (March), as well as information about income sources for the previous year. Chart 7 shows the current employment status in March of each year, from 1988 to 1999, for individuals receiving non-SSI cash welfare in the previous year. The proportion employed held steady at 20 to 21 percent from 1988 through 1992. From 1993 through 1999 there was a persistent increase in employment of these individuals, and more than 36 percent of individuals on welfare in 1998 were employed in March 1999. This upward trend in employment status was observed for Hispanic, non-Hispanic white, and non-Hispanic black individuals alike.

Another important confirmation that many welfare recipients are successfully moving to employment comes from the aggregation of recent state reports. As noted above, the 1996 welfare reform legislation included rewards to encourage states to place people in jobs. According to reports filed by the 46 states competing for these bonuses, more than 1.3 million welfare recipients nationwide went to work in just the one year period between October 1997 and September 1998.

A recent national survey released by the Urban Institute (Pamela Loprest, 1999) provides additional evidence highlighting the importance of work as an alternative for individuals leaving welfare. The study found that 69 percent of individuals leaving welfare did so because of work, and another 18 percent left because they had increased income, no longer needed welfare or had a change in family situation. A second 1999 Urban Institute study (Sarah Brauner and Loprest) reviews evidence from state-level analyses about the employment status of individuals recently leaving welfare. The median of estimates of current employment status for former welfare recipients (from 12 estimates) was 65 percent.

Even among those who remain on welfare rolls, there is an apparent upturn in reported work. According to CPS data, in each year from 1988 through 1993, about one third of individuals who received welfare in March of the year reported that they worked some in the previous year. Chart 8 shows a steady increase in this percentage after 1993, so that by March 1999, more than 51% of welfare recipients reported work during the previous year.

The detailed analysis of Meyer and Rosenbaum (1999) contributes greatly to our confidence that welfare reform is responsible in substantial measure for the upturn in employment of single women with children. Their evaluation of data from the period 1992 to 1996 shows that the grants of federal waivers alone were responsible for approximately 20 percent of the sizable increase in employment of these women. (As previously discussed, reforms to EITC were found to be even more important, and, as we note momentarily, policy innovations in Training and Child Care also contributed.)

Similarly detailed research is not yet available for the post-1996 period, but for 1996 through 1999 there has been a clear continuation of the trends that led to the Meyer-Rosenbaum conclusion about the role of welfare reform in increasing labor supply. Consider, for example, the employment status for low-income mothers with young children. CPS data show that for married women who had children under the age of 6, and who were below 200 percent of the poverty threshold in the previous year, the March employment rate increased gradually, from 35.3 percent in 1992 to 39.0 percent in 1996 and finally to 39.3 percent in 1999. Given that 1992 through 1999 was a period of economic expansion and that employment of women generally has been trending upward over the past several decades, this trend is not surprising. What *is* notable is the comparison of these married mothers of young children to corresponding single mothers (with children under 6 and below 200 percent of poverty the previous year), whose behavior has likely been affected by the change in welfare policy. These latter mothers had virtually the same employment rate as the married mothers in 1992, 34.8 percent. By 1996, though, the employment rate for single mothers increased to 42.6 percent, and by 1999, the employment rate among these women had climbed to 54.6 percent.

One important feature of the current policy is a welfare-to-work tax credit granted to employers who hire qualified welfare recipients, equal to 35 percent of the first $10,000 in wages in the first year and 50 percent in the second year. Although a detailed evaluation of this provision is not yet available, a 1998 study by Harvard economist Lawrence Katz on previous wage subsidy programs creates the presumption that the tax credit is playing a positive role in increasing the demand for labor services of former welfare recipients.

Other Policy Changes Contributing to Increased Labor Supply

Beyond changes to EITC and welfare policy, there are several additional policy changes that have the potential for increasing labor supply. The 1999 Meyer-Rosenbaum study of single mothers examines labor supply effects of rules changes that allow women to retain Medicaid coverage, training expenditures, and expenditures on child care. Although they do not find statistically significant effects of Medicaid coverage, Meyer and Rosenbaum do find meaningful effects of training and child care policy. Over the 1992-1996 period they examine, between 5 and 8 percent of the growth in the employment of single mothers can be attributed to the training and child care policies combined. The 1996 welfare reform expanded funding for child care, and gave States flexibility to provide both pre- and post-employment training to help welfare recipients find and keep a job. In light of existing research, these provisions can be expected to provide additional work incentives for low-income women.

One group of individuals that has historically had low rates of employment is the disabled. According to 1999 CPS data, for both men and women in the 25-64 age range, individuals with a disability that "prevents them from working or limits the kind or amount of work they can do," are less than one third as likely to be employed as the non-disabled. There has been very little recent change in the employment rates of these individuals. However, there is considerable variation in employment among the disabled, correlated with education. In the CPS data, among individuals with less than 12 years of education, only 12 percent of men and 11 percent of women were employed, while employment rates for those with 16 years of education or more were 47 percent for men and 42 percent for women. This variation in employment rates among the disabled suggests that policies that encourage human capital development or otherwise increase returns to work might increase the labor supply of the disabled. A recent study of individuals with severe spinal cord injuries by economists Alan Krueger of Princeton and Douglas Kruse of Rutgers reinforces the potential importance of work skills for labor market success among the disabled. Specifically, the authors find that among individuals with these serious injuries, those with computer skills returned more quickly to work and had relatively higher earnings once there.

One recent initiative designed to increase relative returns to work for the disabled is the Ticket to Work and Work Incentives Improvement Act of 1999. The act provides health insurance protection to the working disabled by giving States new options to allow workers with disabilities to buy into Medicaid. It extends Medicare coverage for an additional 4 ½ years for beneficiaries of disability insurance who return to work. And it provides grants for States to develop infrastructure that will help people with disabilities return to work.

New Policy Initiatives Affecting Labor Supply

The Fiscal Year 2001 budget contains a number of items that may encourage additional labor supply. The first of these items deals with the so-call "marriage penalty." The current tax system can discourage paid work by second earners, especially in combination with the indirect costs of working such as child care. The Administration's proposal will increase the return from work for second earners by: (1) effectively exempting up to $1,450 of earnings by the spouse with the lower earnings from income tax for couples who use the standard deduction, (2) allowing two-earner couples to earn more before having their EITC reduced, (3) reducing the EITC phase-out rate (and thus the effective return to work) by two percentage points for taxpayers with two or more children, and (3) increasing the child and dependent care tax credit for low and moderate-income families. Chart 9 shows in the increase in the EITC for married couples with 3 children in 2001.

A second important set of proposals involves child care expenses. Not surprisingly, child care expenses can be one of the biggest items in the budgets of poor working mothers. Statistics from 1993 suggest that working mothers with income below the poverty level and child care expenses spent 21 percent of their monthly income on care for their children. The Administration's proposals will increase the return to work for many low-income parents by making the child and dependent care tax credit refundable, and increasing the maximum credit rate for the EITC to 45 percent for low-income workers with three or more children.

Disabled individuals may incur additional costs in order to work and earn taxable income. And many moderate-income disabled individuals do not benefit from the current-law tax deduction for impairment-related work expenses because they do not have sufficient work-related expenses and other deductions to benefit from itemizing deductions. In addition, disabled individuals may not benefit from the current-law deduction because they incur significant work-related expenses outside the workplace (which do not qualify for the deduction) or rely on unpaid relatives or friends for assistance. For example, they may require personal assistance to get dressed and be driven to work. To aid disabled workers, the FY 2001 budget proposes a tax credit, equal to the lesser of $1,000 or earned income, for workers who have difficulty with at least one activity of daily living.

We regard the evidence as quite compelling in establishing that many policies affecting the well-being of low- and middle-income families—the EITC and reforms to welfare policy, in particular, but also a number of other related recent policy innovations—have been effective in bringing previously marginalized workers in the economic mainstream. Over the course of the current economic expansion, the strong labor market has been an important source of new opportunities for all workers, but these conscious labor policies have also contributed to an increase in the labor supply of single mothers in particular. A number of additional policy proposals by the Administration hold promise for further reinforcing incentives to work.

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Remarks: __URGENT X For your review __Reply ASAP X Please comment

Very rough first draft. We're also circulating w/in Treasury.

Gus

February 25, 2000

To: David Wilcox

From: Gus Faucher GF

Here's a draft of the piece on the increase in employment that Bob, Lowell Taylor from CEA, and I have been working on. I wanted to get this to you now so you have a chance to look at it over the weekend. I can't vouch that everything matches up, and I know we're missing one of the charts. We also need to do a lot of formatting.

We'd appreciate any comments.

Thanks.

Cc: Bob Cumby
Janet Holtzblatt
Lowell Taylor

Introduction

One of the most important recent trends in the labor market has been a notable increase in employment among several demographic groups that have traditionally played a marginal role in the labor market. This trend has garnered little attention in an economy in which the unemployment rate has declined to its lowest level in 30 years, more than 20 million jobs have been created in just seven years, and labor productivity surged to a 2.9 percent growth rate over the past four years.

The focus of this paper is explaining increased employment rates among low-income workers, especially single women with children. Over the past seven years, employment has increased dramatically for these individuals. The general strength of the U.S. economy has contributed to this growth. But because employment rates for these individuals have increased relative to other groups of individuals that have also benefited from the strong economy, overall economic growth alone cannot be the explanation.

We present persuasive evidence that the growth in employment among single mothers is not merely a by-product of a strong labor market, but is also the result of conscious policies that have been implemented over the past decade. The Earned Income Tax Credit (EITC), for example, is an important program that has been effective in increasing the well-being of the working poor and their families. By increasing the rewards to labor market activity among workers in low-income households, an expanded EITC has also increased incentives to work for many single mothers who previously did not work. Similarly, the 1996 Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA), as President Clinton said, "provides an historic opportunity to end welfare as we know it and transform our broken welfare system by promoting the fundamental values of work, responsibility, and family." The provisions of the legislation were intended to increase the relative returns to work for former recipients, and in so doing resulted in an expansion of employment for these individuals.

The evidence supports the notion that the EITC, work-related provisions of PRWORA, funding of child care, Medicaid expansion for families, and other related policies are not merely tools for raising the living standard of economically disadvantaged families. These policies are also a demonstrably effective means of bringing them into the economic mainstream and increasing the nation's labor force.

The policies we discuss and a strong overall economy are best viewed as complimentary, not competing explanations of the remarkable growth in employment among groups that have too often been out of the economic mainstream. Labor market policies have increased the incentive individuals have to work and the strong economy has provided the opportunity for them to work. And by increasing the nation's labor force, these labor market policies have contributed to the remarkable growth in the U.S. economy during this expansion.

We begin by presenting, in the next section, general trends in the labor force over the past several decades. We then evaluate the EITC, PRWORA, and a small number of other policies potentially relevant to labor supply, and provide concluding remarks.

Recent Trends in Employment

In January 2000, there were almost 141 million Americans in the labor force, a new record. The labor force participation rate was 67.5 percent, also a new record. Employment was at a record high of 135 million, and the employment to population ratio of 64.8 percent was also a record. Labor force growth, along with productivity growth, is an important factor in overall economic growth; as more individuals flow into the labor force Gross Domestic Product (GDP) rises. The Council of Economic Advisers estimates that about one-third of the growth in real GDP during the current economic expansion came from the increase in the labor force. Labor force growth will continue to be an important component of economic growth in the future—through the current expansion continues and beyond.

Since 1975, more than 70 percent of the growth in U.S. employment has come from groups that had previously been underrepresented. For example, the white male employment rate, which traditionally exceed that of other groups, has fallen by about 10 percentage points over the past 45 years. At the same time the employment to population ratios have been rising for women, blacks, and Hispanics. All of these groups had record-high employment rates in January 2000 (Chart 1). In fact, the employment to population ratios for these groups are approaching the national ratio.

Chart 2 shows the employment to population ratios for single women with children and single women without children since 1980. After narrowing in the early 1980s, the gap in employment for single women with children compared to single women without children increased rapidly, particularly in the mid-1990s. This paper will discuss policies that appear to have contributed to the rapid growth in employment for single mothers.

The Earned Income Tax Credit

The earned income tax credit is a refundable tax credit aimed at raising the after-tax income of low- and middle-income working families. Because it is refundable, families whose credit exceeds their federal tax liability receive a refund from the Internal Revenue Service.

EITC benefits rise with a worker's income until a maximum benefit level is reached. Maximum benefit levels and the size of the supplement increase with the number of children the worker is supporting. In 1999 (tax return filed in 2000), workers with no children receive 7.65 percent of their labor income up to a maximum benefit of $347 (reached at an income level of $4,500). Those with one child receive a supplement of 34 percent up to a maximum benefit of $2,312 (reached at an income level of $6,800). Those with two or more children receive a supplement of 40 percent up to a maximum benefit of $3,816 (reached at an income level of $9,550).

Once the maximum credit is reached, the size of the credit remains constant as income rises until the phase-out point is reached. In 1999, the credit begins phasing out at income levels of $5,700 for workers with no children, and $12,500 for workers with children. Once the phase-out point is reached, the size of the credit declines by about 8 cents for each additional dollar of income for childless workers, 16 cents for workers with one child, and 21 cents for workers with two or more children. The credit is fully phased out at income levels of $10,200 for workers with no children, $26,900 for workers with one child, and $30,580 for workers with two or more children. (See Chart 3.)

The EITC is now among the largest Federal programs benefiting low- and moderate-income families. EITC credits were received by almost 19.5 million households and amounted to more than $30.6 billion in 1997. Single mothers received more than two-thirds of these dollars, with the bulk of the remaining one-third going to married taxpayers.

The earned income tax credit was first enacted in 1975 as part of a tax package aimed at stimulating the economy. It gave taxpayers with children a 10 percent refundable credit on the first $4000 of income (a maximum credit of $400), which was then phased out over the next $4000 of income. Over the next 10 years, the EITC remained a relatively small Federal program, and despite small expansions in 1979 and 1985 the real value of the credit eroded slowly.

The Tax Reform Act of 1986 significantly expanded the credit and indexed it to inflation. Credit rates, phase-in ranges, and phase-out ranges were expanded considerably. The budget act of 1990 (OBRA90) increased credit amounts for families with two or more children and expanded eligibility. And starting January 1991, the EITC was not counted as income in most means-tested programs, a change that increased its value to low-income families.

President Clinton proposed a substantial expansion of the EITC in 1993 to meet his goal that no family with a full-time worker should fall below the poverty line. The 1993 expansion in credit rates and the maximum credit were phased in between 1994 and 1996. The maximum credit for families with two or more children was raised by 69 percent. In addition, childless workers with incomes below $9500 became eligible for a small credit. The cumulative effect of the expansions in the EITC has been remarkable: credits in real dollars increased by twelve-fold between 1984 and 1997. Chart 4 shows how the number of households receiving the EITC and the total value of EITC benefits (in constant 1999 dollars) have increased over time.

Effects of EITC on Labor Supply

The EITC, by raising the after-tax wage, unambiguously encourages work by single parents. In this regard, the EITC is unlike other means-tested programs. The work incentives provided by the EITC have been associated with a significant increase in labor force participation.

Chart 5 compares the maximum benefit received under the EITC and the difference in employment to population ratios of single mothers and single women without children.[1] This comparison, similar to one by Eissa and Liebman (1996), is instructive because the EITC primarily affects the first group but not the second. Prior to the expansions of the EITC following 1986, the employment to population ratios of these two groups moved roughly in parallel. Since then, and especially since 1993, employment among single mothers has risen

[1] Since 1990, the maximum benefit is the average of the maximum for families with one child and those with two or more.

dramatically while that of single women without children has been roughly unchanged. As Chart 5 demonstrates, the degree to which relative employment by single mothers and the maximum EITC benefit have moved together is striking.

A number of studies have examined labor force participation and employment by unmarried mothers and EITC benefits in order to determine if the close association exhibited in Chart 5 might be due to other factors. Meyer and Rosenbaum (2000) show that employment rates for single mothers rose during periods of EITC expansion not just relative to single women without children but also relative to two groups less affected by changes in the EITC, black men and married mothers. They also find that employment increases were especially large for high-school dropout single mothers (a group likely to be disproportionately affected by the EITC) during periods of EITC expansion. Perhaps most strikingly, they find that employment rates among single mothers with two or more children relative to single mothers with one child was steady or falling until 1993 and then rose sharply when EITC benefits were increased for those with more than one child.

Meyer and Rosenbaum (1999) supplement a comparison of employment rates with detailed structural models that allow them to control for characteristics (such as age, education, and wages) that may differ across groups and lead to different labor force behavior. They find that the relative employment rate of single mothers increases even more when controlling for these characteristics than it does without controls. In addition, they consider the labor supply impact of changes in a number of social policies in addition the EITC (including AFDC waivers prior to the 1996 Personal Responsibility and Work Opportunity Reconciliation Act, Food Stamps, and Medicaid expansions). Using individual data from the CPS for 13 years, they conclude that the EITC accounts for more than 60 percent of the increase in employment of single mothers between 1984 and 1996.

Ellwood (1999) also looks at a number of controls to determine if policy changes, especially the EITC, are responsible for the dramatic change in employment of single mothers. His results showing that the rise in relative employment rates is especially dramatic for those most affected by the EITC increases – the lowest skill/lowest wage workers – are consistent with those of Meyer and Rosenbaum (1999, 2000) and Eissa and Liebman (1996). In addition, he finds that employment rates for single mothers increased especially dramatically in states aggressively pursing welfare reform.

Table 1 summarizes results of academic studies on the effect of the EITC on employment and labor force participation.

Table 1 Studies of Effects of EITC on Employment/Labor Force Participation				
Study	**Data**	**Time Period Studied**	**Groups Studied**	**Effect of EITC**
Dickert, Houser, and Scholz (1995)	Simulation based on after-tax wages and labor supply parameters	1993 expansion	Single parents	+182,000 in employment
			Primary earners	+30,250 in employment
			Secondary earners	-26,000 in employment
Liebman and Eissa (1996)	CPS	1986 expansion	Single mothers (Relative to single childless women)	+2 percentage point in labor force participation
Eissa and Hoynes (1999)	CPS	1986, 1990, and 1993 expansions	Married men (Less than HS education)	+0.2 percentage point in labor force participation
			Married women (Less than HS education)	-1 percentage point in labor force participation
Meyer and Rosenbaum (1999)	CPS	1984-1996	Single mothers	EITC responsible for 60 percent of increase in employment
Ellwood (1999)	CPS	1980-1998	Low-income single mothers	EITC responsible for 20-30 percent of increase in employment
			Low-income married mothers	4-8 percentage point decline in employment

The effects of the EITC on hours worked by those who would chose to work without the EITC and on the hours and labor force participation of married workers with working spouses is less clear. For workers in the phase-in range of the EITC, the substitution effect is positive – the EITC raises after-tax income and induces more hours. But for these workers and for those in the flat range of the EITC, the income effect is negative. (There is no substitution effect for workers in the flat range.) And for workers in the phase-out range, both the income and substitution effects are negative. Thus, in theory, the effect of the EITC on hours for those in the phase-in range is ambiguous while the effect those in the flat and phase-out ranges is negative.

Married workers can face a disincentive to work as a result of the EITC. When the primary earner receives EITC credits, the income effect discourages labor force participation by secondary household earners. In addition, earnings by a secondary earner can place the family in the phase-out range of the EITC, thus providing a further disincentive for a secondary earner to work. But, for some very low-income families, the primary earner's income is so low that the secondary earner can actually raise the family's EITC benefits. The President has proposed changes in the EITC that would alleviate some of these effects; they are discussed in the final section of this paper.

How large are these effects? The empirical literature on labor supply suggests that participation is more responsive to wage and income changes than are hours worked for those in the labor market.[2] Dickert, Houser, and Scholz (1995) use estimates of labor supply elasticities to simulate the effect of the 1993 EITC expansion on both participation and hours. As is consistent with the results discussed above, they find that the EITC expansion should raise participation by single parents. Their simulations show a smaller increase in participation by primary earners in two-parent families (because most primary earners in these families were already working). Eissa and Hoynes (1999) find a small increase in the labor force participation of married men with less than 12 years of education from the EITC.

Secondary earners in two-parent families reduce participation in their simulations, but that decline is smaller than the increase for primary earners. Ellwood (1999) presents evidence that the EITC results in lower participation among married women. Eissa and Hoynes (1999) also find that participation by married women is reduced by the EITC, but only by about one percentage point.

The predicted impact of the EITC on hours worked for those already in the labor force shows up in the simulations carried out by Dickert, Houser, and Scholz (1995). But the impact on hours is relatively small. On net, their simulations predict a positive effect of the EITC on labor supply – the positive effect on participation outweighs the negative effect on hours. Although the main focus of their work is on participation, Meyer and Rosenbaum (1999) look at the impact of EITC changes from 1984 to 1996 on hours and find that the net effect of EITC changes on hours worked is positive.

Other evidence also suggests that the impact of the EITC on hours *for those already in the labor force* is small. Eissa and Liebman (1996) examine taxpayers already in the labor force when the 1987 extension of the EITC expanded the phase-out range to additional workers and observe no decline in hours worked. In addition, Liebman (1998) argues that if workers respond to EITC phase out, there should be a bunching of taxpayers near the beginning of the phase-out range and few workers near the end of the range. He presents evidence from 1992 tax returns that shows little or no bunching at the beginning of the phase-out range and no sign of the predicted shortage of workers at the break-even point. Eissa and Hoynes (1999) find a 2 percent decline in annual hours worked (45 hours) for married men because of the 1986-1993 EITC expansions, and a decline of 1-6 percent in annual hours (13 to 93 hours) for married women, depending on the specification. Again, all of these effects are for workers *already in the labor force*. The large net increases in employment from the EITC greatly outweigh the small declines in hours worked. Table 2 summarizes the effect of the EITC on hours worked for those already employed (or in the labor force).

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[2] Heckman (1993).

Table 2
Studies of Effects of EITC on Hours Worked for Labor Force Participants/Workers

Study	Data	Time Period Studied	Groups Studied	Effect of EITC
Dickert, Houser, and Scholz (1995)	Simulation based on after-tax wages and labor supply parameters	1993 expansion	Single parents	-10 hours annually
			Primary earners	-8 hours annually
			Secondary earners	-30 hours annually
Liebman and Eissa (1996)	CPS	1986 expansion	Single mothers (Relative to single childless women)	No change
Eissa and Hoynes (1999)	CPS	1986, 1990, and 1993 expansions	Married men (Less than HS education)	-45 hours annually
			Married women (Less than HS education)	-13 to -93 hours annually
Meyer and Rosenbaum (1999)	CPS	1984-1996	Single mothers	Increase in EITC increases hours worked

The Personal Responsibility and Work Opportunity Reconciliation Act

In 1996, the President signed the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA), changing the nation's welfare system into one that requires work in exchange for time-limited assistance. The law contains strong work requirements, and provides performance bonuses to states that effectively move welfare recipients into jobs. Even before PRWORA became law, many states were well on their way to changing their welfare programs to jobs programs. By granting federal waivers, the Administration allowed 43 states to establish work requirements, time-limit assistance, or improve child support.

These policy changes appear to have dramatically affected welfare caseloads. As of June 1999 the number of welfare recipients—adults and children combined—was 6.9 million, 51 percent less than in 1993. This 1999 figure represents 2.5 percent of the total population, the lowest proportion in more than three decades (see chart). A 1999 report by the Council of Economic Advisers examining the welfare caseload from 1996 to 1998 indicated that the single largest identified factor in the decline in repiciency was welfare reform—the change in state welfare programs implemented under the Temporary Assistance for Needy Families (TANF) block grant. Specifically, the report estimates that TANF accounted for 35-36 percent of the decline in recipiency. By way of comparison, the strong economy accounted for 8-10 percent of the decline.

Given the strong emphasis on work requirements, it is perhaps not surprising that the drop in welfare use has been accompanied by an increase in the number of welfare recipients finding employment. One compelling piece of evidence on this trend comes from the Current Population Survey (CPS). These data provide information on individuals' employment status in the month of the survey (March), as well as information about income sources for the previous year. Chart 6 shows the current employment status in March of each year, from 1988 to 1999, for individuals receiving non-SSI cash welfare in the previous year. The proportion employed held steady at 20 to 21 percent from 1988 through 1992. From 1993 through 1999 there was a persistent increase in employment of these individuals, and more than 36 percent of individuals on welfare in 1998 were employed in March 1999. This upward trend in employment status was observed for Hispanic, non-Hispanic white, and non-Hispanic black individuals alike.

Another important confirmation that many welfare recipients are successfully moving to employment comes from the aggregation of recent state reports. As noted above, the 1996 welfare reform legislation included rewards to encourage states to place people in jobs. According to reports filed by the 46 states competing for these bonuses, more than 1.3 million welfare recipients nationwide went to work in just the one year period between October 1997 and September 1998.

A recent national survey released by the Urban Institute (Loprest, 1999) provides additional evidence highlighting the importance of work as an alternative for individuals leaving welfare. The study found that 69 percent of individuals leaving welfare did so because of work, and another 18 percent left because they had increased income, no longer needed welfare or had a change in family situation. A second 1999 Urban Institute study (Brauner and Loprest) reviews evidence from state-level analyses about the employment status of individuals recently leaving welfare. The median of estimates of current employment status for former welfare recipients (from 12 estimates) was 65 percent.

Even among those who remain on welfare rolls, there is an apparent upturn in reported work. According to CPS data, in each year from 1988 through 1993, about one third of individuals who received welfare in March of the year reported have worked some in the previous year. Chart 7 shows a steady increase in this percentage after 1993, so that by March 1999, more than 51% of welfare recipients reported work during the previous year.

The detailed analysis of Bruce Meyer and Dan Rosenbaum (1999) contributes greatly to our confidence that welfare reform is responsible in substantial measure for the upturn in employment of single women with children. Their evaluation of data from the period 1992 to 1996 shows that the grants of federal waivers alone were responsible for approximately 20 percent of the sizable increase in employment of these women. (As previously discussed, reforms to EITC were found to be even more important, and, as we note momentarily, policy innovations in Training and Child Care also contributed.)

Similarly detailed research is not yct available for the post-1996 period, but for 1996 through 1999 there has been a clear continuation of the trends that led to the Meyer-Rosenbaum conclusion about the role of welfare reform in increasing labor supply. Consider, for example, the employment status for low-income mothers with young children. Analysis of CPS data shows that for married women who had children under the age of 6, and who were below 200 percent of the poverty threshold in the previous year, the March employment rate increased gradually, from 35.3 percent in 1992 to 39.0 percent in 1996 and finally to 39.3 percent in 1999. In general, 1992 through 1999 was a period of economic expansion, and in any event employment of women generally has been trending upward over the past several decades, so this trend is not surprising. What is notable is the comparison of these married mothers of young children to corresponding single mothers, whose behavior has been likely affected by the change in welfare policy. These latter mothers had virtually the same employment rate as married mothers in 1992, 34.8 percent. By 1996, though, the employment rate for single mothers increased to 42.6 percent, and by 1999, the employment rate among these women had climbed to 54.6 percent.

One important feature of the current policy is a welfare-to-work tax credit granted to employer who hire qualified welfare recipients, equal to 35 percent of the first $10,000 in wages in the first year and 50 percent in the second year. Although a detailed evaluation of this provision is not yet available, a 1998 study by Harvard economist Lawrence Katz on previous wage subsidy programs creates the presumption that the tax credit is playing a positive role in increasing the demand for labor services of former welfare recipients.

Other Policy Changes Contributing to Increased Labor Supply

Beyond changes to EITC and welfare policy, there are several additional policy changes that have the potential for increasing labor supply. The 1999 Meyer-Rosenbaum study of single mothers examines labor supply effects of rules changes that allow women to retain Medicaid coverage, training expenditures, and expenditures on child care. Although they do not find statistically significant effects of Medicaid coverage, Meyer and Rosenbaum do find meaningful effects of training and child care policy. Over the 1992-1996 period they examine, between 5 and 8 percent of the growth in the employment of single mothers can be attributed to the training and child care policies combined. The 1996 welfare reform expanded funding for child care, and gave States flexibility to provide both pre- and post-employment training to help welfare recipients find and keep a job. In light of existing research, these provisions can be expected to provide meaningful work incentives for low-income women.

One group of individuals that has historically had low rates of employment is the disabled. According to 1999 CPS data, for both men and women in the 25-64 age range, individuals with a disability that "prevents them from working or limits the kind or amount of work they can do," are less than one third as likely to be employed as the non-disabled. There has been very little recent change in the employment rates of these individuals. However, there is considerable variation in employment among the disabled, correlated with education. In the CPS data, among individuals with less than 12 years of education, only 12 percent of men and 11 percent of women were employed, while employment rates for those with 16 years of education or more were 47 percent for men and 42 percent for women. This variation in employment rates among the disabled suggests that policies that encourage human capital development or otherwise increase returns to work might increase the labor supply of the disabled. A recent study of individuals with severe spinal cord injuries by economists Alan Krueger and Douglas Kruse reinforces the potential importance of work skills for labor market success among the disabled. Specifically, the authors find among individuals with these serious injuries, those with computer skills returned more quickly to work and had relatively higher earnings once there.

One recent initiative designed to increase relative returns to work for the disabled is the Ticket to Work and Work Incentives Improvement Act of 1999. The act provides health insurance protection to the working disabled by giving States new options to allow workers with disabilities to buy into Medicaid. It extends Medicare coverage for an additional 4 ½ years for beneficiaries of disability insurance who return to work. And it provides grants for States to develop infrastructure that will help people with disabilities return to work.

New Policy Initiatives Affecting Labor Supply

We regard the existing evidence as quite compelling in establishing that many policies affecting the well-being of low-income families—in particular the EITC and reforms to welfare policy, along with a number of other related recent policy innovations—have been effective also in increasing the labor supply. There are a number of additional policy proposals that hold promise for further increasing incentives to work.

The Fiscal Year 2001 budget contains a number of items that may encourage additional labor supply. The first of these items deals with the so-call "marriage penalty." The current tax system can discourage paid work by second earners, especially in combination with the indirect costs of working such as child care. The Administration's proposal will increase the return from work for second earners by effectively exempting up to $1,450 of earnings by the spouse with the lower earnings from income tax for couples who use the standard deduction; allowing two-earner couples to earn more before having their EITC reduced; reducing the EITC phase-out rate (and thus the effective marginal tax rate) by two percentage points for taxpayers with two or more children; and increasing the child and dependent care tax credit for low and moderate-income families. Chart 8 shows in the increase in the EITC for married couples with 3 children in 2001.

A second important set of proposals involves child care expenses. Not surprisingly, child care expenses can be one of the biggest items in the budgets of poor working mothers. Statistics from 1993 suggest that working mothers with income below the poverty level and child care expenses spent 21 percent of their monthly income on care for their children. The Administration's proposals will increase the return to work for many low-income parents by making the child and dependent care tax credit refundable, and increasing the maximum credit rate for the EITC to 45 percent for low-income workers with three or more children.

Disabled individuals may incur additional costs in order to work and earn taxable income. Moreover, many moderate-income disabled individuals do not benefit from the current-law tax deduction for impairment-related work expenses because they do not have sufficient work-related expenses and other deductions to benefit from itemizing deductions. In addition, many disabled individuals do not benefit from the current-law deduction because they incur significant work-related expenses outside the workplace (which do not qualify for the deduction) or rely on unpaid relatives or friends for assistance. For example, they may require personal assistance to get dressed and be driven to work. To aid disabled workers, the FY 2001 budget proposes a tax credit, equal to the lesser of $1,000 or earned income, for workers who have difficulty with at least one activity of daily living.

Keep These Details as an Appendix (New Initiatives)?

Earned income tax credit (EITC). For families with three or more children, the EITC credit rate would be increased from 40 percent to 45 percent. In 2000, the maximum credit would rise from $3,888 to $4,374, an increase of $486. Two-earner married couples could earn more without having their EITC reduced. The beginning point of the EITC phase-out range would be increased by $1,450. Thus, the EITC would begin to phase out at $14,140 in 2000 for a couple with children. To qualify, each spouse must have earned income of at least $725. The EITC phase-out rate would be reduced by 2 percentage points (from 21.06 percent to 19.06 percent) for taxpayers with two or more children. Nontaxable earned income, such as 401(k) contributions, would no longer be included in earned income. The proposal would be effective beginning in 2000.

Child and dependent care tax credit. The child and dependent care tax credit would be made refundable beginning in 2003. The maximum credit rate would gradually be increased from 30 percent to 50 percent between 2001 and 2005. Beginning in 2001, taxpayers would be eligible for the maximum credit rate if their income is $30,000 or less. The credit rate would be reduced by one percentage point for each additional $1,000 of income in excess of $30,000. The minimum credit rate would be 20 percent. The maximum amounts of qualifying expenses and the income threshold for the maximum credit would be indexed for inflation.

Standard deduction for two-earner married couples. The standard deduction for two-earner couples would be increased to double the amount of the standard deduction for single filers or, if less, the sum of the standard deduction for one-earner couples and the smaller of the two spouses' earned incomes. Earned income must be positive and would equal the sum of wages, salaries, and net income from self-employment less certain deductions for IRA, Keogh, SEP, and SIMPLE plan contributions, self-employed health insurance, and one-half of self-employment taxes. Beginning in 2001, the increase would be phased in over five years. By 2005, the increase in the standard deduction for joint filers would be $1,450 (2001 dollars). Effectively, up to $1,450 of earnings by the spouse with the lower earnings would be exempted from tax for couples who use the standard deduction.

Disabled workers tax credit. Beginning in 2001, a taxpayer would qualify for a $1,000 tax credit if he or she had earned income and was disabled. The credit could not exceed the disabled individual's earned income during the tax year. The credit (aggregated with the child credit and the proposed long-term care credit) would be phased-out for certain high-income taxpayers--that is, the aggregate credit amount would be phased out by $50 for each $1,000 (or fraction thereof) by which the taxpayer's modified AGI exceeds $110,000 (in the case of a joint return), $75,000 (in the case of a taxpayer who is not married), or $55,000 (in the case of a married individual filing a separate return). A taxpayer with earned income would be considered to be a disabled worker if he or she were certified by a licensed physician (prior to the filing of a return claiming the credit) as being unable for at least 12 months to perform at least one activity of daily living without substantial assistance from another individual, due to loss of functional capacity. Activities of daily living would be eating, toileting, transferring, bathing, dressing, and continence.

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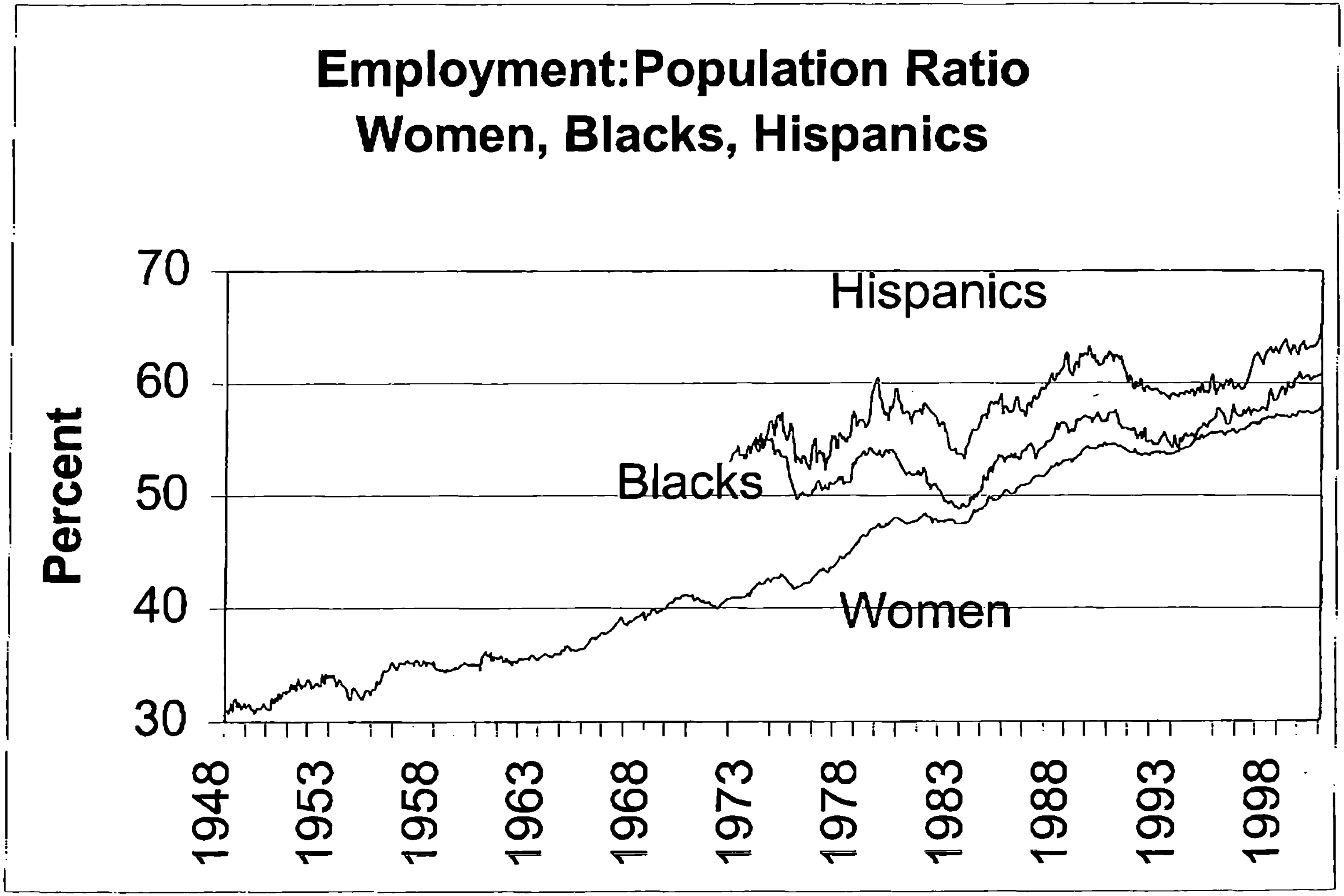
Employment:Population Ratio
Women, Blacks, Hispanics
Percent
70
60
50
40
30
Hispanics
Blacks
Women
1948
1953
1958
1963
1968
1973
1978
1983
1988
1993
1998

Chart 1

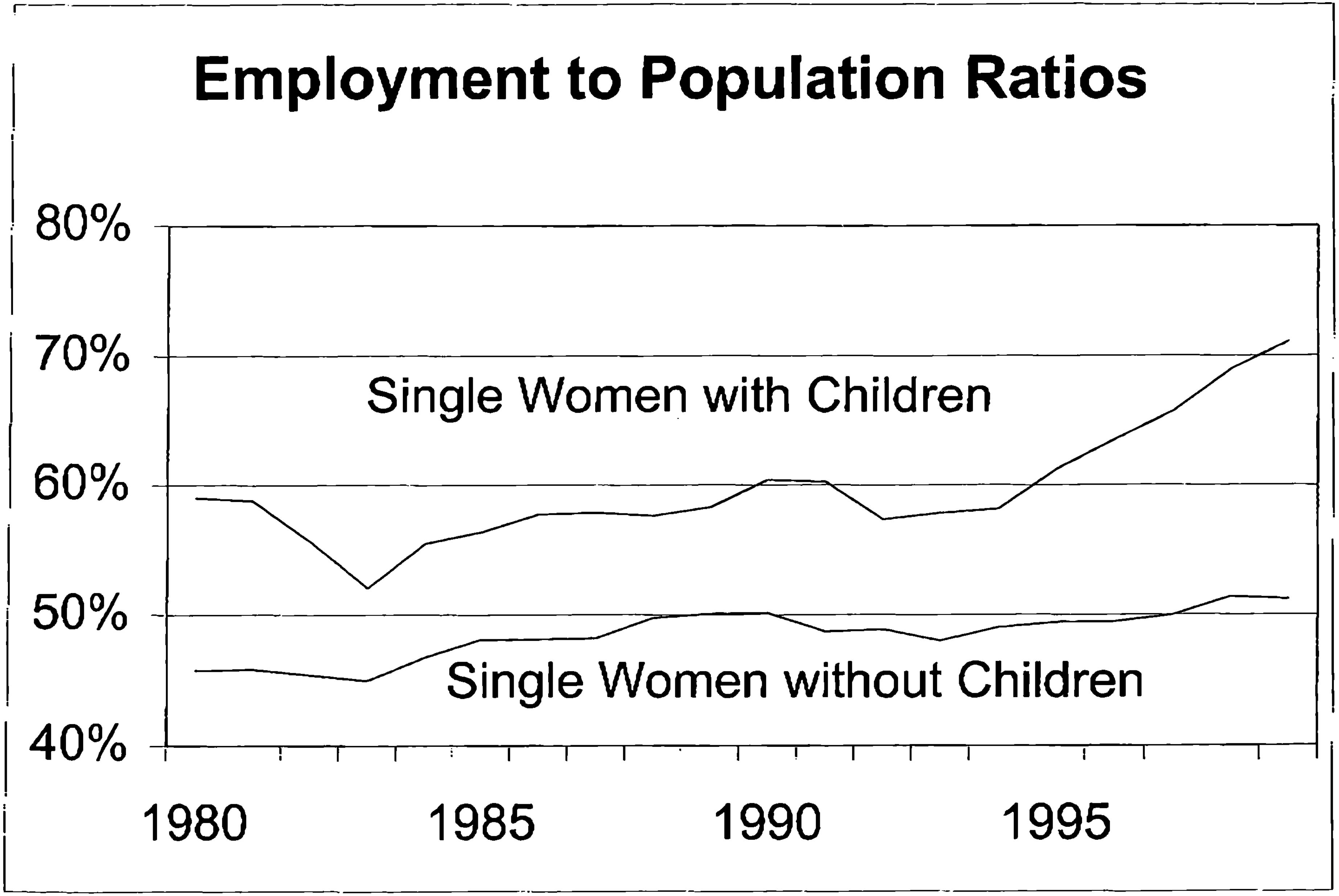
Employment to Population Ratios
80%
70%
60%
50%
40%
Single Women with Children
Single Women without Children
1980
1985
1990
1995

Chart 2

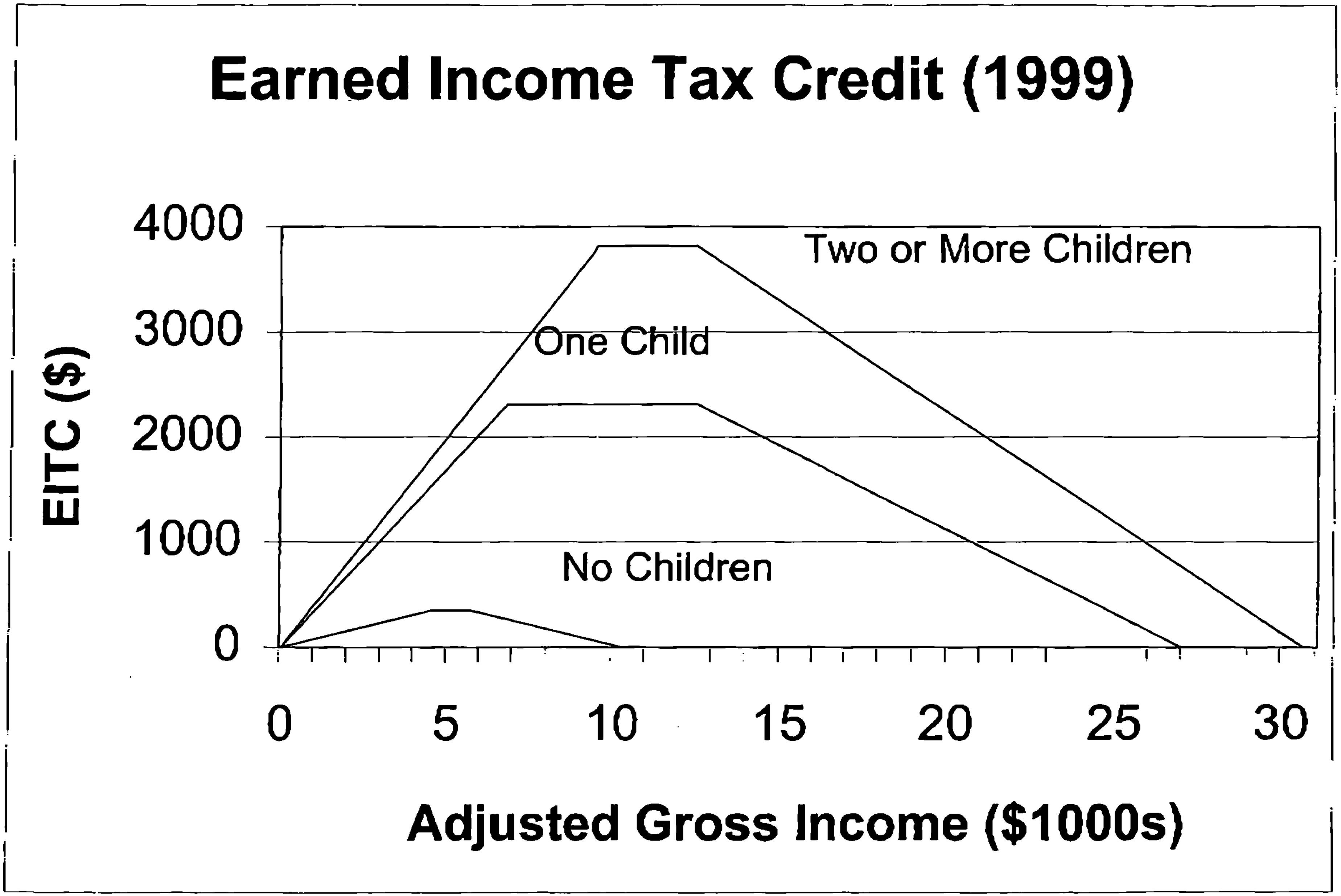
Earned Income Tax Credit (1999)
EITC ($)
4000
3000
2000
1000
0
Two or More Children
One Child
No Children
0
5
10
15
20
25
30
Adjusted Gross Income ($1000s)

Figure 3

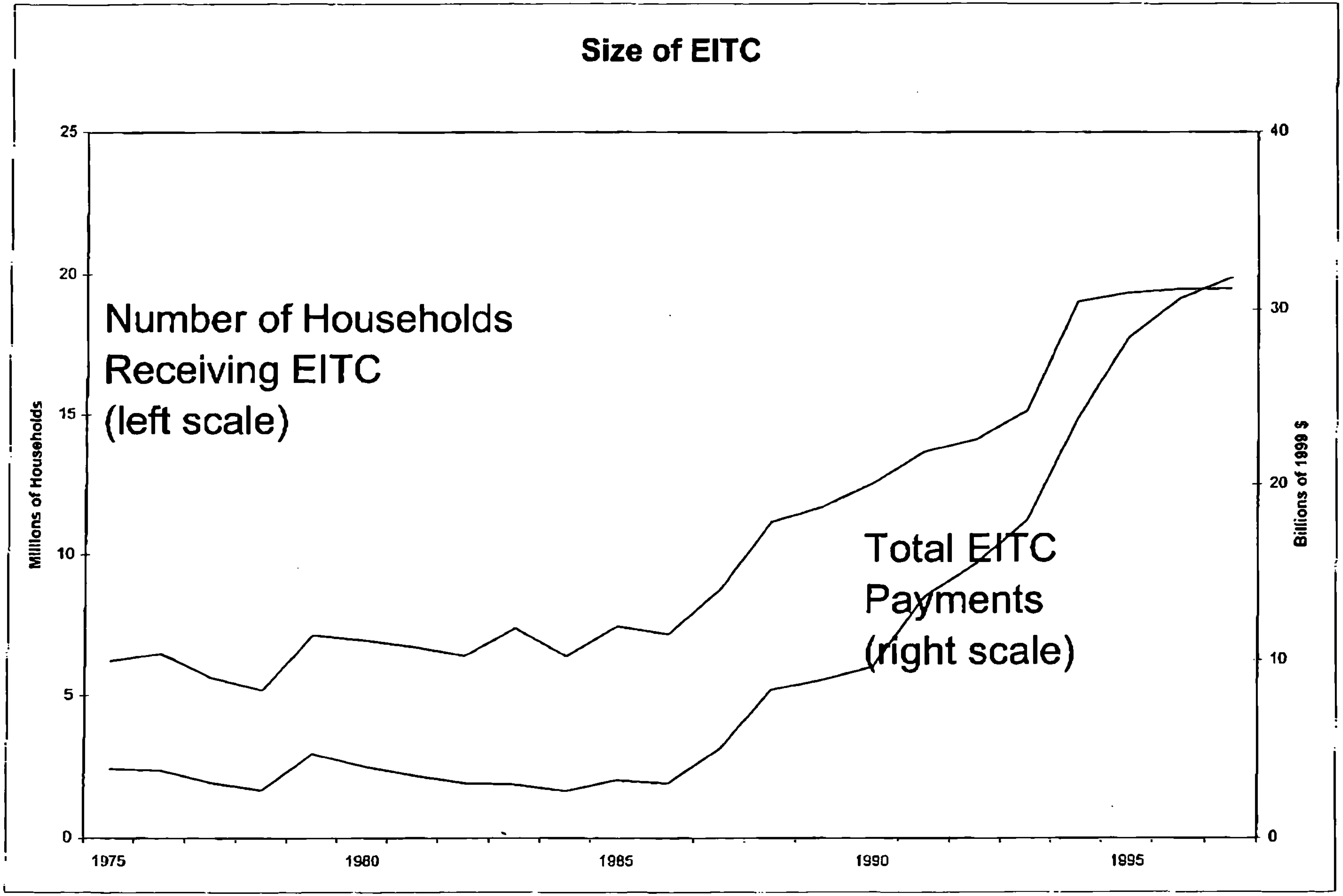
Size of EITC
Number of Households
Receiving EITC
(left scale)
Total EITC
Payments
(right scale)
Millions of Households
Billions of 1999 $
0
5
10
15
20
25
0
10
20
30
40
1975
1980
1985
1990
1995

Figure 4

Maximum EITC and Difference in Employment to Population Ratios for Single Women with and without Children

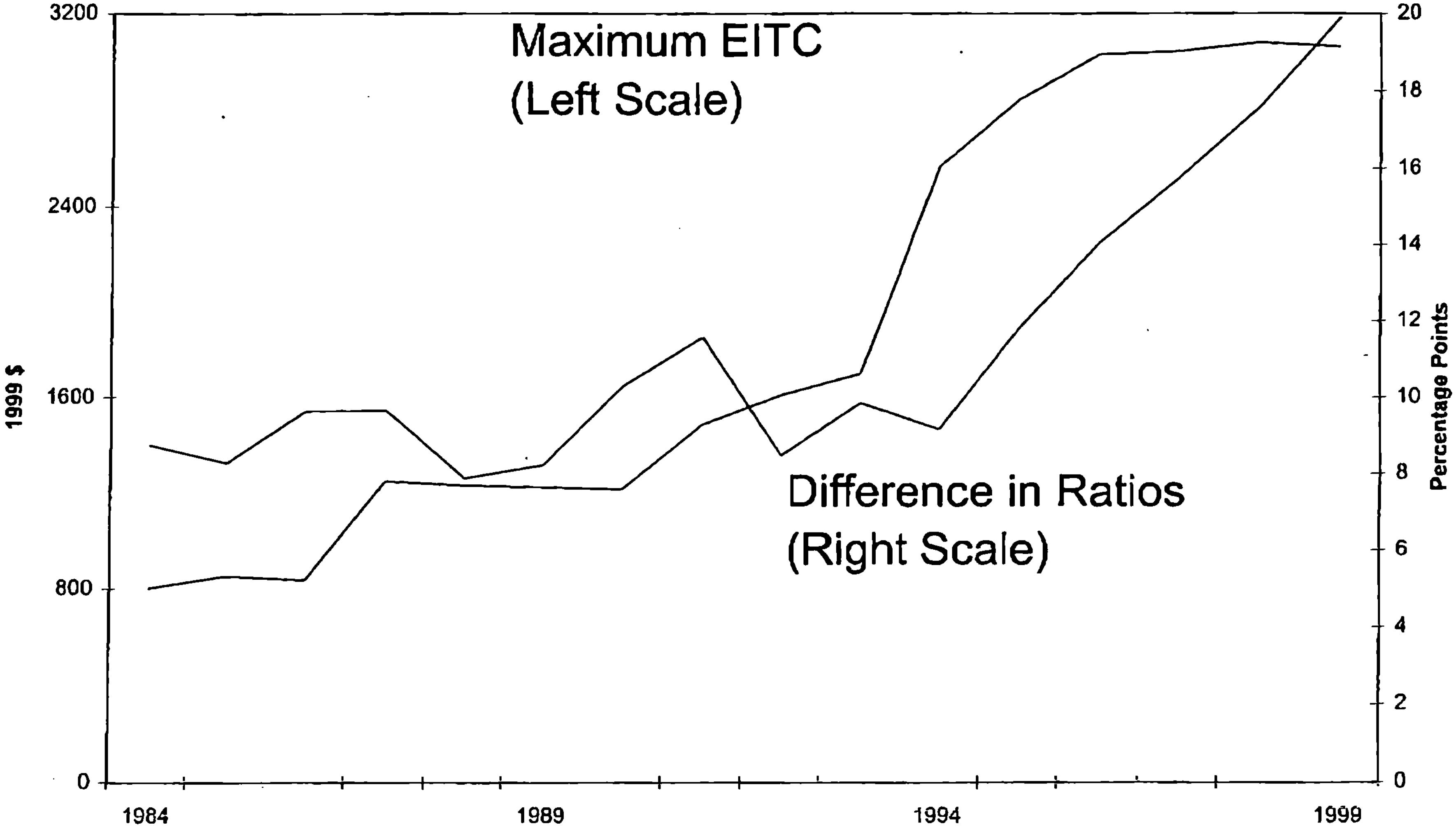

Figure 5

Employment Status in March after Year with Welfare Receipt

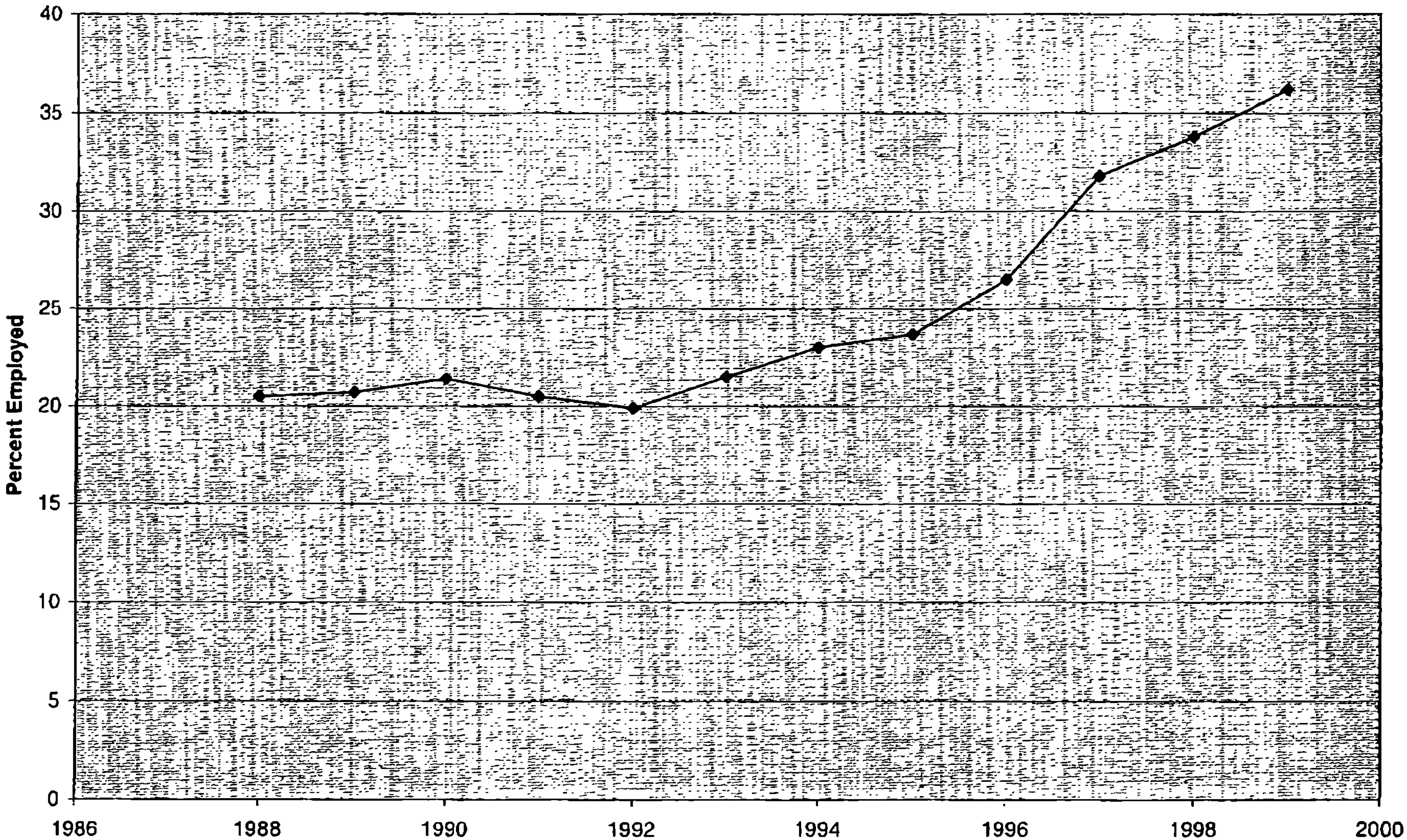

Chart 6

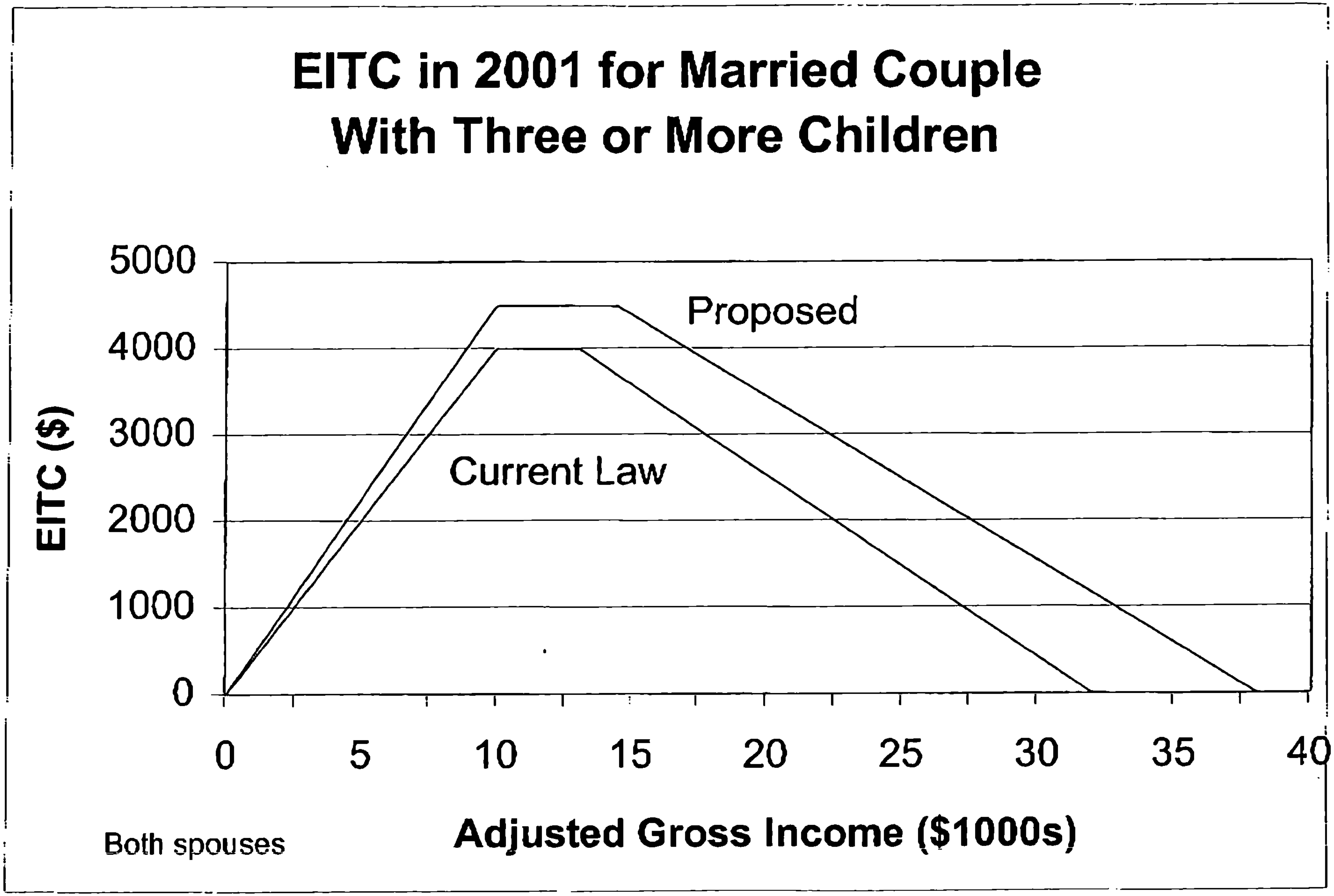
EITC in 2001 for Married Couple
With Three or More Children
EITC ($)
5000
4000
3000
2000
1000
0
Proposed
Current Law
0
5
10
15
20
25
30
35
40
Adjusted Gross Income ($1000s)
Both spouses

Figure 8

Making Work Pay: The Role of Policy in the Expanding Employment in Low Income Families

A Report Prepared by the Council of Economic Advisers
and the Office of Economic Policy, Department of the Treasury

ROUGH DRAFT
March 7, 2000

income growth over the last 30 years, even though married women's earnings on average still account for less than a third of the couple's earnings. The wages of female family heads have not grown as rapidly over time, so that, despite working many hours, their earnings lag behind those of married women.

Challenges Families Face

Over the century just ~~ending~~, the American family ~~has~~ experienced many positive changes that have resulted in richer lives for many parents and their children. Family income has increased dramatically and poverty has decreased. People live longer and are much healthier. Over the past few years, the gains from a strong labor market have been shared widely and fairly equally. Other favorable recent developments include a fall in teen pregnancy and out-of-wedlock birth rates and a stabilization of divorce rates. Despite this general prosperity, however, family income inequality remains high, and many families are experiencing a "money crunch" that makes it difficult to meet basic family needs. Many of these families have incomes that fall below the poverty threshold, but the perception of a "money crunch" is by no means limited to families officially classified as poor.

ended

Perhaps an even greater number of families today are experiencing a "time crunch." With more women working more hours, the amount of family time devoted to work has increased, while that available for leisure and other family activities has declined. This time crunch affects a wide range of families from poor single mothers to prosperous two-earner couples.

This section explores the challenges facing American families as they deal with the money crunch and the time crunch. In each case, an analysis of the dimensions of the challenge and how it affects different kinds of families is followed by a discussion of policies that address that challenge.

?

The "Money Crunch"

couples

rebreak

Despite the increases in female labor supply and earnings discussed above, a large number of families with children—both married and female-headed—belong to what are sometimes called the working poor. Those families with incomes in the lower tail of the distribution in Chart 5-7 are the most likely to suffer from the money crunch. ~~As the chart shows,~~ In 1998, 8 percent of families with working wives, 27 percent of families without working wives, and 64 percent of female-headed families had incomes below $25,000 (about 1.5 times the poverty line for a family of four). These families, whose

(Based on the distributions in the chart,)