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# The EITC and Low-Income Workers

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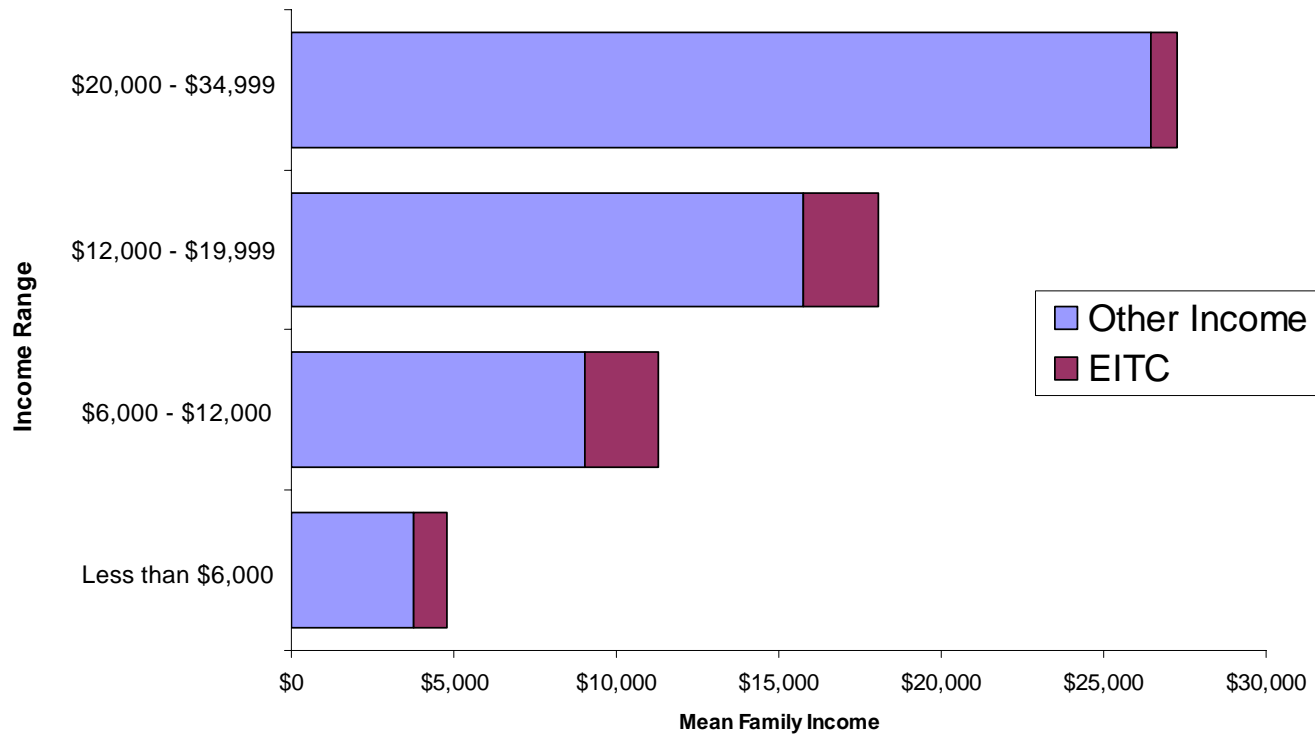
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# The EITC and Income

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- The EITC is well-targeted at low income families with children—a group that is needy and for whom current investments may have a significant payoff.
  - According to SOI data almost 98 percent of dollars go to families with children.
  - About 70 percent of dollars go to those who file head of household returns, mostly single parents.
  - 20, 60 and 89 percent of dollars go to families with income below \$10,000, \$20,000, and \$30,000, respectively.
  - Minimum wage and most other transfer programs much less well-targeted.
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**Figure 2**  
**Mean Family Income With and Without the EITC,**  
**Single Parents**



Source: 1999 Income data from the Current Population Survey: Annual Demographic File, 2000.

# The EITC and Work

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- The EITC encourages work by making it more attractive. Given that for many single mothers the net return to working is so low, weighing what is gained by work compared to what is lost in welfare and other benefits, a few thousand dollars can dramatically change the calculation in favor of working.
  - Meyer and Rosenbaum find that the employment of single mothers in 1996 was already 7 percentage points higher because of the EITC.
  - The work of Hotz et al., Grogger, Eissa and Liebman, Dickert et al., implies similar or larger estimates.
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# The EITC and Welfare Caseloads

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- The EITC reduces welfare receipt by making work more attractive than welfare for a substantial fraction of single mothers.
  - Grogger concludes that the EITC was responsible for about 15 percent of the very large decline in welfare receipt in the 1990s.
  - Most of the reduction in welfare cases seems to be through a reduction in welfare entry.
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# Concerns about the EITC: Hours

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- Hours may fall due to the poor being better off and the phase-out raising marginal tax rates.
  - Hours reductions cannot be found in the data though numerous papers have looked. This is a puzzle—maybe recipients don't fully understand the tax schedule—may not be a surprise given the complexity of the instructions.
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# Concerns about the EITC: Marriage

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- EITC encourages marriage for some—those working little who have children, discourages it for others—those working quite a bit with children, but are still poor. On net, there are more marriage penalties, so we suspect it discourages marriage a bit.
  - Of the two most detailed that estimate the effects on marriage (Ellwood, Eissa and Hoynes), one finds nothing, the other little or no effect on marriage.
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# EITC Concerns: Compliance

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- Misallocation of resources and attention on EITC compliance.
  - A very large share of audits relative to the potentially lost revenue. In FY 2004 48 percent of individual income tax return audits, despite all credits of which EITC only part being 6-9 percent of tax gap. Even this share is probably overstated given IRS methodology because even if the filer in question is not eligible, another person often is.
  - Much of noncompliance driven by needless complexity—14 pages of instructions in Publication 17, 56 pages in Publication 596.
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# EITC Reform Areas

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- Should there be a 3-child schedule?
  - Can we reduce marriage penalties?
  - Can we simplify the credit?
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# A 3-Child Schedule

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- We could add a schedule for families with 3 or more children. Wisconsin has such a state EITC, Hoffman and Seidman and others have proposed for the federal EITC.
  - 3-child families are particularly poor.
  - Can be done with a higher subsidy rate than for 2-child families or with the same subsidy rate applied to a longer phase-in range.
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## Percentiles of Annual Income, by Number of Children, 2001-2003, Single Mothers

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	1 child	2 children	3+ children
	(1)	(2)	(3)
<b>Income Percentiles</b>			
5th Percentile	3,567	3,558	3,675
10th Percentile	5,593	5,949	6,186
20th Percentile	9,025	9,874	8,843
30th Percentile	12,374	12,207	11,406
40th Percentile	15,366	15,151	13,464
50th Percentile	19,351	19,353	16,394
90th Percentile	41,246	47,637	36,291

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# Reducing Marriage Penalties

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- Can extend the plateau of the schedule or low phase-out tax rates.
  - Can add second earner deduction. This option is cheap and nearly all of the expenditures go toward reducing marriage penalties, but requires another worksheet (Holtzblatt/Rebelein).
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# Simplification

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- One definition of child for EITC, CTC, Dependents.
  - Improve IRS claims examination procedures so that so many claims that are ultimately justified are not initially denied.
  - Combine EITC, CTC, Dependent exemption? Not cheap and a more significant change in the overall shape of the tax schedule.
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# Conclusions

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- Income distribution features of EITC good.
  - The incentives of the EITC remarkably favorable given the resources transferred.
  - There are still substantial opportunities for reform.
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