

Hours Mismatch and Income Tax Incentives for Low-Earning Workers*

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Abstract

Many workers do not work their desired number of hours, particularly in the low-earning segment. We study whether income tax notches generate hours mismatch in the context of mini jobs in Germany. These jobs are exempt from income and social security taxes up until a salient earnings threshold. We find substantial underemployment at the threshold, suggesting that it constrains many workers to work less than their optimum. A reform shifting the threshold upwards raised underemployment among mini jobbers. Workers increased their desired hours, but contracts adjusted through small increases in actual hours and wages. These findings are consistent with firms' hours constraints shaping job offers in the low-earning segment. They suggest that firms cater to workers' incentives to bunch, but overprovide mini jobs. While workers are able to achieve higher earnings in the adjustment, the aggravation in underemployment points to ambiguous effects on worker welfare.

Keywords: Hours mismatch, labour supply effects of taxation, low-earning workers.

JEL codes: H24, H31, J22, J62.

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