Introduction

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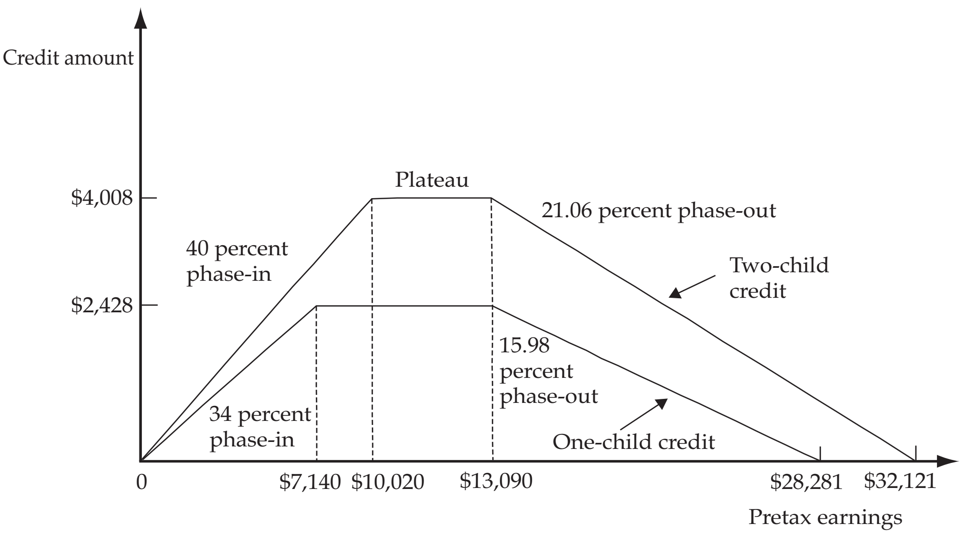
Since its inception in 1975, the federal Earned Income Tax Credit (EITC) has grown dramatically in size, and it is now the largest antipoverty program for the nonaged in the United States. In 1998, 19.7 million families received EITC payments totaling $31.6 billion. As a result, in 1999 the EITC lifted 3.7 million individuals above the poverty line. In addition to directly raising incomes, the EITC has sharply changed work incentives, increasing the after-tax wage by up to 40 percent for those with low earnings. Since the credit is refundable, a person without a tax liability receives it as a payment that, by 2001, could exceed $4,000.

The rapid growth in the EITC in the 1990s left researchers with the challenge of understanding its impact. This book constitutes a large share of the recent efforts, with chapters examining the history of the EITC, its effects on work and marriage, and how the credit is used by recipients. These studies also describe problems with noncompliance and marriage penalties and evaluate the implications of potential changes to the credit.

WHO RECEIVES THE EARNED INCOME TAX CREDIT

The EITC provides an earnings subsidy to family members who satisfy three criteria. First, a family must have a wage earner, since only those who work are eligible. Second, the family must have low income. In 2001, a family with one child could receive the EITC if its income was below $28,281, while a family with two children could earn up to $32,121 and receive the credit. Third, while a small EITC (up to $364 in 2001) is available to the childless, to receive a significant EITC a family has to have children. The maximum credit for a family with one child was $2,428 in 2001, while that for a family with two or more children was $4,008. Since the EITC is refundable, a family can receive the credit even if they do not have an income tax liability. In the vast majority of cases, the credit is received as a lump sum as part of a tax refund early the following year. In summary, the credit subsidizes work by poor parents as it transfers income to them.

FIGURE I.1 / Federal Earned Income Tax Credit Schedule for Families With Children, 2001



Source: Authors' configuration.

The EITC schedule for families with children in 2001 is illustrated in figure I.1. The schedule for families with two or more children (represented by the upper line) provides a larger credit at all income levels than that for families with only one child (the lower line). Both schedules provide a large earnings subsidy initially as the credit is phased in: forty cents for each dollar earned for the first $10,020 in earnings for those with two or more children. For example, a single mother with two children who earned $10,000 in the previous year would receive a credit of $4,000. At the flat part of the schedule, the plateau, the total credit received does not change with earnings. With additional earnings beyond the plateau, however, the credit is decreased, resulting in an implicit tax on earnings at a rate just over 21 percent for those with two or more children. For those with one child there are somewhat lower earnings subsidies, credits, and implicit taxes.

To paint a statistical portrait of recipients, we examine their characteristics from several angles and with two data sets. The two sources of data do not perfectly agree, but they lead to roughly similar conclusions. Table I.1 is calculated from the Current Population Survey (CPS), the largest in-depth survey of the economic status of American households.[1] The table shows that a majority of EITC dollars go to single mothers. Adding in single fathers, one can see that 60 percent of EITC dollars go to single parents. Since poor families with children are disproportionately headed by single parents, such families receive the preponderance of EITC payments. The vast majority of remaining dollars go to married couples with children, who receive 37 percent of the credit dollars. While a substantial number of recipient couples or individuals are childless (24

TABLE I.1 / EITC Benefits Received and Number of Recipients, by Family Type, 1999

Recipient Category	EITC (Millions)	Distribution of EITC (Percentage)	Average Benefit Received
Single women with children			
Total benefits	$12,138	52.95	$1,903
Number of recipients	6.379	39.41	
Single men with children			
Total benefits	$1,570	6.85	$1,701
Number of recipients	0.923	5.70	
Married couples with children			
Total benefits	$8,522	37.17	$1,682
Number of recipients	5.066	31.30	
Individuals without qualifying child			
Total benefits	$623	2.72	$184
Number of recipients	3.384	20.91	
Couples without qualifying child			
Total benefits	$72	0.31	$166
Number of recipients	0.435	2.69	
Total			
Total benefits	$22,926	100.00	$1,416
Number of recipients	16.187	100.00	

Source: Authors' calculations using the Current Population Survey, annual demographic file 2000. All numbers are weighted.

percent), they receive only 3 percent of the credit dollars. This concentration of 97 percent of EITC dollars in families with children reflects the program design that provides larger credits to these families.

The EITC is also targeted toward large families. Table I.2 reports total benefits received and the number of recipient families for families with different numbers of children. More than two-thirds of payments go to families with two or more children. Thirty-eight percent of dollars go to families with two children, while 27 percent of dollars go to families with three or more children.

Table I.3 reports descriptive information on the age, race, and education of recipients and the ages of their children. Single-mother EITC recipients are disproportionately young, less educated, and white. Their children are fairly evenly spread across the age ranges. Married mothers are slightly older, with even less education, more likely to be white, and have disproportionately young children. Recipients without children tend to be even older, but their other characteristics are similar to those with children.

While the CPS is the best source of detailed information on the characteristics of families receiving the EITC, data from the Internal Revenue Service (IRS) provide better information on numbers of recipients and credit amounts. Table I.4

TABLE I.2 / EITC Benefits Received and Number of Recipients, by Number of Children in Family, 1999

Recipient Category	EITC (Millions)	Distribution of EITC (Percentage)	Average Benefit Received
Recipients without a qualifying child			
Total benefits	$696	3.03	$182
Number of recipients	3.819	23.59	
Recipients with one qualifying child			
Total benefits	$7,300	31.84	$1,432
Number of recipients	5.096	31.48	
Recipients with two qualifying children			
Total benefits	$8,789	38.34	$2,046
Number of recipients	4.296	26.54	
Recipients with more than two qualifying children			
Total benefits	$6,141	26.79	$2,064
Number of recipients	2.976	18.38	
Total			
Total benefits	$22,926	100.00	$1,416
Number of recipients	16.187	100.00	

Source: Authors' calculations using the Current Population Survey, annual demographic file 2000. All numbers are weighted.

TABLE I.3 / Demographic Characteristics of EITC Recipients, 1999

	With Children		Without Children	
Recipient Characteristic	Single	Married	Single	Married
Average age (years)	34.839	37.432	40.458	56.055
Educational attainment (percentage)				
High school dropout	23.1	36.3	26.9	37.7
High school graduate	40.5	35.2	37.6	37.7
Some college	30.2	20.4	22.8	16.5
College graduate	06.1	08.1	12.7	08.1
Black (percentage)	24.0	07.7	15.4	07.6
Average number of children, by age				
0 to five years old	0.506	0.725	—	—
Six to seventeen years old	1.051	1.248	—	—
Total	1.557	1.974	—	—

Source: Authors' calculations using the Current Population Survey, annual demographic file 2000. All numbers are weighted.

TABLE I.4 / EITC Benefits and Number of Recipients, 1998, Comparisons of IRS Data to CPS Data

	IRS		CPS		
Recipient Characteristic	EITC (Millions)	Distribution of EITC (Percentage)	EITC (Millions)	Distribution of Credit (Percentage)	Ratio (CPS $EITC / IRS $EITC)
By filing status of recipient					
Head of household					
Total benefits	$21,215	67.15	$13,634	59.94	0.64
Number of recipients	10.42	52.88	7.318	45.00	0.70
Joint					
Total benefits	$9,683	30.65	$8,532	37.51	0.88
Number of recipients	5.73	29.10	5.589	34.37	0.97
Single					
Total benefits	$694	2.20	$581	2.55	0.84
Number of recipients	3.549	18.01	3.357	20.64	0.95
Total					
Total benefits	$31,592	100.00	$22,747	100.00	0.72
Number of recipients	19.71	100.00	16.264	100.00	0.83
By number of qualifying children					
Returns without a qualifying child					
Total benefits	$694	2.20	672	2.95	0.97
Number of recipients	3.549	18.01	3.894	23.94	1.10
Returns with one qualifying child					
Total benefits	$11,818	37.41	$6,860	30.16	0.58
Number of recipients	7.803	39.60	4.949	30.43	0.63
Returns with more than one qualifying child					
Total benefits	$19,080	60.40	$15,215	66.89	0.80
Number of recipients	8.353	42.39	7.421	45.63	0.89
Total					
Total benefits	$31,592	100.00	$22,747	100.00	0.72
Number of recipients	19.705	100.00	16.264	100.00	0.83

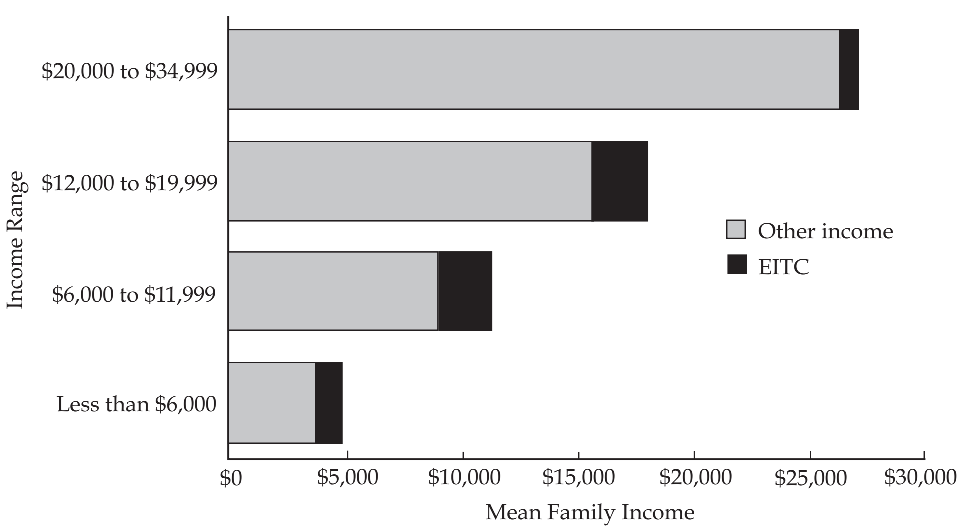
Source: Authors' calculations using data from Current Population Survey, annual demographic file 1999; IRS 2000, figure H; U.S. House 1998, table 13-13.

provides a less detailed breakdown of the characteristics of EITC recipients and compares CPS and IRS data.[2] The IRS data indicate that an even larger share of EITC dollars go to single parents (those filing as heads of households): 67 percent of all payments in 1998. Almost all of the remaining dollars go to married couples, who receive 31 percent of all payments. Again, families with more than one child receive most of the credit dollars, but the IRS data indicate that they receive 60 percent of payments, a somewhat lower share than that indicated by the CPS. Overall, we can see from table I.4 that the IRS paid out $31.6 billion dollars under the EITC in 1998.[3]

HOW THE EITC AFFECTS THE DISTRIBUTION OF INCOME

Because its effect on the income distribution is among the most important consequences of the EITC, we provide a brief description of the distributional effects of the credit.[4] Figure I.2 reports mean income with and without the EITC for single parents in various income groups. For those with incomes under $6,000, the EITC raises average income by about 30 percent. For those with incomes between $6,000 and $12,000, the increase in mean income is about 25 percent. Together, these two income groups include 23 percent of families with children that are headed by a single parent. For single-parent families with incomes between $12,000 and $20,000, the EITC raises mean income by between 3 and 4 percent. For other income groups the effects are smaller, with little discernible effect on the incomes of those with pretax income of more than $35,000. In short,

FIGURE I.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 goes primarily to very low-income single parents, and it amounts to a large share of the resources this group has available to consume.[5]

A second way to gauge the distributional effects of the EITC is to ask how many people it raises above the poverty line or other target income levels. As shown in table I.5, in 1999 the EITC lifted almost 1.0 million families with more than 2.0 million children above the poverty line.[6] The credit lifted 3.7 million people above the poverty line, reducing the overall poverty rate by 13 percent and the poverty rate among children by 21 percent. While no other antipoverty program approaches these poverty-reduction numbers, one caution is that the effects of the EITC are concentrated around the poverty line (see Liebman 1998). Table I.5 also shows that the number of families or children below other target levels, such as 50 percent of the poverty line or 200 percent of the poverty line, is also sharply reduced by the EITC, although the largest effects occur around the poverty line itself. Other programs such as Temporary Assistance for Needy Families or the Food Stamps program are targeted more toward those with the very lowest incomes.

THE COVERAGE OF THIS BOOK

The chapters of this book cover four broad areas of interest. One chapter outlines the history of the EITC and examines how research has informed the political debate regarding its expansion. Four studies examine the extent of work and marriage incentives inherent in the EITC and how tax policy could be altered in light of these incentives. Two chapters address whether the tax credit goes to its intended recipients and examine the extent of noncompliance in the EITC. Finally, three studies identify how EITC recipients view the credit and what types of expenditures are made with the funds.

The History of the Earned Income Tax Credit

In chapter 1, Dennis J. Ventry Jr. outlines the emergence of the EITC from the political debates surrounding failed-negative-income tax and guaranteed-annual-income proposals during the Nixon administration. He describes how forces coalesced around an antipoverty program that was perceived as pro-work, pro-growth, and low cost. These forces led to the introduction of the Earned Income Tax Credit in 1975, fostered its expansion though the 1980s and early 1990s, and came to its defense in the late 1990s.

Work and Marriage Incentives

Owing to the design of the EITC, with its combination of work subsidies and implicit taxes for families with children and low earnings, incentives to work

TABLE I.5 / Number of Families, Individuals, and Children in Poverty With and Without the EITC, 1999 (In Thousands)

Recipient Income Level	Without EITC	With EITC	Difference (Without EITC − With EITC)	Ratio (Without EITC / With EITC)
Families				
Below 50 percent of poverty line	2,621.67	2,332.72	288.94	1.12
Below 75 percent of poverty line	4,486.47	3,762.89	723.59	1.19
Below the poverty line	6,675.82	5,694.26	981.56	1.17
Below 150 percent of poverty line	12,259.67	11,357.94	901.73	1.08
Below 200 percent of poverty line	18,166.54	17,891.13	275.42	1.02
Individuals				
Below 50 percent of poverty line	13,146.44	12,024.81	1,121.63	1.09
Below 75 percent of poverty line	21,797.60	18,866.13	2,931.46	1.16
Below the poverty line	32,302.25	28,574.93	3,727.32	1.13
Below 150 percent of poverty line	56,975.27	53,889.70	3,085.57	1.06
Below 200 percent of poverty line	81,490.25	80,452.91	1,037.34	1.01
Children under the age of eighteen				
Below 50 percent of poverty line	4,659.60	4,004.55	655.05	1.16
Below 75 percent of poverty line	8,055.56	6,390.59	1,664.97	1.26
Below the poverty line	11,607.58	9,567.64	2,039.94	1.21
Below 150 percent of poverty line	19,503.70	18,001.90	1,501.81	1.08
Below 200 percent of poverty line	26,842.22	26,382.19	460.02	1.02

Source: Authors' calculations using the Current Population Survey, annual demographic file 2000. All numbers are weighted.
Note: The poverty line refers to the standard measure reported by the U.S. Census Bureau. Calculations based on money income of families and individuals before taxes (excluding capital gains).

and marry are altered. In chapter 2, Bruce D. Meyer and Dan T. Rosenbaum put the EITC's work incentives in the larger context of recent tax and welfare program changes that have promoted work. The authors show that the EITC was the most important change in work incentives for single mothers from 1984 to 1996, during which period the employment rate of single mothers rose sharply. The authors then compare employment rates of groups affected by the EITC and other policies and conclude that recent EITC expansions have led to a large increase in the labor force participation of single mothers.

David T. Ellwood, in chapter 3, examines the effects of the EITC on the employment of single and married women and on marriage and living arrangements. He argues that welfare reform and a strong economy, in combination with the EITC, have been responsible for the unprecedented recent increase in the employment of single mothers. Ellwood concludes that social policy changes have had a dramatic impact on the labor force participation of low-income single parents but that the EITC also has dampened the increase in work by low-wage married parents. He also considers the possible effect of the EITC and other social policy changes on marriage behavior, finding little effect of these policies on marriage patterns.

Further focusing on the marriage penalties and bonuses created by the EITC, Janet Holtzblatt and Robert Rebelein, in chapter 4, measure the prevalence and magnitude of EITC marriage penalties and bonuses and consider the effects of possible reform proposals. They show how measures of penalties are sensitive to assumptions regarding income, living arrangements, and child custody agreements if a couple were not married. Their preferred approach indicates that on net the EITC increases marriage penalties by approximately $3.5 billion. They then show how various reform proposals differ in their targeting of low-income taxpayers and their reduction in marriage penalties. They find that a two-earner deduction is the best targeted of these proposals but that it is somewhat more complicated than the alternatives.

These early chapters focus largely on the EITC in its current form and study its effects on labor supply and marriage. In chapter 5, Jeffrey B. Liebman examines what would be the optimal level of the maximum credit, the phase-in rate, and the phase-out rate. Taking into account the increased work and reduced welfare receipt that occurs as a result of the EITC, he finds lower efficiency costs of the EITC than past authors. While he finds that optimal parameters depend crucially on society's taste for redistribution, the results suggest that a credit close to the current EITC is optimal.

Compliance Problems

In addition to concerns about work and marriage disincentives embodied in the EITC, some policymakers are also concerned about what they consider a high incidence of "cheating" on taxes by people who claim the credit. Chapters 6 and 7 address this issue and examine more closely who wrongly claims the EITC and how such noncompliance can be prevented.

In chapter 6, Janet McCubbin uses U.S. Treasury tax data to estimate a model of noncompliance. McCubbin finds that reducing the size of the EITC would have only a modest effect in decreasing the EITC error rate. She suggests other methods of improving noncompliance, including simplifying eligibility requirements for qualifying children, tightening social security number requirements for claiming a child, and adding new penalties.

Jeffrey B. Liebman, in chapter 7, also examines EITC noncompliance. Liebman reports that according to IRS tabulations from the 1980s, one-third of EITC recipients were not eligible for the credit, primarily because they did not have eligible children. Using household survey data matched to 1990 tax returns, Liebman finds that overall, between 11 and 13 percent of EITC recipients had no children in their households when they claimed the credit (in 1990 there was no credit for the childless). He also finds that a large share of overpayments went to low-income families with children.

How Recipients Use Their Credit

The remaining chapters turn to a final question: how do recipients use their EITC dollars? For many EITC recipients, the tax refund check constitutes a large part of their annual income. Three chapters address how this "lumpiness" in their income affects EITC recipients.

In chapter 8, Timothy M. Smeeding, Katherin Ross Phillips and Michael O'Connor examine a large sample of individuals filing 1997 income tax returns in Chicago. Most EITC recipients, they argue, expect to receive a tax refund. These recipients plan to use their credit for purposes that extend beyond current consumption, including savings, car purchases, tuition payments, residential moves, and other uses that lead to economic and social mobility. They also find that families with more children are more likely to use the credit for current consumption. The authors conclude that the EITC does more than increase consumption; it also allows recipients to make changes in economic status.

In contrast with social programs that pay benefits evenly over the year, the vast majority of EITC recipients receive their benefits in a single check averaging more than $1,500. In chapter 9, Lisa Barrow and Leslie McGranahan ask whether the lumpy nature of EITC payments induces changes in expenditure patterns among recipients. This issue is particularly important given recent congressional proposals to alter the timing of EITC payments. Barrow and McGranahan find that consumption rises, particularly for durable goods, in the months in which EITC refunds are received. Thus, the evidence suggests that the EITC facilitates the purchase of big-ticket items by low-income families.

In chapter 10, Jennifer Romich and Thomas Weisner examine how low-income participants in Milwaukee's New Hope Project have perceived and used the EITC. They find that the families generally know about the EITC and other programs. Still they do not know much about how to receive the EITC on a monthly basis rather than as a single lump-sum payment—or they choose not to do so. Romich and Weisner also find that recipients use their refund checks for such things as furniture, transportation, housing, and savings. They conclude that families use the lump-sum delivery as a form of forced savings and that the lump-sum option enables families to save for asset purchases.

Taken together, the studies in this volume provide a broad summary of the state of knowledge on the Earned Income Tax Credit. They describe a large program that appears to have mostly favorable incentive effects and is used for valuable purposes by its recipients. They assess the degree of noncompliance, discuss how it has changed, and put it in perspective relative to other programs. Finally, the studies provide directions for future efforts to explore the effects of the EITC and improve its design.

NOTES

1. The CPS imputes EITC receipt using family composition and income information and an algorithm that is checked against IRS records. One might reasonably suppose that the CPS overstates EITC receipt since the algorithm assumes that all eligible recipients receive the credit. However, comparisons of CPS and IRS data suggest that the CPS sharply understates receipt, particularly for single parents.
2. The CPS numbers here are slightly different from those in table I.2 because 1998 data are used, to allow comparability with the IRS numbers.
3. For total EITC payments as well as dollars received by single parents or those with one child, the IRS numbers are substantially larger than comparable CPS numbers. These discrepancies suggest substantial EITC noncompliance, an issue discussed in two of the chapters in this volume. These discrepancies also potentially raise questions about the CPS coverage of low-income groups.
4. For earlier discussions of the effects of the EITC on the distribution of income, see Hoffman and Seidman 1990, Burkhauser, Couch, and Glenn 1996, Liebman 1998, and Hotz and Scholz 2001.
5. See also Hotz and Scholz 2001, especially figure 3, which shows that EITC payments are primarily received by those with incomes between $5,000 and $20,000.
6. It should be emphasized that these calculations are made under the assumption that the EITC has no effect on pretax income or family formation, both of which assumptions are challenged in the chapters of this book. Nevertheless, the direct effect of the transfers on incomes are probably much larger than effects through earnings and marriage, making these descriptions useful.

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