

THE STRENGTHS AND LIMITS OF THE EARNED INCOME TAX CREDIT AS A TOOL TO FIGHT POVERTY

by Daniel S. Feder, Yale University

Over the past two decades, a wage subsidy operating through the tax system called the Earned Income Tax Credit has developed into America's biggest program specifically dedicated to lifting low-income citizens out of poverty. Many Republicans as well as Democrats support this tax subsidy, which goes to people who work for modest wages. The extra money helps to reduce deprivation among poor families with children – something liberals very much want to do – yet it is the opposite of the sort of no-strings-attached “handout” that conservatives often decry.

As a tool to reduce poverty, the Earned Income Tax credit has a lot going for it. But it also has important limitations. The credit can be improved, and other programs are needed to help poor people find and hold jobs.

How the Earned Income Tax Credit Fights Poverty

The Earned Income Tax Credit is designed as a “refundable tax credit,” meaning that it comes as a payment to low-income workers who file income tax returns even if they earn too little that year to owe an income tax payment. The credit has different terms depending on an earner's marital status and number of children. In 2012, the largest credit, for families with three or more children, is worth \$5,891. Although the credit tails off as earnings rise, families earning up to \$45,060 (\$50,270 if married and filing jointly) receive some benefit from the program.

Between 2006 and 2010, the “median” – or typical, middling – American household income was \$51,914, so it is clear that many families in the lower and lower middle classes get at least a little help from the Earned Income Tax Credit. Some families use the income as a regular supplement to help buy necessities; others claim it in a lump sum at tax time and use it to pay for a big expense like fixing the family car or buying new winter coats for children.

According to the most recent U.S. Census report on poverty, only Social Security reduces America's poverty rate by more than the Earned Income Tax Credit. The credit was bolstered both in the 2009 stimulus bill and again in the late 2010 budget negotiations, helping to buffer millions of low-income Americans from the devastation of the recent Great Recession.

Why Men Have Not Benefitted Much

The credit is one of just a handful of federal programs that offers any aid to poor childless adults who work. But it offers very little to them – a maximum of \$475 in 2012. After 1996, welfare in the United States switched from cash benefits to programs that require and encourage paid work; this shift was accompanied by expansions in the Earned Income Tax Credit. Most of the boost in income for employed poor people went to women, especially poor single mothers who had previously qualified for welfare. Poor men with or without children have not gained as much. In

fact, childless male workers whose wages hover near the poverty line actually end up paying more in federal taxes than they get back from the Earned Income Tax Credit.

There are proposals to expand the federal credit for childless workers, many of whom are actually noncustodial fathers who pay child support. Those payments can propel them further into poverty, creating a disincentive to work that an expanded tax credit could help to correct. New York State and Washington, D.C. have instituted larger credits for non-custodial parents who are up to date on child support payments they owe. Other proposals would simply cover all individual workers equally, whether or not they have children.

What If Jobs are Not Available – Or Pay Too Little?

Another shortcoming of the Earned Income Tax Credit is that it depends on jobs being available for poor adults to take and hold. But sometimes, the jobs are simply not there; during the past four years, for instance, the drop in nonfarm payrolls has been steeper and longer lasting than in any other recession and recovery since the 1970s. In fact, the neediest would-be workers are the hardest hit by a lack of jobs. According to researchers at the Center for Labor Market Studies at Northeastern University, at the height of the recession in late 2009, unemployment in households in the lowest tenth of all 2008 income earners skyrocketed to a level nearly ten times higher than job losses for households in the top tenth. Obviously, if jobs are not available for those most in need of wage subsidies, the Earned Income Tax Credit cannot help.

Even in better economic times, to be sure, low-earners may only be able to get temporary, menial jobs that offer poor wages, no benefits, and no prospect for advancement. Even if the Earned Income Tax Credit increases a bit each year, such workers may be stuck trading water at best.

Some studies suggest that poor women with children who entered the workforce in the 1990s and received credits have continued to do relatively well. But childless workers may not have gained as much. And the Earned Income Tax Credit may limit wage progress for some poor workers if their employers take advantage of the credit as an excuse to limit wage hikes. Fortunately, there are obstacles to this kind of abuse – employers do not necessarily know which workers have applied for and received the credit, and which have not.

A Good Start – But We Must Do More

Income-support programs like the Earned Income Tax Credit are a key component of America's overall effort to mitigate poverty. Work-based programs boast bipartisan support and reinforce the high value all Americans place on making one's own way through work. Nevertheless, if our society wants to reduce poverty for all citizens, more must be done. Workers without children at home get very little help right now, even if they are contributing to the support of children. And many young workers just starting out in the labor force may not be able to find jobs or hold them in weak labor markets.

To allow the Earned Income Tax Credit to do its job, we must help prospective workers find suitable jobs, reduce the expenses and difficulties associated with holding low-wage jobs, and offer training for future positions when current jobs are not available or offer too little in wages and prospects for advancement. Wage subsidies are an important part of fighting poverty in the United States, but they are not a panacea. They cannot do the job alone.