Disclaimer

- The view expressed today are mine alone.
- They do not necessarily reflect those of the Federal Reserve Bank of Richmond, or the Federal Reserve System
Roadmap for the Talk

- Overview and facts
- What have economists learned?
Overview of EITC

- Refundable tax credit for working, low-income tax filers
- The value of the credit varies with earned income and number of children, with larger credit amounts for families with children.
  - The average credit in 2010 was $2,805.
- Largest cash or near cash program for low-income families in the US (2011 data).
History of EITC

- Started in 1975 as modest “work bonus,” made permanent in 1978
- Substantial expansions have taken place:
  - 1986 Tax Reform Act: general expansion and indexed for inflation
  - 1990 OBRA: general expansion and added separate schedule for families with 2 or more children
  - 1993 OBRA: general expansion (larger expansion for families with 2 or more children) and added EITC for childless filers
  - 2001 EGTRRA: extended flat/phase-out regions for married couples
  - 2009 ARRA: expand EITC for families with 3 or more children and for married couples
- About half of all states now offer “add on” EITCs
  - MD: 25% of Federal credit+50% of Fed EITC as nonrefundable credit
EITC Recipients, 1975-2009

Number of Families Receiving Federal Earned Income Tax Credit

Source: Tax Policy Center
Spending on EITC, 1975-2011

Figure 3. Real Federal Spending on EITC, CTC, and Welfare, 1975-2011

Source: Budget of the United States Government, Fiscal Year 2014, for AFDC/TANF; Internal Revenue Service Statistics of Income, various years for EITC and CTC; Bureau of Labor Statistics for CPI Deflator.
EITC Eligibility and Payments

- **EITC Eligibility:**
  - Positive earned income; below limit

- **Earned income and adjusted gross income (AGI) must each be less than (in 2014):**
  - $14,590 ($20,020 married filing jointly) with no qualifying children
  - $38,511 ($43,941 married filing jointly) with one qualifying child
  - $43,756 ($49,186 married filing jointly) with two qualifying children
  - $46,997 ($52,427 married filing jointly) with three or more qualifying children

- **Maximum credit:**
  - $6,143 with three or more qualifying children
  - $5,460 with two qualifying children
  - $3,305 with one qualifying child
  - $496 with no qualifying children
EITC Eligibility and Payments, contd.

- Credit amount depends on family earnings and number of children:
  - Phase-in: credit is flat percentage of earned income
  - Flat range: receive maximum credit
  - Phase-out: credit is phased out at a flat rate
EITC Benefit Structure: Single mothers

- Substantially larger credit for families with 2+ children

earnings income vs credit amount

- Phase in Region
- Flat Region
- Phase out Region

- Poverty line, mom, one-kid
- Poverty line, mom, two-kids

Credit Amount (2006$)

Earned Income 2006$

One Child - Blue
Two or more Children - Red
EITC Benefit Structure: Married Couple Extensions and Credit for Childless

Subsidy rate 34%, 40%
Phase-out rate 16%, 21%

Married couple extensions
Childless

Earned Income (2007 $)

0 5,000 10,000 15,000 20,000 25,000 30,000 35,000 40,000
$0 $500 $1,000 $1,500 $2,000 $2,500 $3,000 $3,500 $4,000 $4,500 $5,000
Real EITC Benefits Increasing over Time (2+ children)
EITC Sensitivity: It’s about Kids!

- Until 2001, EITC parameters were identical for single and married filers.
  - EGTRRA extended flat/phase-out regions for married couples; now $3100 higher than for singles.
- Q: What’s the biggest source of sensitivity?
- A: Kids
Eligibility extends well into moderate earning ranges. Median household income for 2013 was about $52,000 (US Census Bureau, 2014).

EITC by Age for Recipient Households

Source: Figure 2a, Athreya, Reilly and Simpson (2010)
EITC by Age for Recipient Households, contd.

Source: Figure 2b, Athreya, Reilly and Simpson (2010)
Marginal Tax Rates with and without EITC
# Labor Market Characteristics of EITC Recipient vs. non-Recipient Households

<table>
<thead>
<tr>
<th></th>
<th>All</th>
<th>Married, no kids</th>
<th>Married, 1 kid</th>
<th>Married, 2+kids</th>
<th>Single, no kids</th>
<th>Single, 1 kid</th>
<th>Single, 2+kids</th>
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</thead>
<tbody>
<tr>
<td><strong>EITC Recipients:</strong></td>
<td></td>
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<tr>
<td>Mean Household</td>
<td>$15,194</td>
<td>$8,325</td>
<td>$18,700</td>
<td>$21,212</td>
<td>$7,024</td>
<td>$15,761</td>
<td>$17,421</td>
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<tr>
<td>Income</td>
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<tr>
<td>Average EITC</td>
<td>$1,782</td>
<td>$495</td>
<td>$1,812</td>
<td>$2,623</td>
<td>$423</td>
<td>$1,808</td>
<td>$2,728</td>
</tr>
<tr>
<td>EITC as % of Income</td>
<td>11.7%</td>
<td>5.9%</td>
<td>9.7%</td>
<td><strong>12.4%</strong></td>
<td>6.0%</td>
<td>11.5%</td>
<td>15.7%</td>
</tr>
<tr>
<td><strong>Non-EITC Recipients:</strong></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean Household</td>
<td>$47,235</td>
<td>$68,549</td>
<td>$83,372</td>
<td>$94,271</td>
<td>$23,696</td>
<td>$32,125</td>
<td>$31,723</td>
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<tr>
<td>Income</td>
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</tbody>
</table>

Source: Table 4a, Athreya, Reilly and Simpson (2010)
# Assets, Debt and Net Worth of EITC Recipient vs. non-Recipient Households

<table>
<thead>
<tr>
<th></th>
<th>All</th>
<th>Married, no kids</th>
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<tr>
<td><strong>EITC Recipients:</strong></td>
<td></td>
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<tr>
<td>Mean Net Worth</td>
<td>$103,753</td>
<td>$284,403</td>
<td>$204,918</td>
<td>$118,468</td>
<td>$67,574</td>
<td>$56,102</td>
<td>$49,837</td>
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<tr>
<td>Mean Assets</td>
<td>$149,507</td>
<td>$359,963</td>
<td>$255,239</td>
<td>$179,050</td>
<td>$86,545</td>
<td>$89,365</td>
<td>$96,465</td>
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<tr>
<td>Mean Debt</td>
<td>$45,755</td>
<td>$75,560</td>
<td>$50,321</td>
<td>$60,582</td>
<td>$18,971</td>
<td>$33,263</td>
<td>$46,628</td>
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<tr>
<td><strong>Non-EITC Recipients:</strong></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Mean Net Worth</td>
<td>$580,245</td>
<td>$803,447</td>
<td>$621,345</td>
<td>$737,654</td>
<td>$275,437</td>
<td>$351,416</td>
<td>$223,309</td>
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<tr>
<td>Mean Assets</td>
<td>$708,564</td>
<td>$929,270</td>
<td>$790,176</td>
<td>$933,762</td>
<td>$334,930</td>
<td>$448,206</td>
<td>$296,280</td>
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<tr>
<td>Mean Debt</td>
<td>$128,319</td>
<td>$125,823</td>
<td>$168,830</td>
<td>$196,108</td>
<td>$59,493</td>
<td>$96,790</td>
<td>$72,971</td>
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</tbody>
</table>

Source: Table 5, Athreya, Reilly and Simpson (2010)
## Credit Constraints

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>St Dev</th>
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</thead>
<tbody>
<tr>
<td><strong>EITC Recipients:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bad credit</td>
<td>2.3%</td>
<td>0.3%</td>
</tr>
<tr>
<td>Credit card balance (2007 $)</td>
<td>$2,131</td>
<td>$140</td>
</tr>
<tr>
<td>Late payment for 60+ days</td>
<td>11.2%</td>
<td>0.6%</td>
</tr>
<tr>
<td>Has no checking account</td>
<td>27.9%</td>
<td>0.9%</td>
</tr>
<tr>
<td><strong>Non-EITC Recipients:</strong></td>
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<td></td>
</tr>
<tr>
<td>Bad credit</td>
<td>0.5%</td>
<td>0.1%</td>
</tr>
<tr>
<td>Credit card balance (2007 $)</td>
<td>$4,174</td>
<td>$91</td>
</tr>
<tr>
<td>Late payment for 60+ days</td>
<td>5.4%</td>
<td>0.2%</td>
</tr>
<tr>
<td>Has no checking account</td>
<td>7.0%</td>
<td>0.3%</td>
</tr>
</tbody>
</table>

Source: Table 7, Athreya, Reilly and Simpson (2010)
What Have Economists Learned About the effects of EITC?
What can we say about how EITC should work?

- In a one-earner household, the effect of the EITC on labor force participation is unambiguously positive, but:
  - The EITC may increase or decrease total household work hours!
  - Especially applies to “second” earner
Pros

- Directly increases the reward to working
- Keeps people connected to work
- Insures workers—more on this later
Cons

- Phase-out acts like a tax on work.
- Historically, about half of claimants have been in the phase-out region.
- Recent expansions have made this less problematic.
- Wage subsidies can discourage human capital.
What are the hurdles to learning about what the EITC is doing?

- **Problem:**
  - Never see the “counterfactual”!

- **Have to be clever:**
  - Natural experiments
  - Simulate artificial economies
The EITC’s Effect on Work

- The EITC
  - Does affect work hours!
  - Convinces people to enter workforce: single moms!
  - Does not change men’s work hours.
  - Seems to lead married women to leave work.

- This is because the EITC acts the same way as welfare from the perspective of the second earner.
  - Eissa and Hoynes (1998):
    - Married women in phase-out region are 2 percentage point (5 percent) less likely to work
    - If they work, work as much as 276 hours (20 percent) less annually!
Single moms are key...

Source: Eissa, Kleven and Kreiner (2008)
The EITC’s Effect on Poverty

- Earlier CEA studies: in late 1990s, the EITC removed 4.3 million individuals from poverty (Hotz and Scholz, 2003).
- More than 60% of EITC payments go to families below poverty line based on pre-EITC income (Hotz and Scholz, 2003).
EITC and Child Poverty

- Studies (e.g., Liebman, 1998) have found that EITC not critical for antipoverty. Why?
  - EITC aims to keep a household with a FULL-TIME worker out of poverty
  - Many poor kids in household without full-time worker
  - Only 40% of households with income equal to 1/2 of poverty line got EITC. (no elig. earnings + nonfiling)
Do the “right” people get EITC?

- EITC does seem to go to low-wage, high-hours workers, not high wage earners who choose to work limited hours. (Scholz, 1996)
- Using the SIPP, two-thirds of EITC payments go to workers with wages less that $6.43/hr. (Scholz, 1996).
- In 1990, 60% of EITC recipients worked more than 1500 hours (Liebman, 1998).
Distributional Consequences

- Between 1976 and 1996, the share of income to the lowest fifth in the US fell from 4.4% to 3.7% (Liebman, 1998).
- Liebman (1998) finds that, for families with children, the EITC offsets 29% of that decline.
Using Simulations (Chan 2013)

- Sets up and simulates model (what do I mean?)
- “Policy simulations reveal that the economy accounts for half of the increase in the labor supply of female heads of family between 1992 and 1999.”
- “Between 1992 and 1999, time limits and EITC explain 5.8 and 4.5 percent of the increase in employment and 16.0 and 3.4 percent of the decline in welfare participation, respectively.”
What do economists know about what people know about the EITC?

- All that economists say about the effects that EITC “should” have is premised on workers knowing:
  - About the EITC
  - How to use it, and get it.
- Practitioners have long recognized that it takes work to get the word out.
Chetty, Friedman, Saez (2013)

- Very interesting use of special IRS Optimal use of EITC means self-employed people (especially) should “bunch” at the income level that maximizes EITC payouts
- But this is not seen: people vary
- But: people who move to areas where more bunching is happening tend to bunch more!
- Bunching getting sharper and more widespread over time! Outreach working?!
The EITC as an “Insurance” program

- The structure of the EITC is set up to provide insurance against productivity loss. (Athreya, Reilly, Simpson 2014).

- Why?
  - Keeps wage fluctuations from being passed through
  - Benefits workers no matter what the source of the wage fluctuation is.
  - Sensitivity to kids “insures” against dependent composition changes
Open Questions/Issues

- How does EITC fit into overall tax/transfers schemes?
- What should we be trying to get low-market-productivity individuals to do?
- EITC discouraging human capital accumulation?
Open Questions/Issues, contd.

- “Big picture” tradeoff: low level of no-questions asked assistance vs. high level of targeted assistance
  - US shifting towards the latter (PRWORA, especially)
- Job matching: ideally, paying single moms facing low wages to work may have costs
  - Depends on substitute opportunities—attaching strings sounds good, but it might be inefficient relative to other ways to help this group.