

# The Earned Income Tax Credit

Michael R. Strain, Ph.D.

American Enterprise Institute

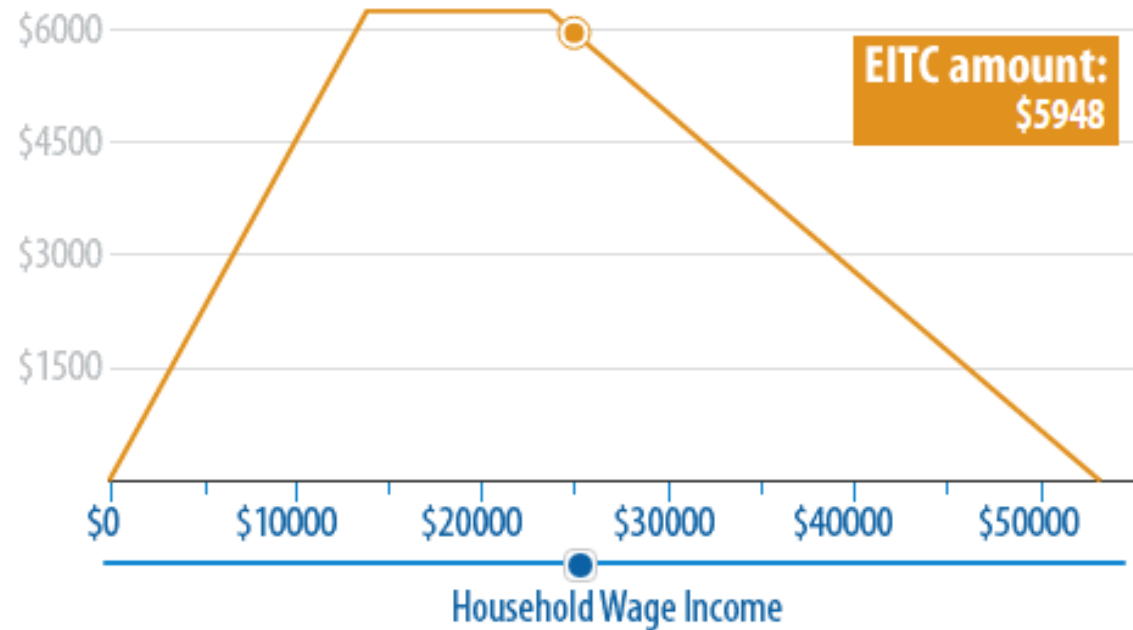
# This presentation

1. How the EITC works.
2. State EITCs.
3. Some features of the EITC.
  - Efficiency.
  - Increases workforce participation.
  - Reduces poverty.
  - Helps children.
4. The EITC's values

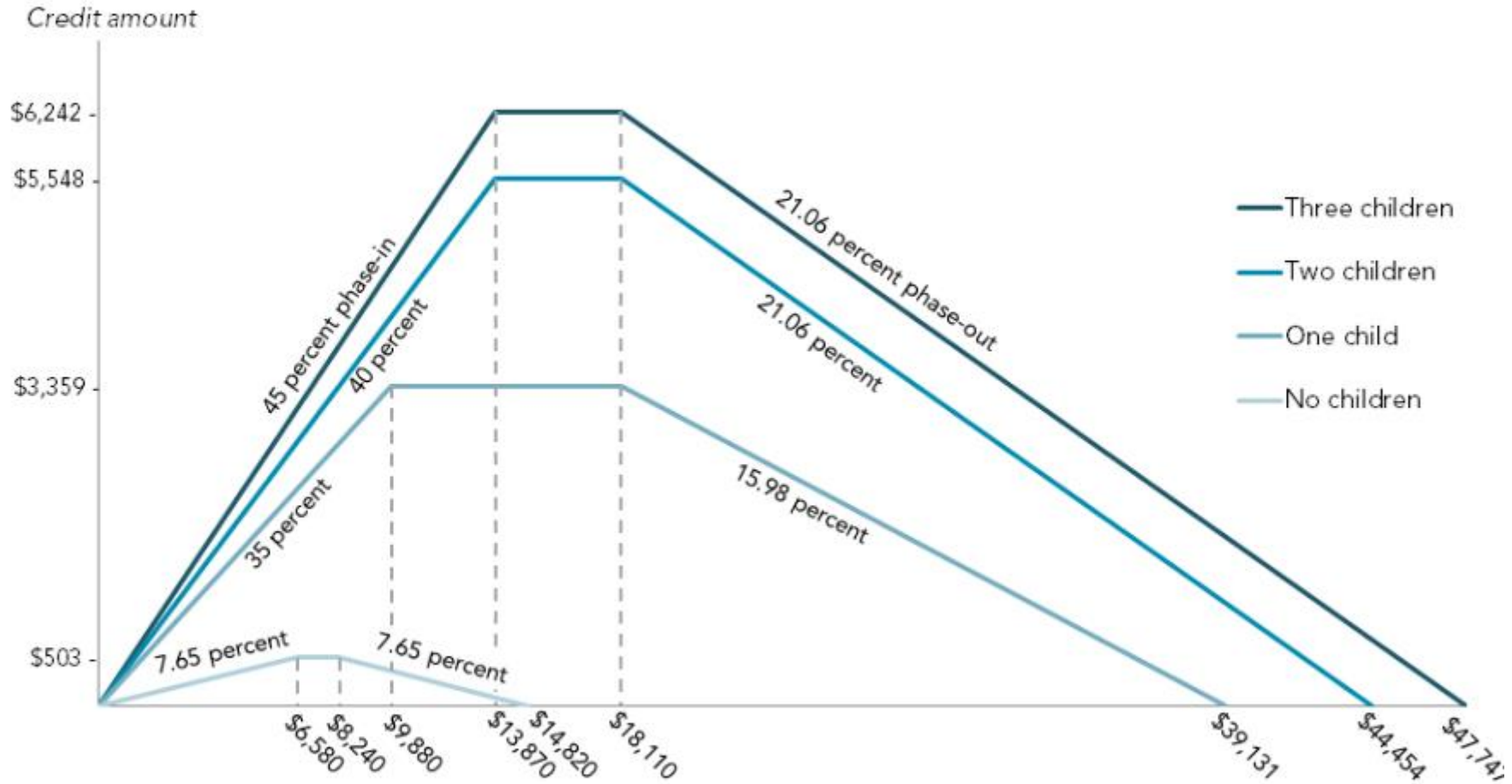
# How the EITC works

- Eligibility.
  - Family structure. (“Qualifying child.”)
  - Earnings.
  - Income.
- The credit equals a fixed percentage of earnings from the first dollar until its maximum value, then plateaus over a range of earnings, and then declines with every additional dollar of earnings, eventually reaching zero.
- The EITC is “refundable.”

Lesley and Tom have three children and earn \$25,000 in income in 2015



# Earned Income Tax Credit 2015



Source: Tax Policy Center, 2015.

Note: Assumes all income comes from earnings. Amounts are for taxpayers filing a single or head-of-household tax return. For married couples filing a joint tax return, the credit begins to phase out at income \$5,520 higher than shown.

# How the EITC works

- Basic economics: If you want more of something, subsidize it.
  - Work.
  - Income.
- 
- *The good things that come with work and income.*

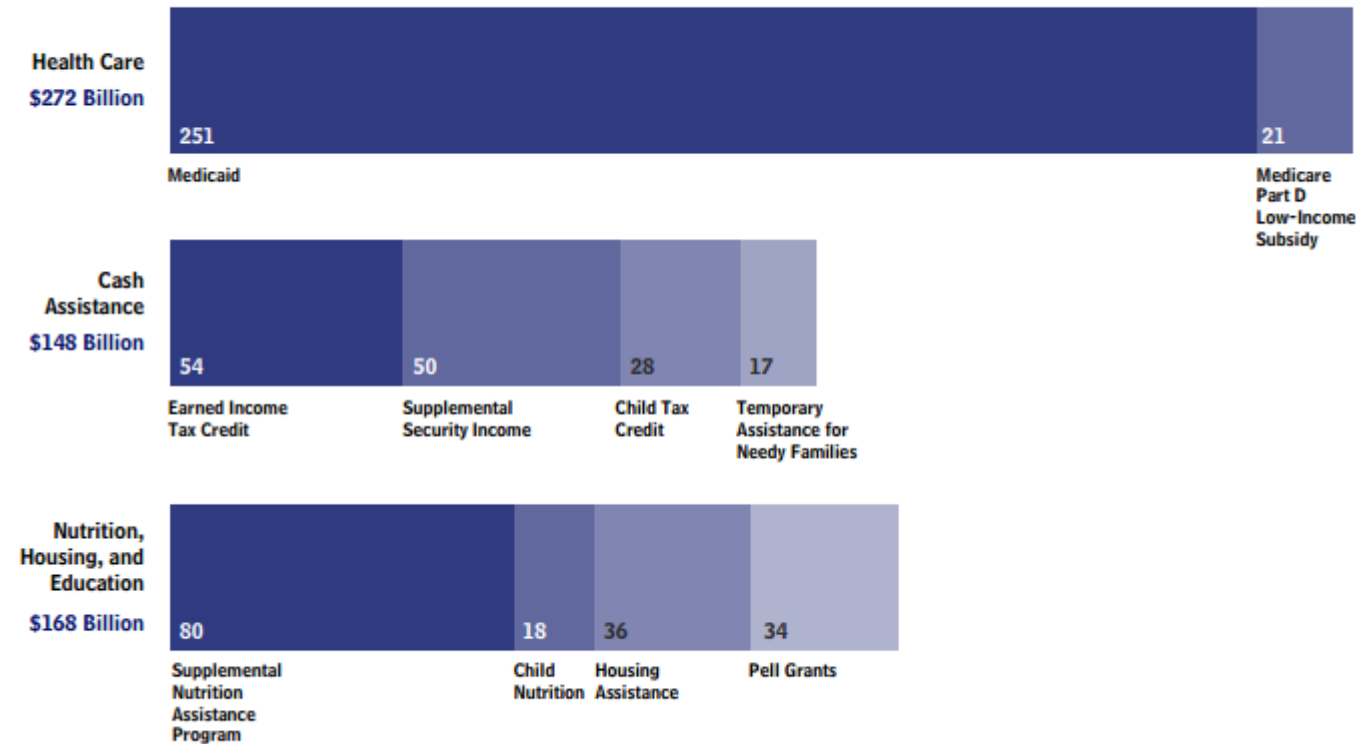
# Basic EITC program statistics

- Tiny administrative costs.
  - About 1% of benefits (Treasury Inspector General for Tax Administration, 2011)
- For the 2014 tax year, 27.5 million recipients shared \$66.7 billion. Average credit was around \$2,400.
- Utah: 191,000 recipients. \$447 million in total payments. Average credit of \$2,337. (IRS, 2016)

# Putting this in context with the overall “safety net”

## Federal Spending on Selected Means-Tested Programs and Tax Credits, 2012

(Billions of dollars)



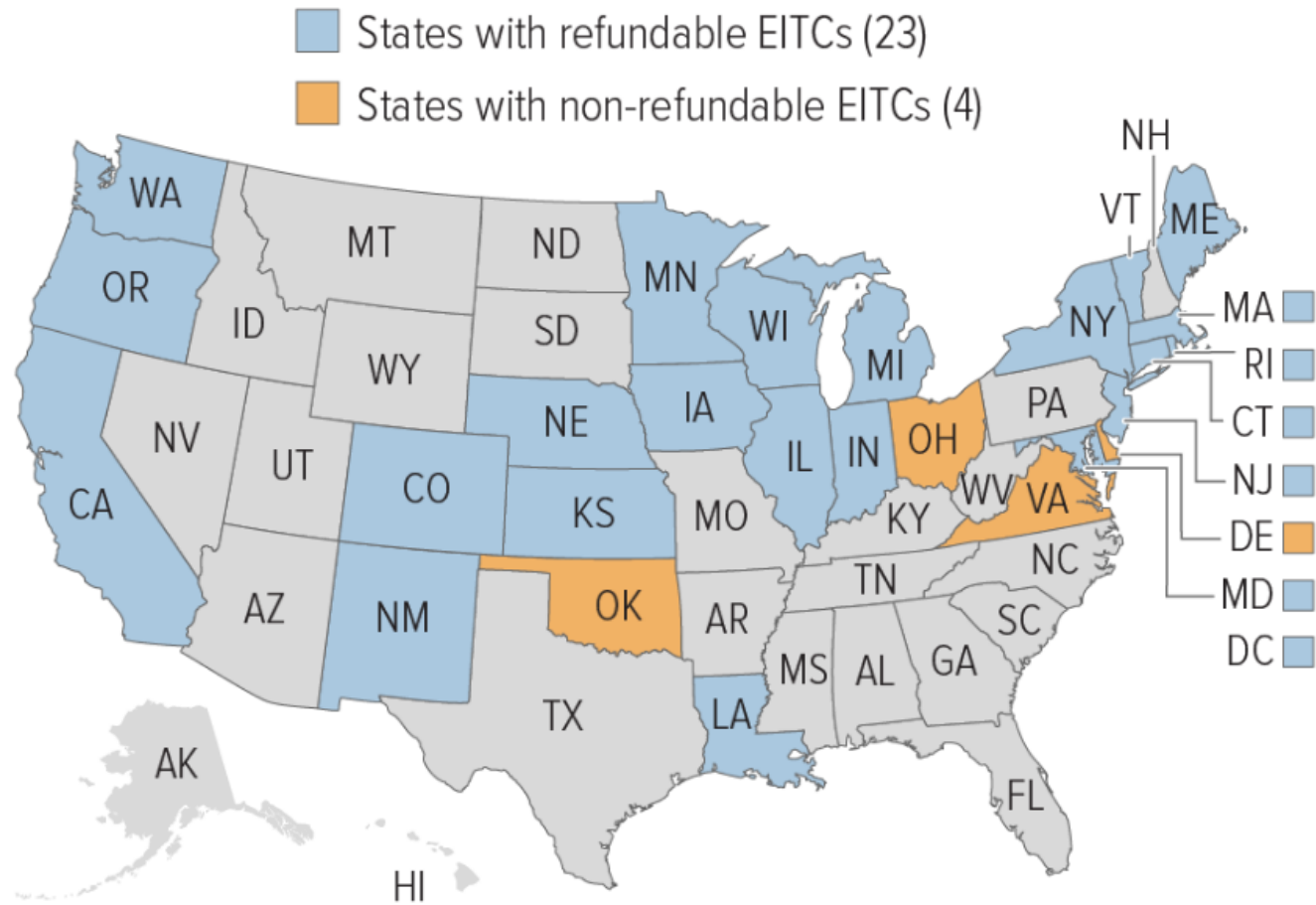
Source: Congressional Budget Office.



# State EITCs

- Twenty-six states and Washington, DC have EITCs. (Twenty-three of which are refundable.)
- States report very low administrative costs. Typically less than 1 percent of program expenditures. (Center for Budget and Policy Priorities, 2016)
- States typically set their EITCs as a percentage of the filer's federal credit.
  - Katie's state EITC amount = Katie's federal EITC amount \* 30 percent.

## Twenty-six States and DC Have Enacted EITCs, 2016



Source: CBPP analysis

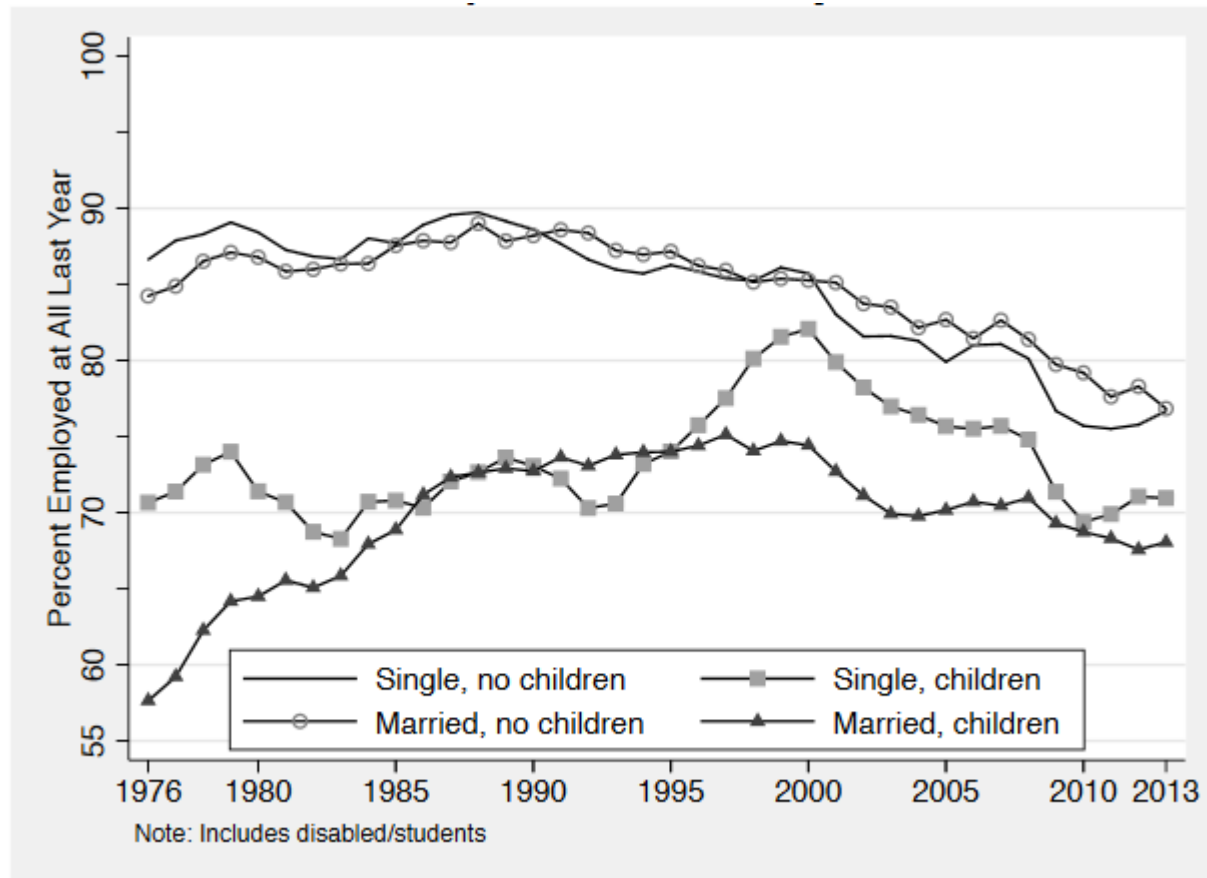
# The EITC is efficient

- Unlike other policies designed to help the working poor, the EITC is very well-targeted.
- Raising the federal minimum wage to \$10.10 per hour would generate \$31 billion in extra earnings. “However, those earnings would not go only to low-income families, because **many low-wage workers are not members of low-income families**. Just **19 percent of the \$31 billion** would accrue to families with earnings below the poverty threshold, whereas **29 percent** would accrue to families earning **more than three times the poverty threshold**, CBO estimates.” (Congressional Budget Office, 2014)
- A “universal basic income” is designed to be poorly targeted.

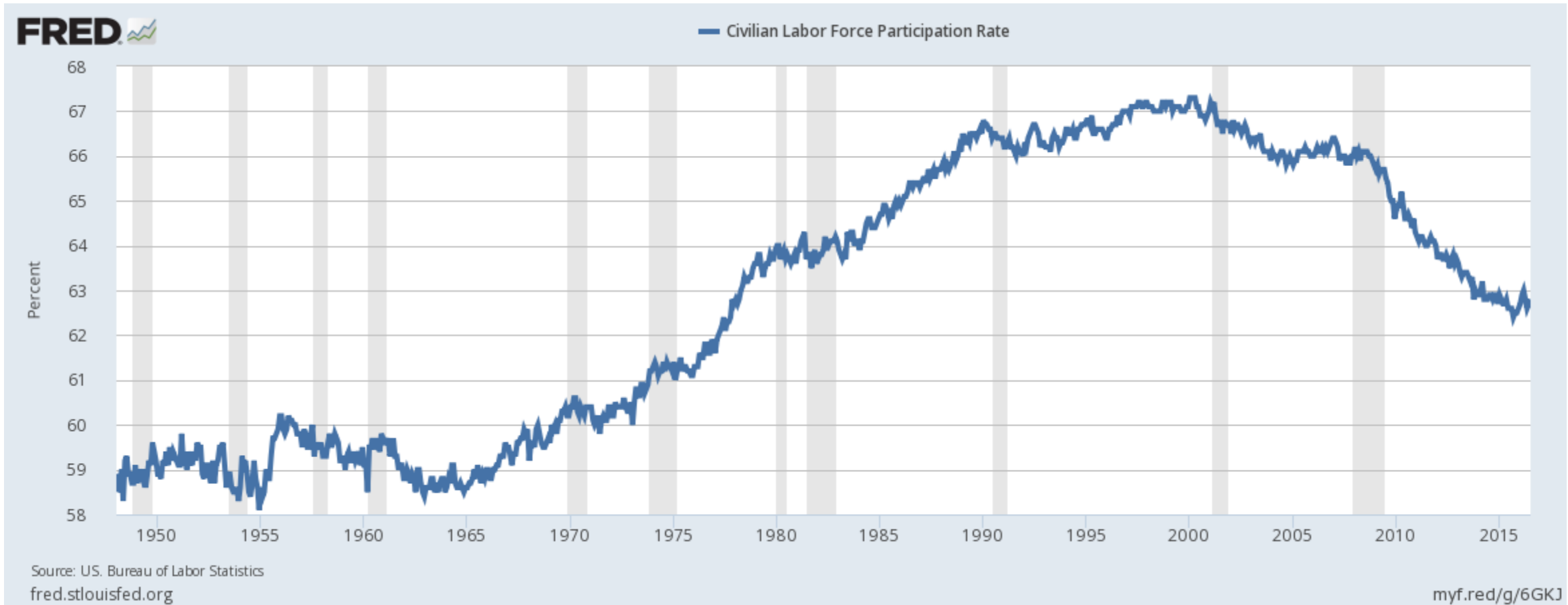
# The EITC increases workforce participation

- The “phase-in” region pulls people into the workforce. The credit gets larger as you earn more money.

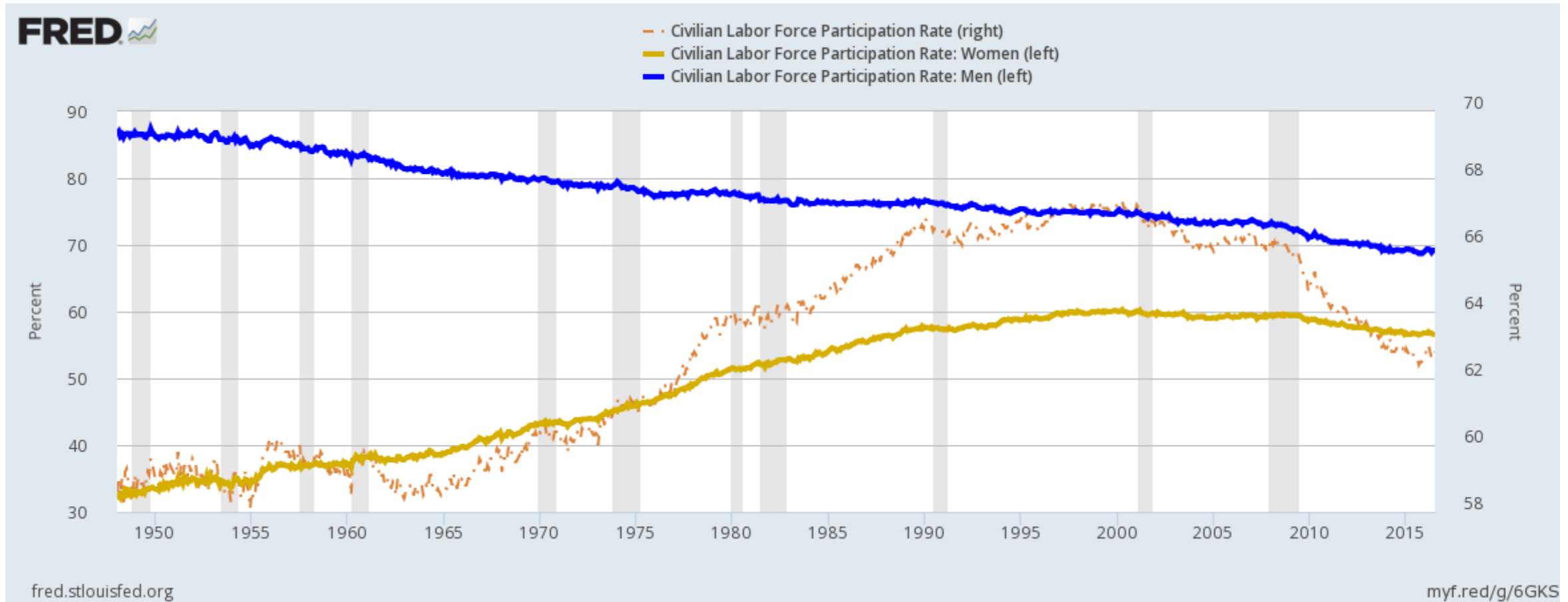
# Female employment rate



# Workforce participation rate



# Male workforce participation has been declining



# The EITC increases workforce participation

- The 1993 federal expansion increased the employment rate among single mothers by 3.1 percentage points. (Meyer and Rosenbaum, 2001)
- Studies of other federal and state expansions find similar labor supply effects among single parents and primary earners in married couples.
- Evidence suggests that secondary earner's workforce participation decreases as a consequence of expansions, though by much less than the expansions increased participation among single mothers. (Eissa and Hoynes, 2004)
- The economics literature has failed to find any significant effects on hours worked. (Meyer, 2002)
- EITC-eligible households spend relatively more money on durable goods in February, mostly on vehicles. (Goodman-Bacon and McGranahan, 2008)



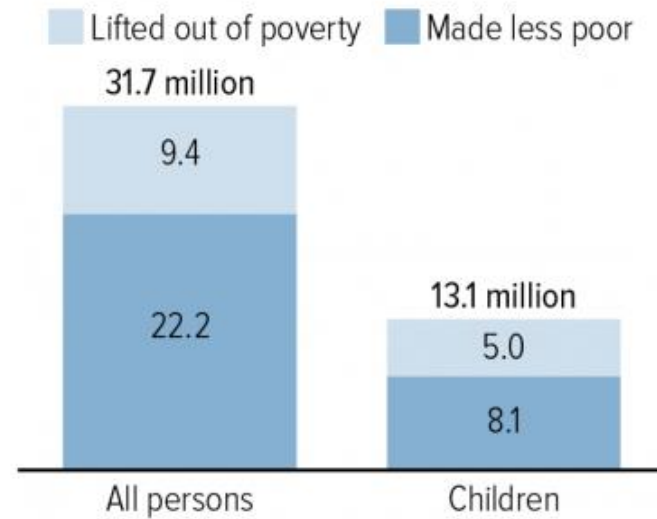
# The EITC reduces poverty

- The EITC is the most effective antipoverty program for households headed by working-age adults.
- In 2013, 6.2 million people, including 3.2 million children, were lifted out of poverty by the EITC. (Center on Budget and Policy Priorities, 2016)
  - “Direct effect.”
- The introduction of state EITCs lifts families out of poverty through increasing their earnings. Earnings are found to have been increased through the EITC inducing labor market entry among non-participants. (Neumark and Wascher, 2001)

# The EITC reduces poverty

## Earned Income Tax Credit and Child Tax Credit Have Powerful Antipoverty Impact

Millions of persons lifted out of poverty or made less poor (using Supplemental Poverty Measure) by EITC and CTC, 2013



Note: Unlike the Census Bureau's official poverty measure, the SPM counts the effect of government benefit programs and tax credits. Figures may not add due to rounding.

Source: CBPP analysis of Census Bureau's March 2014 Current Population Survey and 2013 SPM public use file.

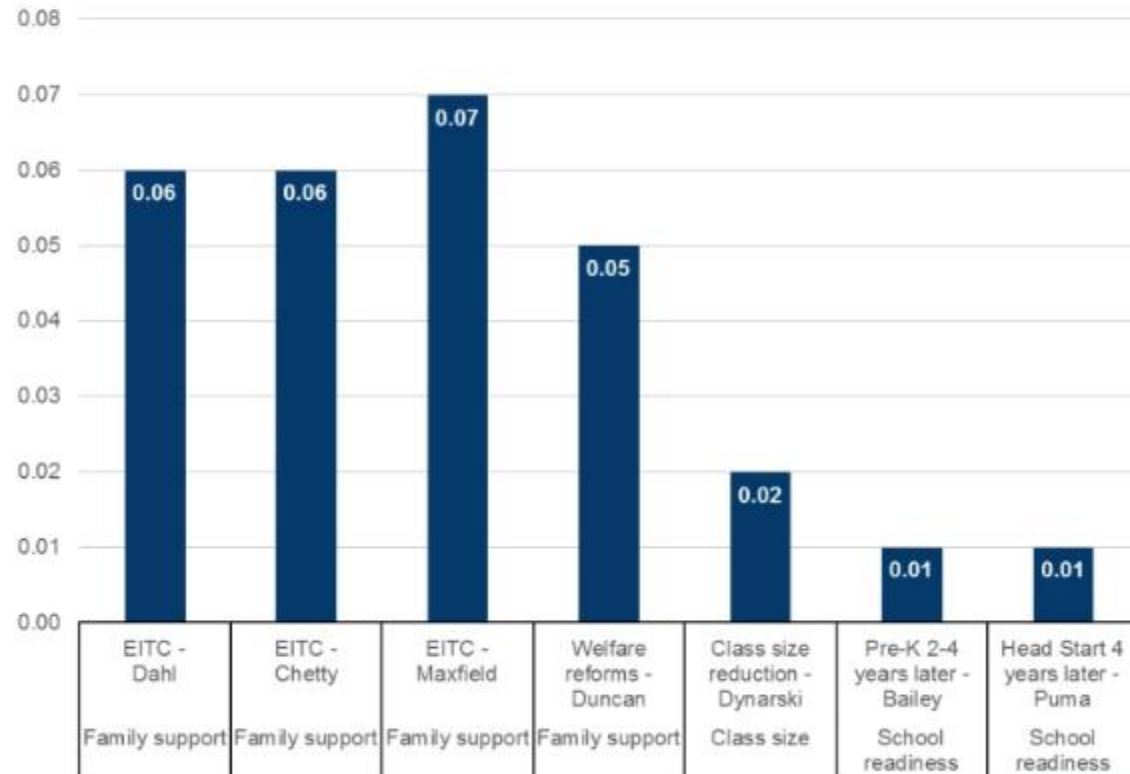
# The EITC advances children's health

- EITC expansions reduce the incidence of low birth weight among infants, possibly through increased access to prenatal healthcare or through increased workforce participation among mothers. (Hoynes, Miller, and Simon, 2013)

# The EITC advances children's education

- When family income increases by \$1,000 due to EITC expansions, math and reading test scores increased by six percent of a standard deviation, with larger effects for minority children and children of unmarried parents. (Dahl and Lochner, 2012)
- A \$1,000 increase in state EITCs is associated with 18-23 year olds in EITC-eligible households being 1 percentage point more likely to go to college. (Micheltmore, 2013)

**Impact on test scores of low-income children during the school years, reported in effect size, of \$1,000 of public expenditure on family support, class size reduction, or school readiness**



# The EITC advances children's education

“Family support in the form of putting more money in the pockets of low-income parents **produces substantially larger gains in children's school achievement per dollar of expenditure** than a year of preschool, participation in Head Start, or class size reduction in the early grades. The finding that family financial support enhances academic achievement in the form of test scores is consistent with other research on the impact of the EITC showing impacts on later outcomes such as college enrollment.”

-Grover J. Whitehurst

Senior Fellow, The Brookings Institution; former Assistant Secretary of Education for Educational Research and Improvement, George W. Bush administration

# The EITC's values

- *Work is good, and should be encouraged by public policy.*
- This statement can be supported on economic grounds.
- But inherently it is a normative statement, and is predicated on beliefs over **dignity** and **duty**.

# The EITC's values

- An aversion to dependency on government for the poor, and an embrace of self-sufficiency.
- A commitment to work from the poor.
  - Raise the *earned* income of the poor, instead of merely transferring income to the poor.
- Using resources efficiently.
- Making work pay.
  - Doesn't penalize work, unlike many public programs.
- Using social resources to meet a social goal.



# Questions and discussion

Michael R. Strain, Ph.D.

American Enterprise Institute

[Michael.Strain@AEI.org](mailto:Michael.Strain@AEI.org)