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## STUDIES SHOW EARNED INCOME TAX CREDIT ENCOURAGES WORK AND SUCCESS IN SCHOOL AND REDUCES POVERTY

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Some 27 million working adults with low and moderate incomes, most of whom are raising children, received the Earned Income Tax Credit (EITC) in 2009 to reduce their taxes and supplement their earnings.<sup>1</sup> Studies have found that the EITC encourages work, reduces poverty, helps families meet basic needs, and improves children's achievement in school and likely increases their earnings as adults. The Child Tax Credit (CTC), a related tax credit designed to help offset the cost of raising children, also plays a pivotal role in helping low-income families.

- **Encouraging work.** Numerous studies have found that the EITC promotes work. “[T]he overwhelming finding of the empirical literature is that EITC has been especially successful at encouraging the employment of single parents, especially mothers,” write economists Nada Eissa of Georgetown University and Hilary Hoynes of the University of California, Davis.<sup>2</sup> In fact, while policymakers often point to the 1996 welfare law’s creation of Temporary Assistance for Needy Families (TANF) as the primary reason for increased work among single mothers, the research indicates that expansion of the EITC had a larger effect than the welfare law in producing these gains.<sup>3</sup>
- **Reducing poverty.** The EITC and CTC lifted 9.2 million people — including 4.9 million children — above the poverty line in 2010, under a broad measure of poverty that counts refundable tax credit payments as income (and subtracts income and payroll taxes).<sup>4</sup> Improvements in these credits enacted as part of the 2009 Recovery Act are responsible for lifting 1.6 million of those people above the poverty line.<sup>5</sup>

<sup>1</sup> In 2009, the most recent year for which data are available, EITC filers with qualifying children received 97 percent of EITC benefits. The other 3 percent went to poor workers not raising minor children, some of whom can qualify for a small childless workers’ EITC. IRS, Statistics of Income Division, July 2011, <http://1.usa.gov/Tx82i>.

<sup>2</sup> Nada Eissa and Hilary Hoynes, “Behavioral Responses to Taxes: Lessons from the EITC and Labor Supply,” October 10, 2005, [http://www.econ.ucdavis.edu/working\\_papers/05-29.pdf](http://www.econ.ucdavis.edu/working_papers/05-29.pdf).

<sup>3</sup> Jeffrey Grogger, “The Effects of Time Limits, the EITC, and Other Policy Changes on Welfare Use, Work, and Income among Female-Head Families,” *Review of Economics and Statistics*, May 2003.

<sup>4</sup> These estimates come from a poverty measure based on the 1995 National Academy of Sciences recommendations for poverty measurement, <http://www.nap.edu/openbook.php?isbn=0309051282>.

<sup>5</sup> The improvements enacted in 2009 were extended at the end of 2010. They are now scheduled to expire at the end of 2012.

- **Providing a short-term safety net.** Most EITC recipients claim the credit only temporarily when a job disruption or other significant event reduces their income. A recent study found that, of people who received the EITC over an 18-year period, 61 percent received the credit for only one or two years at a time.<sup>6</sup> A forthcoming study finds that over time, EITC recipients as a whole pay far more in federal income taxes than they receive in EITC benefits.<sup>7</sup>
- **Improving children’s school performance and increasing their work effort and earnings as adults.** A small but growing body of research indicates that lifting the incomes of low-income families helps children in those families do better in school. The added income may help children later in life, as well: recent research finds that raising a poor family’s income by \$3,000 a year<sup>8</sup> (a fairly typical amount for a poor family to receive from the CTC and EITC) between a child’s prenatal year and fifth birthday is associated with a significant increase in the child’s earnings in adulthood. The leading study finds a 17 percent increase in earnings in adulthood, and an average of 135 hours of additional work per year, compared to similar children whose families do not receive the increase in income.<sup>9</sup>

Policymakers can build on the tax credits’ successes by making permanent the EITC and CTC improvements in the Recovery Act, protecting the two credits from cuts in tax reform or deficit-reduction legislation (as both the Bowles-Simpson deficit-reduction plan and the Senate’s “Gang of Six” plan recommended), and strengthening the very small EITC for workers not raising minor children.

## How the EITC and CTC Work

A taxpayer must have earnings from work in order to claim either the EITC or the low-income component (the partially refundable component) of the CTC.

The EITC is a federal tax credit for low- and moderate-income working families and individuals; it is designed to encourage and reward work, as well as to offset federal payroll and income taxes. The EITC is “refundable,” which means that if it exceeds a low-wage worker’s federal income tax liability, the Internal Revenue Service refunds the balance to the taxpayer.

The EITC’s primary recipients are working parents with children, though there is a small EITC for working adults without minor children. The amount of the credit rises with earned income until it reaches a maximum level (which varies by the number of qualified children) and then phases out

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<sup>6</sup> Tim Dowd and John B. Horowitz, “Income Mobility and the Earned Income Tax Credit: Short-Term Safety Net or Long-Term Income Support,” *Public Finance Review* (September 2011), 619-652.

<sup>7</sup> The forthcoming study is from Tim Dowd of the Joint Committee on Taxation and John B. Horowitz of Ball State University. See previous footnote.

<sup>8</sup> The \$3,000 figure is in 2005 dollars, equivalent to approximately \$3,530 in 2012. Greg J. Duncan, Kathleen M. Ziol-Guest, and Ariel Kalil, “Early-Childhood Poverty and Adult Attainment, Behavior, and Health,” *Child Development* (January/February 2010), pp. 306-325.

<sup>9</sup> Greg J. Duncan, Kathleen M. Ziol-Guest, and Ariel Kalil, “Early-Childhood Poverty and Adult Attainment, Behavior, and Health,” *Child Development* (January/February 2010), 306-325.

as income increases further.<sup>10</sup> In 2012, the EITC begins phasing down at \$17,090 for single-parent filers and at \$22,300 for married-parent filers.

The CTC, designed to help families offset the costs of raising children, is worth up to \$1,000 per child under age 17.<sup>11</sup> Unlike under the EITC, the CTC is not targeted on low- and moderate-income families but extends to middle and most upper-middle income families as well.<sup>12</sup> The CTC is partially refundable: families whose credit exceeds their federal income tax liability can receive the remainder of the credit in the form of a refund, but the refund cannot exceed 15 percent of the amount by which their earnings exceed a minimum earnings threshold (set at \$3,000 in 2012). When we discuss the CTC in this paper, we focus on the low-income (i.e., partially refundable) part of the credit.

## Encouraging Work

A substantial body of research over the past 15 years has found that the EITC significantly boosts work effort.<sup>13</sup>

- EITC expansions instituted between 1984 and 1996 were responsible for more than half of the large increase in employment among single mothers during that period, economists Bruce D. Meyer of the University of Chicago and Dan T. Rosenbaum of the University of North Carolina at Greensboro found.<sup>14</sup> They also found that the most significant gains in employment attributable to the EITC were for mothers with young children and mothers with low education levels.
- Recent research by social scientist Chris Herbst of Arizona State University finds that the EITC is particularly effective at encouraging work among low-wage working mothers.<sup>15</sup>

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<sup>10</sup> For more on how the EITC operates, see “Policy Basics: The Earned Income Tax Credit,” Center on Budget and Policy Priorities, revised February 22, 2012, <http://www.cbpp.org/files/policybasics-eitc.pdf>.

<sup>11</sup> For more on how the CTC operates, see “Policy Basics: Child Tax Credit,” Center on Budget and Policy Priorities, updated May 14, 2012, <http://www.cbpp.org/files/policybasics-ctc.pdf>.

<sup>12</sup> The CTC begins to phase out at incomes of \$75,000 for single parents filing as heads of household, \$110,000 for married couples filing jointly, and \$55,000 for married couples filing separately. The income level at which the credit phases out completely depends on the number of qualifying children. For example, the credit phases out at \$150,000 for married couples filing jointly with two children.

<sup>13</sup> For a summary of research on the EITC, see V. Joseph Hotz and John Karl Scholz, “The Earned Income Tax Credit,” in Robert A. Moffitt, ed., *Means-Tested Transfer Programs in the United States* (Chicago: The University of Chicago Press, 2003). The refundable CTC is much newer and has not been studied as extensively.

<sup>14</sup> See Bruce D. Meyer and Dan T. Rosenbaum, “Making Single Mothers Work: Recent Tax and Welfare Policy and its Effects,” in Bruce D. Meyer and Douglas Holtz-Eakin, eds., *Making Work Pay: The Earned Income Tax Credit and Its Impact on America's Families* (New York: Russell Sage Foundation, 2001) and Bruce D. Meyer and Dan T. Rosenbaum, “Welfare, The Earned Income Tax Credit, and the Labor Supply of Single Mothers,” *Quarterly Journal of Economics* 116(3): 1063-2014.

<sup>15</sup> Chris M. Herbst, “The labor supply effects of child care costs and wages in the presence of subsidies and the earned income tax credit,” November 17, 2009,

[http://www.chrisherbst.net/files/Download/C.\\_Herbst\\_Labor\\_Supply\\_Effects.pdf](http://www.chrisherbst.net/files/Download/C._Herbst_Labor_Supply_Effects.pdf).

- Economist Jeffrey Grogger of the University of Chicago has found that the EITC is one of the most effective policies for increasing the work and earnings of female-headed families. Grogger found that the EITC expansions enacted in the 1990s “appear to be the most important single factor in explaining why female family heads [of households] increased their employment over 1993-1999.”<sup>16</sup> He concluded that the EITC expansions actually had a larger effect in increasing employment among single mothers than the 1996 welfare law.
- The EITC expansions phased in between 1994 and 1996 not only boosted employment among single mothers, but the women who benefited most from them likely had higher wage growth in later years than otherwise-similar women, according to research by Molly Dahl and Jonathan Schwabish of the Congressional Budget Office (CBO) and Tom DeLeire of the University of Wisconsin.<sup>17</sup>
- In a recent CBO working paper, Dahl, Schwabish, DeLeire, and University of Wisconsin economist Timothy Smeeding project that the EITC — by raising employment and earnings levels for working-age women — will also boost their Social Security retirement benefits, which should result in lower poverty in old age.<sup>18</sup> (Social Security eligibility and benefit levels are based on how much one works and earns.)

Other studies have found that the EITC, by boosting employment among single mothers, has produced large declines in the receipt of cash welfare assistance.

- Expansions of the EITC in the 1990s induced more than a half a million families to move from cash welfare assistance to work, according to research by economists Stacy Dickert of Michigan State University, Scott Houser of the Colorado School of Mines, and John Karl Scholz of the University of Wisconsin-Madison.<sup>19</sup>
- Economist Jeffrey Grogger’s study of the effects of welfare time limits, the EITC, and other policy changes occurring from 1993 to 1999 concluded that the EITC likely contributed about as much to the decline in receipt of cash welfare assistance among female-headed families during that period as did the introduction of time limits and other welfare reforms.<sup>20</sup>

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<sup>16</sup> Grogger, 2003.

<sup>17</sup> Molly Dahl, Thomas DeLeire, and Jonathan A. Schwabish, “Stepping Stone or Dead End? The Effect of the EITC on Earnings Growth,” Institute for the Study of Labor, revised April 2009, <http://ftp.iza.org/dp4146.pdf>.

<sup>18</sup> Molly Dahl, Jonathan Schwabish, Thomas DeLeire, and Timothy Smeeding, “The Earned Income Tax Credit and Expected Social Security Retirement Benefits Among Low-Income Women,” Congressional Budget Office, revised March 5, 2012, <http://www.cbo.gov/publication/43033>.

<sup>19</sup> Stacy Dickert, Scott Houser, and John Karl Scholz, “The Earned Income Tax Credit and Transfer Programs: A Study of Labor Market and Program Participation,” *Tax Policy and the Economy*, Vol. 9, MIT Press, 1995.

<sup>20</sup> Jeffrey Grogger, “The Effects of Time Limits, the EITC, and Other Policy Changes on Welfare Use, Work, and Income among Female-Head Families,” *Review of Economics and Statistics*, May 2003. Using different data, in another study, Grogger reaches similar conclusions. Jeffrey Grogger, “Welfare Transitions in the 1990s: the Economy, Welfare Policy, and the EITC,” NBER Working Paper No. 9472, January 2003, <http://www.nber.org/papers/w9472.pdf>.

Also of note, there is little evidence that the phasing down of EITC benefits as income rises above certain levels causes workers to significantly reduce their work hours.<sup>21</sup> What the research does show is very strong evidence that the EITC induces substantially more workers to enter the labor force.

## Reducing Poverty

The EITC reduces poverty in two ways: by encouraging work and by supplementing the wages of workers who are still poor because of their low pay.

Many Americans work for very low wages. For example, the food-preparation sector (cooks, servers, dishwashers, and so on), which employs 11 million people and accounts for about one in every 11 jobs, had a median wage in 2011 of only \$9.09 an hour. At full-time, year-round employment, that wage would generate \$18,180 in earnings, or 80 percent of the poverty threshold for a two-adult, two-child family.<sup>22</sup>

The Economic Policy Institute (EPI) estimates that, in recent years, roughly one in five male workers and three in ten female workers have earned less than a “poverty-level wage,” defined as the hourly wage that would put a full-time, full-year worker at the poverty line for a family of four. (This poverty-level wage was \$10.55 in 2009.)<sup>23</sup> Meanwhile, the minimum wage is not indexed to inflation, and policymakers’ occasional adjustments to it over the years have been too infrequent and modest to keep pace with inflation. Prior to its most recent increases between 2007 and 2010, the minimum wage had fallen to 64 percent of its peak 1968 level, adjusted for inflation. Even today, after those increases, it equals less than 80 percent of its 1968 value.<sup>24</sup>

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<sup>21</sup> Once EITC recipients reach the phase-out range, recipients with no children have their EITC reduced by 8 cents for each additional dollar earned, recipients with one child have their EITC reduced by 16 cents, and recipients with two or more children have their EITC reduced by 21 cents. In theory, the phase-out could have some effect in encouraging fewer hours of work among those with incomes high enough to be in the phase-out range. The only studies to find a reduction in work hours, however, have found such effects to be small. Moreover, those studies generally found such effects only among *married* EITC recipients, and many analysts believe this effect is likely due in large part to the fact that the additional income the EITC provides allows the second earner in some married families to choose to spend more time raising children and less time working out of the home. Analysts across the political spectrum have observed that the fact that the EITC may lead some married parents to make such a choice should *not* be regarded as an adverse policy outcome. See David T. Ellwood, “The Impact of the Earned Income Tax Credit and Social Policy Reforms on Work, Marriage, and Living Arrangements,” June 2000, [http://www.ipr.northwestern.edu/jcpr/workingpapers/wpfiles/ellwood\\_eitc99\\_update.PDF](http://www.ipr.northwestern.edu/jcpr/workingpapers/wpfiles/ellwood_eitc99_update.PDF).

<sup>22</sup> Bureau of Labor Statistics, Occupational Employment Statistics, [http://www.bls.gov/oes/current/oes\\_nat.htm](http://www.bls.gov/oes/current/oes_nat.htm); U.S. Census Bureau, <http://www.census.gov/hhes/www/poverty/data/threshld>.

<sup>23</sup> “Percentage earning poverty-level wage is high,” Economic Policy Institute, updated January 24, 2011, <http://stateofworkingamerica.org/charts/share-of-workers-earning-poverty-level-wages-by-gender-1973-2009/>. EPI’s calculations are based on 52 weeks of work. Elsewhere in this paper, when we refer to a full-time worker or a full-time year-round worker, we are referring to a person who works 50 weeks a year.

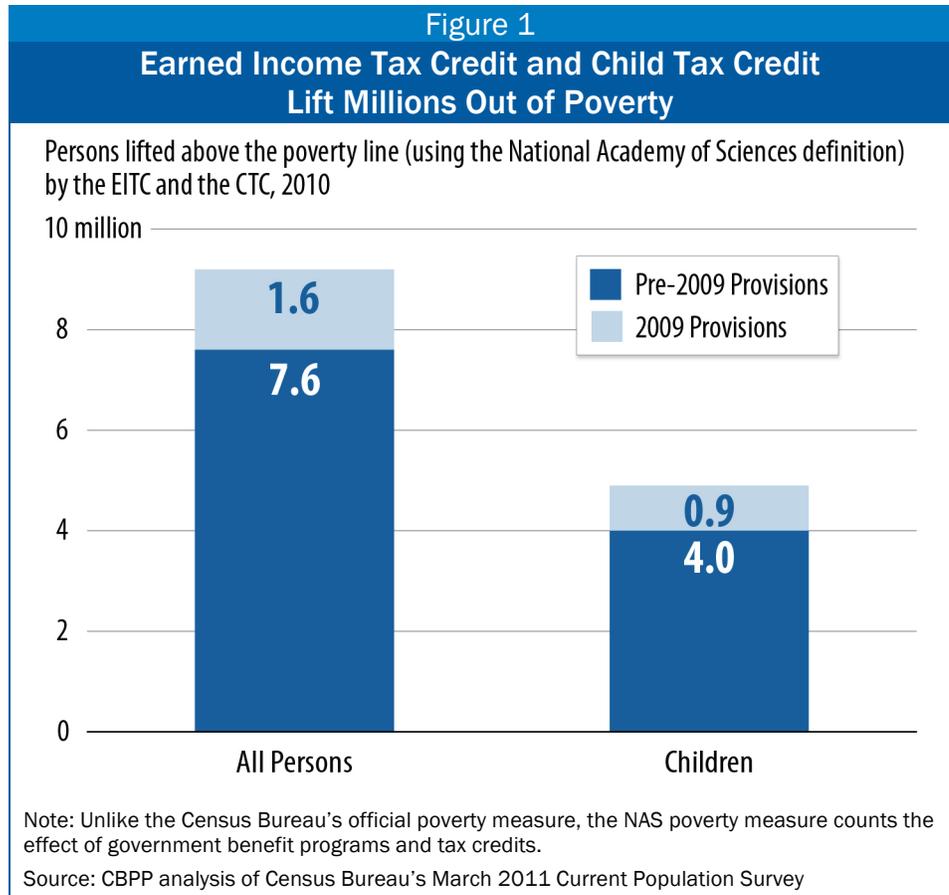
<sup>24</sup> CBPP analysis of data from the U.S. Department of Labor, Wage and Hour Division, Bureau of Labor Statistics (<http://www.dol.gov/whd/minwage/chart.htm>), and the U.S. Census Bureau, (<http://www.census.gov/hhes/www/poverty/data/threshld>).

In addition, four of the ten occupations that the Bureau of Labor Statistics expects to generate the most new jobs over the next decade — home health aides, food preparers, personal care aides, and retail salespersons — paid median wages that, in 2010, would have placed them below the poverty line for a family of four with two children.<sup>25</sup>

The EITC and CTC, by supplementing the wages of low-paid workers, lifted 9.2 million people above the poverty line in 2010 (under a poverty measure many analysts favor that counts non-

cash public benefits and refundable tax credit payments as income). Temporary improvements in the credits made by the 2009 Recovery Act (discussed below) were responsible for raising about 1.6 million of these 9.2 million people above the poverty line (see Figure 1) — about 1 million people from improvements in the CTC and another 500,000 from improvements in the EITC.

The 9.2 million people included 4.9 million children — 3.3 million lifted out of poverty by the EITC and 1.6 million by the CTC.<sup>26</sup> Overall, the EITC lifted 6.3 million of these 9.2 million people above the poverty line.



<sup>25</sup> Bureau of Labor Statistics, Occupational Outlook Handbook, 2010-2011 Edition, <http://www.bls.gov/oco/oco2003.htm#occupation>.

<sup>26</sup> CBPP analysis of the Census Bureau's March 2011 Current Population Survey.

## Providing a Short-Term Safety Net

The EITC provides an ongoing wage supplement to some low-wage workers, but it helps a larger group of workers meet a temporary need. Recent research by Tim Dowd of the Joint Committee on Taxation and John Horowitz of Ball State University has found that “the EITC acts as a short-term safety net to many taxpayers who claim the EITC for short periods during shocks to income or family structure,” after which, their study indicates, their earnings grow again.<sup>27</sup>

Some 61 percent of those who received the EITC over the 18-year period from 1989 through 2006 did so for only one or two years at a time, Dowd and Horowitz found (see Figure 2). They also found that approximately *half* of all U.S. taxpayers with children used the EITC at least once during the 18-year period. With its broad but temporary reach, the EITC provides critical income insurance for working families that face hardship or care for newborns or very young children.<sup>28</sup>

In addition, Dowd and Horowitz found that EITC recipients pay significant federal income taxes over time, even though they may receive more in EITC benefits in a given year than they pay in federal income taxes in that year. In a forthcoming study, they report that taxpayers who claimed the EITC at least once from 1989 through 2006 paid *a few hundred billion dollars more* in federal income taxes over that period than they received in EITC benefits.<sup>29</sup>

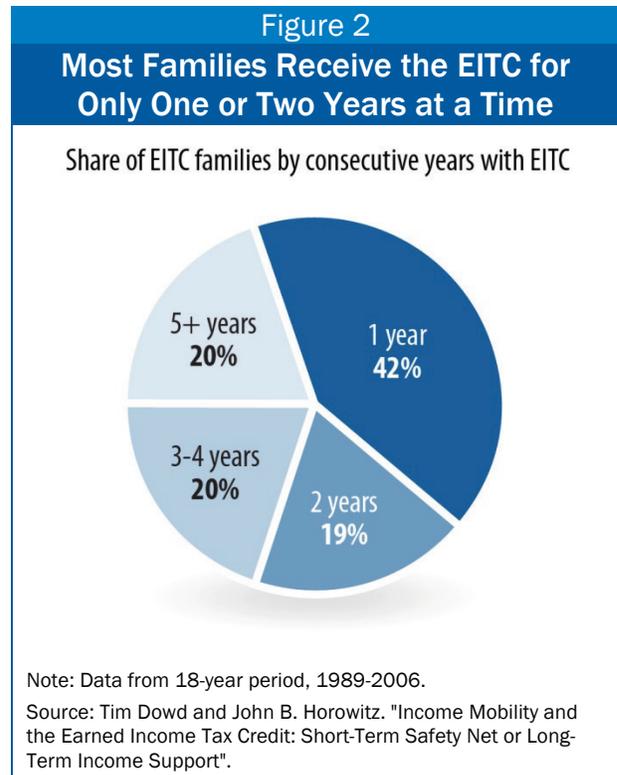
Moreover, low-income households also pay very substantial state and local taxes. Most state and local taxes are regressive, meaning that low-income families pay a larger share of their incomes in these taxes than more affluent households do. The bottom fifth of U.S. taxpayers paid an average of 12.3 percent of their incomes in state and local taxes in 2011, according to the Institute on Taxation and Economic Policy, well above the 7.9 percent of income that the top 1 percent of households paid.<sup>30</sup>

<sup>27</sup> Dowd and Horowitz, 2011.

<sup>28</sup> Dowd and Horowitz, 2011.

<sup>29</sup> Authors’ communications with Tim Dowd of the Joint Committee on Taxation and John B. Horowitz of Ball State University, October 18, 2011.

<sup>30</sup> Citizens for Tax Justice, “Who Pays Taxes in America?” April 4, 2012, <http://www.ctj.org/pdf/taxday2012.pdf>.



## Boosting Children's School Achievement

Research suggests that the EITC and other income-enhancing measures improve the educational outcomes of young children in low-income families.<sup>31</sup>

- Economist Greg J. Duncan of the University of California, Irvine and his colleagues, Pamela A. Morris of New York University and MDRC and Chris Rodrigues of Columbia University, analyzed ten anti-poverty and welfare-to-work experiments and found a consistent pattern of better school results for children in programs that provided more income. Each \$1,000 increase (in 2005 dollars) in annual income (the equivalent of a full Child Tax Credit for one child) sustained over two to five years led to modest but statistically significant increases in young children's school performance on a number of measures, including test scores. While the study did not specifically analyze the EITC's impact, the researchers noted that their results are most germane to "income-boosting policies that link increases in income to increases in employment" — like the EITC.<sup>32</sup>
- Economists Raj Chetty and John N. Friedman of Harvard University and Jonah Rockoff of Columbia University analyzed administrative data for grades 3-8 from a large urban school district and the corresponding U.S. tax records for families in the district. They found that even under conservative assumptions, additional income from the EITC and CTC leads to significant increases in students' test scores.<sup>33</sup> Additionally, economists Gordon B. Dahl of the University of California, San Diego and Lance Lochner of the University of Western Ontario, after studying nearly two decades' worth of survey data on mothers and their children, concluded that additional income from the EITC raises the combined math and reading test scores of students by similarly large magnitudes.<sup>34</sup> Although these two studies and the study in the previous bullet used different datasets and analytical techniques, their results are roughly similar in magnitude, adding confidence to the findings of all three.
- An additional study by Duncan and Katherine Magnuson of the University of Wisconsin concludes that a credit worth about \$3,000 (in 2005 dollars) to a working parent during a child's early years may increase that child's achievement by the equivalent of about two extra months of schooling.<sup>35</sup>

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<sup>31</sup> For a discussion of the research on the impact of early childhood poverty, see Greg J. Duncan and Katherine Magnuson, "The Long Reach of Early Childhood Poverty," *Pathways*, Winter 2011, 22, [http://www.stanford.edu/group/scspi/\\_media/pdf/pathways/winter\\_2011/PathwaysWinter11\\_Duncan.pdf](http://www.stanford.edu/group/scspi/_media/pdf/pathways/winter_2011/PathwaysWinter11_Duncan.pdf).

For a more technical discussion of the evidence, see Greg J. Duncan, Pamela A. Morris, and Chris Rodrigues, "Does Money Really Matter? Estimating Impacts of Family Income on Young Children's Achievement with Data from Random-Assignment Experiments," *Developmental Psychology* (June 2011), 1263–1279.

<sup>32</sup> Duncan, Morris, and Rodrigues, 2010.

<sup>33</sup> Raj Chetty, John N. Friedman, and Jonah Rockoff, "New Evidence on the Long-Term Impacts of Tax Credits," *Statistics of Income Paper Series*, November 2011, <http://www.irs.gov/pub/irs-soi/11rpchettyfriedmanrockoff.pdf>.

<sup>34</sup> The figures in the Dahl and Lochner study are expressed in 2000 dollars. Gordon Dahl and Lance Lochner, "The Impact Of Family Income On Child Achievement: Evidence From The Earned Income Tax Credit," NBER Working Paper No. 14599, December 2008, <http://www.nber.org/papers/w14599>.

<sup>35</sup> Duncan and Magnuson, "The Long Reach of Early Childhood Poverty," Winter 2011, which is based on an analysis of studies, including those cited here, of the impact of early-childhood poverty.

Gordon Berlin, the president of MDRC (one of the nation’s leading research organizations, which is known for rigorous evaluation of anti-poverty and welfare-to-work programs) has summarized these results. Berlin has noted:

[There is] a remarkably strong body of research — much of it based on large-scale, well-implemented, experimental research designs — showing that supplementing the earnings of parents helps raise families out of poverty and improves the school performance of young children. This point is so important — and to many so surprising — that I want to state it again: We have reliable evidence involving thousands of families in multiple studies demonstrating that “making work pay” causes improvements in young children’s school performance.

Berlin noted that these positive school effects, while based on evaluations of policies other than the EITC, are likely to apply to the EITC.<sup>36</sup>

## **Boosting Employment and Earnings When Children Reach Adulthood**

As discussed above, a substantial body of research has demonstrated the EITC’s powerful effects in increasing the work effort of parents, particularly single mothers. Recent research suggests that the EITC’s pro-work effect likely extends to the next generation.

- Boosting family income through refundable tax credits increases the likelihood that children in the family will attend college and raises their earnings as adults, according to research by Raj Chetty and John N. Friedman of Harvard University and Jonah Rockoff of Columbia University.<sup>37</sup> The estimated effects of tax credits on children’s test scores, and the subsequent correlation between children’s test scores and their adult earnings, are sufficiently strong that “a substantial fraction of the cost of tax credits may be offset by earnings gains in the long run,” the researchers noted.
- Children in low-income families that received an annual income boost of \$3,000 (in 2005 dollars)<sup>38</sup> between the child’s prenatal year and fifth birthday earned an average of 17 percent more as adults, and worked 135 hours more annually, than similar children whose families do not receive the added income, according to research by Greg J. Duncan, Kathleen Ziol-Guest of Cornell University, and Ariel Kalil of the University of Chicago.<sup>39</sup>

In short, studies indicate that young children in low-income families that receive the type of income support offered by the EITC and CTC are likely to perform better in school and to grow up

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<sup>36</sup> Gordon L. Berlin, remarks at National Summit on America’s Children, May 22, 2007, <http://www.mdrc.org/publications/456/presentation.html>.

<sup>37</sup> Chetty, Friedman, and Rockoff.

<sup>38</sup> The authors refer to pre-tax income here. However, they re-estimated their models using a measure of childhood income that excluded federal income taxes and had fairly similar results to the models that use pre-tax income.

<sup>39</sup> The paper says 19 percent but our calculations, later confirmed by one of the authors, show that this is a typographical error and 17 percent is correct. Duncan, Ziol-Guest, and Kalil, 2010.

to work more and earn more. Chetty and his colleagues conclude, “when analyzing the costs and benefits of policies such as the Earned Income or Child Tax Credit, policymakers should carefully consider the potential impacts of these programs on future generations.”<sup>40</sup>

## **Building on the Success of the EITC and CTC**

Policymakers can build on the success of the EITC and CTC by making permanent recent temporary improvements in the credits, protecting and strengthening the credits as part of tax reform and deficit reduction, and enacting pro-work and pro-marriage improvements.

### **Making Recent Improvements Permanent**

The 2001 Bush tax cuts modestly raised the income level at which married couples can receive the maximum EITC in order to reduce the marriage penalty that couples with modest incomes can face if both spouses work.<sup>41</sup> This reduced but did not eliminate the marriage penalty that couples can face. The 2009 Recovery Act made a further adjustment in the EITC for married couples to eliminate a significant share of the marriage penalty that remained.<sup>42</sup>

The Recovery Act also expanded EITC benefits for families with more than two qualified children. These families’ living costs are higher than those of smaller families, and the poverty line and cash welfare benefit levels are set higher for larger families to reflect this reality. But wages are not adjusted for family size. Census data show that although 36 percent of all U.S. children lived in nuclear families with three or more children in 2008, some 52 percent of *poor* children did. A somewhat larger EITC for larger families helps to ensure that full-time work lifts these families and their children out of poverty and that work pays more than welfare. The Recovery Act provision increased the maximum EITC for families with three or more children by about \$629 in 2009 (and by \$655 in 2012).

These two Recovery Act EITC improvements — greater marriage-penalty relief and a modestly higher EITC for families with three or more children — kept an estimated 500,000 people out of poverty in 2010.<sup>43</sup>

As for the CTC, the 2001 and 2003 tax cuts enlarged the credit from \$500 per child to \$1,000 and made it partially refundable,<sup>44</sup> and the Recovery Act modified the CTC so that a larger share of a working-poor parent’s earnings counts in determining the amount of the family’s credit. Without

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<sup>40</sup> Chetty, Friedman, and Rockoff.

<sup>41</sup> The 2001 Bush tax cut provisions increased the earnings level at which married families can receive the maximum EITC by \$3,000, a figure that is indexed for inflation. For an outline of the legislative history of the EITC, see: Christine Scott, “The Earned Income Tax Credit (EITC): An Overview,” Congressional Research Service, December 21, 2011.

<sup>42</sup> Married couples are allowed the maximum EITC at moderately higher income levels than single parents in order to help prevent couples from facing a very sharp reduction in their combined EITC after marrying.

<sup>43</sup> CBPP analysis of the Census Bureau’s March 2011 Current Population Survey.

<sup>44</sup> See the following for an introduction to the CTC, “Policy Basics: Child Tax Credit,” Center on Budget and Policy Priorities, updated May 14, 2012, <http://www.cbpp.org/files/policybasics-ctc.pdf>.

the Recovery Act improvements, a low-income working family would not qualify for even a partial credit in 2012 unless it had more than \$13,050 in earnings; a parent with two children would not qualify for the *full* credit until her earnings reached \$26,383. (The credit phases in slowly as earnings rise above the minimum threshold.) Under the Recovery Act provisions, a family now begins to qualify for the CTC when its earnings surpass \$3,000, and a parent with two children receives the full credit when her earnings reach \$16,333.

These EITC and CTC improvements were originally scheduled to expire at the end of 2010, but Congress extended them through 2012, along with the Bush tax cuts and other tax cuts that had been slated to expire at the end of 2010. If the EITC and CTC improvements are not extended beyond 2012, large numbers of low-income working families will be heavily affected.

- If policymakers decline to extend the Recovery Act's EITC marriage-penalty provision, substantial numbers of low-income married couples will face larger marriage penalties.
- If policymakers do not extend the Recovery Act's EITC improvement for larger families, families with three or more children will lose up to \$669 in EITC benefits, and some will fall into poverty — or deeper into poverty — as a result. Married couples with three or more children would be doubly affected, losing both a portion of their EITC marriage penalty relief and the EITC increment for larger families; a married couple with three children and earning \$25,000 — which is below the poverty line for a family of five — would lose an estimated \$1,088 in 2013.
- Failure to extend the Recovery Act's improvement in the Child Tax Credit would have an even more pronounced impact. It would make working families *ineligible* for the CTC unless their earnings surpassed \$13,350 in 2013 and would cut the CTC substantially for families with earnings modestly above that. The Urban Institute-Brookings Institution Tax Policy Center estimates that 7 million children in working families earning less than \$13,350 would lose the CTC entirely, while an additional 10 million children in low-income working families with earnings somewhat above \$13,350 would have their CTC cut, in many cases by very large amounts.<sup>45</sup>

For example, a single mother with two children working full-time, year-round at the minimum wage of \$7.25 an hour — and earning \$14,500 per year — will receive a \$1,725 Child Tax Credit in 2013 if policymakers extend the provision but just \$173 if they do not. (See Table 1.)

### **Protecting and Strengthening Credits as Part of Tax Reform and Deficit Reduction**

Income inequality has widened to historic levels in recent decades. Although that is due largely to increases in the inequality of *pre-tax* income, changes in tax policy have exacerbated this trend. The tax code does less now to lean against inequality than it did a few decades ago.

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<sup>45</sup> “Reform Child Tax Credit: Various Options; Impact on Number of Children, 2012-21,” Tax Policy Center, May 24, 2011, <http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3006>.

Table 1 Value of Child Tax Credit in 2013 to a Single Parent with Two Children Who Works Full-Time, Year-Round at the Minimum Wage	
	Value of CTC
If Congress extends 2009 CTC provisions*	\$1,725
If Congress does not extend 2009 provisions*	\$173
* Both entries assume Congress assumes the 2001 Child Tax Credit provisions.	

CBO has found that from 1979 to 2007, the increase in *after-tax* income inequality was greater than the increase in *before-tax* income inequality. In other words, changes in tax policy made the trend toward greater inequality even more pronounced.<sup>46</sup>

This makes it especially important that any measures that policymakers adopt to reform the tax code or to raise revenue for deficit reduction strengthen the progressivity of the tax code and protect (and, if possible, improve) the EITC and the low-income component of the CTC. As policymakers work to reduce long-term deficits, they should keep in mind the principle that deficit reduction should not increase poverty or inequality — a core principle of the 2010 Bowles-Simpson report and one the bipartisan Senate Gang of Six sought to honor in its 2011 plan.

Major deficit-reduction agreements over the past quarter-century have adhered to this principle. In fact, the 1990 and 1993 agreements *expanded* the EITC, demonstrating that deficit reduction can be paired with policy improvements that reduce poverty at the same time.

Last year, a group of Christian leaders ranging from the Catholic Bishops’ Conference and the Episcopal Church to the Salvation Army and the National Association of Evangelicals issued a call for policymakers to safeguard the poor in deficit reduction and to draw a “circle of protection” around programs targeted on them, including the EITC and CTC.

### Pro-Work and Pro-Marriage Improvements

The EITC and CTC have increased work effort and reduced poverty among their prime beneficiaries: low-income working parents with children. They largely leave out, however, adult workers without qualified children (i.e., childless adults and noncustodial parents), the sole group that the federal income tax system taxes *into* (or deeper into) poverty.

Adults under age 25 who are not raising minor children are ineligible for the EITC. Adults between the ages of 25 and 64 who aren’t raising minor children are eligible, but the EITC for which they may qualify is very small: the maximum credit is \$475 in 2012 and the average credit was \$259 in 2009 (the most recent year for which those data are available). Moreover, the credit for workers not raising minor children is so limited that an individual worker loses eligibility when his or her earnings reach just \$13,980. Childless workers and noncustodial parents employed full-time, year-

<sup>46</sup> Congressional Budget Office, “Trends in the Distribution Of Household Income Between 1979 and 2007,” October 25, 2011, <http://cbo.gov/publication/42729>.

round at the minimum wage earn too much to qualify.

Providing a more adequate EITC to low-income workers who aren't raising minor children should have several beneficial effects:

- **Encouraging work.** Even before the Great Recession, men aged 18 to 24 were much less likely to be in the labor force (i.e., working or looking for work) than men aged 25 to 64. The Great Recession has further widened this gap; by 2010, the gap between the labor-force participation rate of men aged 25 to 64 and that of younger men surpassed the previous record high, reached back in 1968.<sup>47</sup> These young men are particularly unlikely to have qualified children and thus are potentially eligible for only a very small EITC. Yet, the larger EITC for families with children has a proven record of significantly increasing work effort and labor force participation. Unfortunately, the current EITC for workers without children is too small to have a comparable impact; increasing it could boost work among this population.
- **Encouraging marriage.** Research indicates that the weakened employment prospects of young male workers make them less “marriageable.” Economist Harry Holzer has written that “it is very hard to raise marriage rates dramatically without improving the marriageability of a lot of these young people, especially the young men. Their attractiveness as marriage partners is going to be very low if their earnings are going to be very low.”<sup>48</sup> And if marriage rates remain low among low-skilled workers, many children will continue to grow up in low-income, single-parent households. Raising a child in a single-parent household significantly increases the chance that the parent and the child will face hardship.<sup>49</sup> An expanded EITC for workers not raising minor children may help to improve employment and marriage rates.

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<sup>47</sup> These data go back to 1948.

<sup>48</sup> House Ways and Means Committee hearing, 110th Congress, “The Economic and Societal Costs of Poverty,” January 2007, <http://www.gpo.gov/fdsys/pkg/CHRG-110hrg34734/html/CHRG-110hrg34734.htm>. In congressional testimony on solutions to poverty, Gordon Berlin, the president of MDRC, noted that the marriage rates of young men are partially dependent on their level of employment and income. Testimony at House Committee on Ways and Means, Subcommittee on Income Security and Family Support, April 26, 2007, <http://www.mdrc.org/publications/450/testimony.html>.

<sup>49</sup> Daniel R. Meyer and Geoffrey L. Wallace, “Poverty Levels and Trends in Comparative Perspective,” *Focus*, 26:2, 7-13, <http://www.irp.wisc.edu/publications/focus/pdfs/foc262b.pdf>.