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Estimating Labor Supply Responses and Welfare Participation: Using a Natural Experiment to Validate a Structural Labor Supply Model

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Abstract:

In this paper, we formulate and estimate an economic model of labor supply and welfare participation. The model is estimated on data on single men from Quebec drawn from the 1986 Canadian Census. Budget sets for each work-welfare combination – accounting for income taxes, tax credits and welfare benefit rules – are derived using a microsimulation model. We validate our model by comparing reactions to a welfare reform that implied a dramatic increase in welfare benefits predicted by our model to those obtained by using a regression discontinuity approach. The results show that our model is capable of recovering actual changes in labor supply and welfare participation. We also show the advantage of having estimated a structural model by illustrating how labor supply and welfare participation change when benefit levels change.

Text: See [Discussion Paper No. 5718](#)



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