The Earned Income Tax Credit and
the Need to Synchronize Public Assistance Benefits

by

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During the 1992 presidential campaign, candidate Bill Clinton made it clear that those who played by the rules and worked shouldn't live in poverty. As president, he introduced legislation, and Congress passed it in the Omnibus Budget Reconciliation Act of 1993 (OBRA 93), intended to assist the poor through the expansion of the Earned Income Tax Credit (EITC). Essentially, working households with children receive a credit to offset payroll taxes, and if they owe no taxes they receive a check for the difference. Because the EITC is refundable, government is effectively in the business of subsidizing low-wage labor. Although it doesn't entail social spending as we commonly think of it, it is nonetheless a maintenance program, involving the expenditure of tax revenues. The Office of Management and Budget puts the cost at close to 16 billion dollars by 1995, and some estimates place the figure at around 22 billion in 1995. When 0BRA93 is fully phased-in in 1996, with the maximum credit equalling $3370 for families with two children, $2040 for those with only one eligible child, and $382.50 for those with no children, the cost is estimated to be $24.5 billion.' In this regard, it is no different from any other social program, and thus warrants the same type of scrutiny as do others. Given that Clinton's expansion will in effect double the EITC budget by 1996, the question of concern in this paper is whether it justifies the cost. Is it a worthwhile a program? As much as this is a subjective question, the evidence would seem to suggest that the EITC has differing effects on

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[1] these are figures drawn from the Joint Tax Committee

different groups of people. As easy as it is to ask whether it justifies the cost, the real question *is* just whom would derive the greatest benefit and whether it serves those most in need. Through a disaggregation of income data, I will show that the EITC could be of tremendous benefit to specific subpopulations, which isn't the same as saying it is cost-effective. But at the same time, those who would derive the greatest benefit also overlap with those participating in the major public assistance programs. Given that there are target groups who would serve as appropriate focal points for general assistance, including welfare reform, the EITC may need to be restructured. What should ultimately become clear is that as difficult as it may be to measure the effectiveness of EITC relative to its cost, a cut in EITC, or even its elimination, would disproportionately hurt already vulnerable groups in American society. But that, in and of itself, isn't a reason to maintain it if its effectiveness is questionable. Rather, the concept of the EITC could be a very effective approach to welfare reform if it and the other public assistance programs are synchronized.

Why EITC?

The reasons for the EITC are twofold. First, during the 1992 presidential campaign, then candidate Bill Clinton made it a central theme that nobody working full-time, and "playing by the rules" should be "poor."[2] About six months after taking office, President Clinton unveiled his plan to expand the EITC as part of his overall economic plan, and in so doing alluded to the second reason for the expansion, welfare reform. By raising the EITC, the president hopes to

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[2] See "The Earned Income Credit -- Integrating Tax & Welfare Provisions," *Tax Policy Notes No.* **7** (July 1994)

reward those who work and offer an incentive to those who do not. As the president announced, "a pivotal part" of his economic plan was "the earned income tax credit which, more than anything else we could do, will reward work and family and responsibility and make a major down payment on welfare reform." More importantly, one working forty hours a week with children at home would be able to say s/he was lifted out of poverty.[3] The president only echoed the same theme when in March 1994, he said: "The earned income tax credit is an important symbol of the core commitment of this administration to promote the values of work and family and community, and to help people who work hard and play by the rules."[4]

As an income maintenance program, EITC enjoys broad support among both liberals and conservatives. Liberals view the EITC as a supplement to, and not a replacement of, welfare. They also see it as a complement to a relatively low minimum wage. Conservatives, however, view the EITC as a replacement for welfare for the nonelderly and able-bodied. In lines with their traditional distinction between the "worthy" and "unworthy" poor, they believe that the working poor are generally more worthy and deserving than the nonworking, nonelderly, and able-bodied poor. As the worthy poor should be assisted, and even rewarded, the financing for EITC should come at the expense of welfare.[5] Conservatives also view it as a means of subsidizing low income labor without having to raise minimum wages. Burkhauser and Glenn,

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[3] "Remarks by the President at the Earned Income Tax Credit Event," The White House, Office of the Press Secretary (July 29, 1993)

[4] "Remarks by the President in Announcement of Advance Earned Income Tax Credit for Federal Employees," The White House, Office of the Press Secretary (March 9, 1994)

[5] See Saul D. Hoffman & Laurence S. Seidman, The *Earned Income Tax Credit: Antipoverty Effectiveness and Labor Market Effects* (Kalamazoo, MI; W.E. Upjohn Institute for Employment Research, 1990)

for instance, hold that the advent of EITC ultimately makes advocates of increasing minimum wages as the means of helping children of the working poor guilty of social policy malpractice. Minorities were not overwhelmingly helped by the minimum wage boost in 1989. Only 15% of gains went to blacks and only 6% went to blacks living in poverty. For every dollar going to a poor black worker living in poverty, more than five dollars went to upper income non-blacks. As they see it, the EITC is a superior mechanism for raising the "minimum wage" for those in lower income households without directly affecting the wages of those in higher income households. On the contrary, raising minimum wages would be a costly policy, with most rewards being captured by non-poor households. For very low income workers, the EITC is likely to increase their desire to work since it supplements private wages with a government credit.[6] But as we will see later, it isn't entirely clear that the EITC as it is currently structured, especially when interacting with other programs, does any better in targeting the poor population than have previous programs.

Mechanics

The EITC was introduced in 1975 as a means of offsetting the social security payroll tax for low-income taxpayers. For those at the low end of the income scale, EITC was intended to improve incentives to work. It was part of the 1975 Tax Reduction Act. The economy at the time was experiencing its steepest decline since the 1930s, with unemployment standing at 8.2% Although budgeted expenditures for EITC were only $1.5 billion, they were part of a $29.2

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[6] Richard V. Burkhauser and Andrew J. Glenn, ***Public Policies for the Working Poor: The Earned Income Tax Credit vs. Minimum Wage Legislation*** (Washington, Employment Policies Institute, 1994

billion program to stimulate the economy. The original bill also emphasized the need to assist low-income wage earners severely affected by rapidly rising food and energy costs.[7] But it was also seen as being part of a longer history of welfare reform efforts. Because the EITC is the only program to assist the poor nationwide, it was also considered to be a means of reducing whatever inequities arose in coverage from other public assistance programs due to disparities between the states.' Over the years, EITC has been expanded to keep up with inflation. The first major expansion of EITC occurred with the Omnibus Budget Reconciliation Act of 1990 (OBRA 90), which substantially increased the size of the credit and added provisions for larger families. It is worth noting that this expansion was actually proposed by the Carter administration as part of its welfare reform efforts in 1977.[9] These provisions granted larger credits to households with more than one child, households with a child less than one year old, and those households which paid for health insurance covering a qualifying child. OBRA 90 was also intended to increase the progressivity of the overall federal tax system." Then the credit was expanded even further in OBRA 93. Originally the credit was equal to 10% of the first **4000** dollars of earned income. Below is a table from the General Accounting Office illustrating the parameters of EITC from 1975 to 1994.

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[7] Colin D. Campbell & William L. Peirce, The *Earned* Income **Tax Credit** (Washington, American Enterprise Institute, 1980)

[8] Wayne Lee Hoffman, The **Earned Income Tax Credit:** *Welfare* **Reform or** *Tax* **Relief? An Analysis of Alternative Proposals** (Washington, The Urban Institute, 1978)

[9] See Wayne Hoffman, The **Earned Income Tax Credit**

[10] U.S. General Accounting Office, **Tax Policy: Earned Income Tax Credit: Design and Administration Could be Improved** (Washington, GAO, September 1993)

Table I

Years	Credit Rate	Minimum income for maximum credit	Maximum credit	Earned income Phase-out rate	phase-out range
1975-78	10.0%	$4,000	$400	10.00%	$4,000-8,000
1979-84	10.0	5,000	500	12.50	6,000-l 0,000
1985-86	11.0	5,000	550	12.22	6,500-l 1,000
1987	14.0	6,075	851	10.00	6,925-l 5,432
1988	14.0	6,225	874	10.00	9,850-l 8,576
1989	14.0	6,500	910	10.00	10.250-19,340
1990	14.0	6,800	953	10.00	10,750-20,264
1991	16.7	7,100	1,192	11.93	11,250-21,250
1992	17.6	7,500	1,324	12.57	11,850-22,370
1993	18.5	7,750	1,434	13.21	12,220-23,050
1994	23.0	8,030	1,846	16.43	12,650-23,890

these figures assume a household with only one qualifying child. The final projection for 1994 is based on OBRA 90.[11]

Under OBRA 93, the credit will be equal to 40% of the first 8,425 dollars of earned income for families with two or more children. For those with only one child, the credit phases in at 34% of the first 6,000 dollars of earned income. So by 1996, the credit for household with two eligible children will be $3370 and $2040 for households with only one. The Congressional Budget Office has in fact put the credit, when indexed to inflation, at $3,560 for taxpayers with adjusted gross incomes of up to about $11,600.[12] The effects of the increase can be seen below in table II.

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[11] table comes from GAO, *Tax Policy: Earned Income Tax Credit,* p. 16

[12] The Congress of the United States Congressional Budget Office, *Reducing Entitlement Spending* (Washington, Government Printing Office, 1994)

Table II EITC parameters under prior law (OBRA 90) and OBRA 93

| | Credit Rate | Flat Range | | Maximum Credit | Phaseout Range | |
		Beginning Income	Ending Income		Phaseout Rate	Income Cutoff
Prior Law						
1990 (1990 $)						
All taxpayers	14%	$6,810	$10,730	$953	10%	*$20,264*
1993 (1993 $)						
1 qualified child	18.5	7,750	12,200	1,434	13.2	*23,050*
2+ children	19.5	7,750	12,200	1,511	13.93	*23,050*
Young child	5	7,750	12,200	388	3.57	*23,050*
Health Credit	6	7,750	12,200	465	4.285	*23,050*
1994 and after						
1 qualified child	*23*	*7,990*	*12,680*	*1,838*	16.43	*23,760*
2+ children	*25*	*7,990*	*12,680*	*1,998*	17.86	*23,760*
Young child	*5*	*7,990*	*12,680*	*400*	3.67	*23,760*
Health credit	*6*	*7,990*	*12,680*	*479*	4.285	*23,760*
Omnibus Budget Reconciliation Act of 1993 (OBRA 93)						
1994						
1 child	26.3	7,750	11,000	2,038	15.98	*23,760*
2+ children	30.0	8,425	11,000	2,528	17.68	*25,300*
No children	7.65	4,000	5,000	306	7.65	*9,000*
1995						
1 child	34.0	6,000	11,000	2,040	15.98	*23,760*
2+ children	36.0	8,425	11,000	3,033	22.22	*26,000*
No children	7.65	4,000	5,000	306	7.65	*9,000*
1996 and beyond						
1 child	34.0	6,000	11,000	2,040	15.98	*23,760*
2+ children	40.0	8,425	11,000	3,370	21.06	*27,000*
No children	7.65	4,000	5,000	306	7.65	*9,000*
1996 indexed to Inflation						
1 child	34.0	6,160	11,290	2,094	15.98	*24,395*
2+ children	40.0	8,900	11,620	3,560	21.06	*28,524* [13]

[13] this table was reproduced with slight modification from John Karl Scholz, "The Earned Income Tax Credit: Participation, Compliance, and Antipoverty Effectiveness," *National Tax*

The EITC is a tax credit on the federal personal income tax. It enables eligible households to reduce the taxes they would otherwise pay. But unlike a negative income tax *or some* other type of minimum income floor, the EITC is completely dependent on household income, not the individual. And the household income is the determinant of the household's credit. Therefore, in order to receive the credit, one must work and one must file a tax return. Moreover, it is refundable. If the tax credit exceeds household tax liability, the government will pay the household the difference. The EITC operates through three ranges: the phase-in, the stationary range, and the phase-out. During the phase-in range when OBRA 93 is fully phased in, a household with two children will receive a credit equal to 40% until an income of 8,425 dollars per year. Upon achieving this income, they will receive the maximum credit of 3370 dollars. The maximum credit continues in what is called the stationary phase. Households earning between 8,425 and 11,000 dollars will receive the maximum credit. After 11,000 dollars, the EITC goes into what is regarded as the phase-out range. Households earning more than 11,000 dollars will have their credits reduced at a rate of 2 1.06% until their earned income reaches 27,000 dollars, at which time the credit will equal 0. This can be seen in the following graph below.
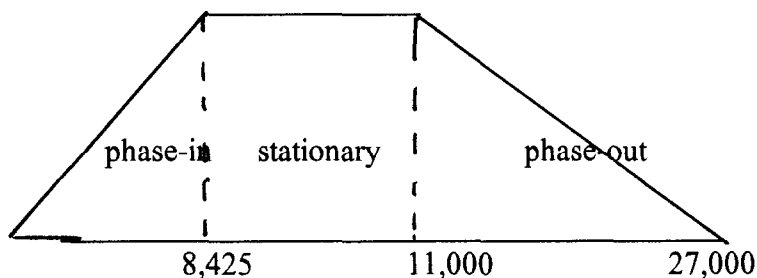
The EITC differs from other programs in that one has to have qualifying children, and *one* must have earned income. One has to work in order to enjoy the benefits of the credit. Recipients can either obtain their credit in one lump sum upon filing at the end of the year, or they can have their employers pay out the credit through regular payroll checks. This is an option which isn't widely known about. The General Accounting Office estimated that in 1989, less than 0.5% of those who received the EITC in 1989 received it in advance. The low participation rate was accounted for, in part, by the fact that many eligible workers and their employers simply weren't aware of the advance payment option. In a survey of 6 17 employers, the GAO found that 60% had no familiarity with either the credit or the advance payment option. Although the IRS, through its outreach efforts, did seek to publicize the credit, it did little to publicize the advance payment option.[14] Clinton attempted to publicize this by instructing federal agencies and departments to inform all federal employees who would qualify for the credit. Because the EITC requires filing a tax return, many people who are eligible for the credit may not be getting it. Many poor people who earn too little to pay taxes simply do not file returns. Hence they are not getting a credit they are otherwise entitled to. Figures on participation are, however, sketchy at best. Scholz, for instance, estimated that the participation rate for 1990 was **80-86%.** This meant that fewer than 2.1 million eligible taxpayers failed to receive the credit." And according to the Office of Tax Analysis of the Treasury Department, the number of filers who will benefit from EITC will reach 16 million by 1996. This represents an increase from the 13.7 million tilers in

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[14] U.S General Accounting Office, *Earned Income Tax Credit: Advance Payment Option is Not Widely Known or Understood by the Public* (Washington, GAO, February 1992)

[15] Scholz, "The Earned Income Tax Credit: Participation, Compliance, and Antipoverty Effectiveness"

1991. The number of filers between 1991 and 1996 can be seen in Table **III.**

Table III Filers for EITC

1991 13.7 million
1992 14.1 million
1993 14.5 million
1994 15.1 million
1995 15.5 million
1996 16.0 million

While the Office of Tax Analysis estimates that 16 million filers will receive the credit in 1996, the Congressional Budget Office estimates that more than 18 million will receive $23 billion dollars in EITC. $3 billion will be in reduced taxes, and $20 billion will be in refundable payments.[16] It should also be noted that in 1994, 4.4 million childless households filed for the credit as well." But the number of filers is less than the number of eligible households. General income data on households ought to provide some clue as to how many are actually eligible.

It is possible to formulate estimates based on income distributions in the March 1993 Current Population Survey. Such figures, however, only provide a rough estimate. Because it provides income ranges, it is possible to make an educated guess as to how many would fall within the range of EITC eligibility. But a cautionary note must be added nonetheless. The first problem is that income figures merely tell us how many people fall within the parameters of a particular income range. They do not, however, tell us the source of that income. The EITC is based on **earned** income solely. One could have investment and little by the way of earned income. So, for instance, a family with an income of $30,000 could conceivably qualify for the

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[16] CBO, *Reducing Entitlement Spending, p.21*

[17] These figures were obtained through a phone conversation with Janet Holtzblatt of the U.S Department of Treasury's Office of Tax Analysis.

EITC, assuming that at least $3,000 is investment income. As an example of this flaw, O'Neal and Nelsestuen found that on the basis of the IRS's Individual Statistics of *Income* (SOI) database, approximately 10% of the EITC benefits paid in 1988 went to households with substantial accumulations of investment assets, as evidenced by portfolio income consisting of interest and dividends. One recipient in the database had portfolio income in excess of $299,000.[18] The second problem is that the Census Bureau divides the income ranges into intervals of $5,000. The three stages of the EITC do not correspond to these intervals. Hence the placement of EITC stages within these ranges will not be an exact fit. Nevertheless, for the purposes of making some estimates of eligibility, I have chosen to focus only on the population earning between $0 and $29,999. The phase-in would then have to be defined as $0-9,999. The stationary range would then run from $10,000 to 14,999, even though it technically begins in 1994 at $8,425 for those with two children and $6,000 for those with only one child, and ends at $11,000. And the phase-out range would run from $15,000 to 29,999, even though it technically begins at $11,000 and ends completely at $27,000. Nevertheless, despite the imprecision in this data, the estimate of the overall number of eligible EITC families is close to the actual number of filers for 1992. In fact, the estimate of eligibility exceeds the number of filers by approximately 4.8%

On the basis of published data from the March 1993 Current Population Survey, it can be estimated that out of 68,144,000, approximately 19.4% of families could be said to fall within the parameters of the EITC income distribution. 11.6% were black with median income of

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[18] Cherie J. O'Neal and Linda B. Nelsestuen, "The Earned Income Tax Credit: The Need for a Wealth Restriction for Eligibility Determination," *Tax Notes* (May 30, 1994):1789-1201

$2 1,16 1, and 7.8% were **hispanic** with a median income of $23,901. These figures can be seen

below in Table **IV**.[19]

Table IV Income Summary
                         1992

	Number (thous.)	Med. income
Families		
All families	68,144	36,812
White	57,858	39,909
Black	7,888	21,161
Hispanic	5,318	23,901
Family Type		
All race		
married couples	53,171	42,064
female-headed	11,947	17,221
White		
married couples	47,60 1	42,738
female-headed	7,848	20,130
Black		
married couples	3,738	34,196
female-headed	3,680	11,956
Hispanic		
married couples	3,674	28,515
female-headed	1,238	12,894

Roughly 40% of families have incomes below $30,000, and would therefore fall within the

parameters of EITC eligibility. Or so this would be the case were income alone to be a qualifying

factor. But as the principal qualification is that at least one child be present, the percentage drops

to approximately 21.7%. Out of **68,144,000** families in America, approximately **14,816,000** or

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[19] This table and those on pages 13, 14 and 16 are drawn from U.S. Department of Commerce, Current Population Reports, Series **P60-184** *Money Income of Households, Families, and Persons in the United States: 1992* (Washington, Government Printing Office, 1993)

21.7% had at least one related qualifying child and thus were within the parameters of EITC eligibility. However, about 52% of this group would have fallen in the phase-out range, with only 34.6% falling in the target group -- those whose incomes are such that they would qualify for most, if not all, of the credit.

When these figures are broken down into family type, some interesting results emerge. 9.8% of eligible families out of all families in America are female-headed. But within the category of female-headed families, the percentage of EITC eligibility rises to 56.2% out of a total of 11,947,000 female-headed families in America, as compared to 2 1.7% of families overall. Moreover, the percentage within the target population is greater than those in the phase-out range. Within the female-headed family category, the target group now accounts for 63.3% of EITC eligible female-headed families, and the phase-out only accounts for 33.7% This compares to 37.3% of all female headed families falling within the target group, and 18.9% falling within the phase-out range. Tables V and VI show these figures.

Table V EITC Eligibility with one or more children under 18

	Number	Percent of all	Percent of Group
All Families	14,8 16,000	21.7*	
Female-hd	6,712,000	56.2^	*45.3*
target group	4,45 1,000	37.3^	*66.3*
phase-out	2,261,000	18.9^	*33.7*
White Families	10,596,000	71.5	
Female-hd	3,937,000	26.6	37.2
target group	2,447,000	20.5^	62.2
phase-out	1,490,000	12.5^	37.8
Black Families	3,624,000	*24.5*	
Female-hd	2,560,000	*17.3*	70.6
target group	1,864,000	17.3^	72.8
phase-out	696,000	5.8^	27.2

Hispanic Families	2,328,000	15.7	
Female-hd	841,000	5.7	36.1
target group	586,000	4.9^	69.7
phase-out	255,000	2.1^	30.3

The target group is defined as those falling in the phase-in and stationary ranges: $0-$14,999.
* is the percentage from all families in America -- 68,144,000.
^ is the percentage from all female-headed families in America -- 11,947,000

Table VI EITC Eligibility according to family type

	Percent Female-hd	Percent of fam w/ children <6 of	Percent female-hd w/ children <6 of
All	45.3	29.1	40.6
White	58.0	29.9	43.8
Black	38.1	26.4	65.1
Hispanic	12.5	28.2	32.5

What the data shows overall is who would derive the greatest benefit from an expanded EITC. It also becomes possible from this data to identify a subpopulation who, if they aren't already receiving the EITC, should be the target of whatever efforts are made to ensure that they do. Overall, single mothers with children are those who policymakers would want to target. More single mothers with children fall within the phase-in and stationary ranges than in the phase-out range. And this is particularly true for minorities. Moreover, those with children, as Table VI suggests, would especially need to be targeted. This is actually the opposite of what the data shows when fully aggregated.

According to a table of adjusted gross income put out by the Internal Revenue Service

for 1991, only about 5% of EITC returns could be said to fall within the phase-in range. But more than 50% fell within the phase-out range. This distribution only varies slightly from that suggested by the CPS. The breakdown can be seen in the following table.

Table VII *EITC* **Distribution**

Income	Number of returns	Percent	Amount (thousands)
$5,000-$10,000	332,636	.05	32,853
$10,000-$15,000	2,079,143	.31	754,474
$15,000-$20,000	3,056,909	.50	1,238,448

Figures come from Internal Revenue Service, Statistics of Income-1991, Individual Income Tax Returns, Washington, DC 1994

Or as Holtzblatt, et al. calculated, 4.1 million, or 28% were in the phase-in range as a consequence of OBRA 90, the first major EITC expansion. Approximately 2.8 million or 19% were in the stationary range, and 7.6 million or 53% were in the phase-out range. But as a consequence of OBRA 93, the number of households in the phase-in and stationary ranges declined, and the number in the phase-out increased. Consequently, 3.5 million or 22% were in phase-in, 2.5 million or 16 percent were in the stationary range and 9.8 million or 62% were in phase-out.[20] Similarly, Hoffman and Seidman found that the typical EITC family had low-to-moderate income, which placed it above the poverty line. Although 76% had incomes below $15,000 (in 1988 dollars), 1/9 had incomes above $20,000, and some even had incomes above $30,000. On the whole, then, the program appeared to be providing benefits primarily to moderate income, nonpoor families -- precisely the group excluded from most **income** transfer programs. The majority of families had a single parent, of which 80% were female-headed. And more than 80% had only one or two children. Almost 60% worked at least 1500 hours a year,

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[20] Janet Holtzblatt, Janet McCubbin and Robert Gillette, "Promoting Work Through the EITC," Office of Tax Analysis, U.S. Department of Treasury (June 4, 1994), p. 6

and almost a quarter reported working more than 2,080 hours -- 40 hours/week for 52 weeks." But what the CPS data as a whole ultimately suggests is that while those generally in the phase-out range are generally higher than those in the target range, the opposite is actually true within the category of female-headed families. Moreover, percentages rise for those female heads with children under six. In Table VI, where the percentage of families with children under six is compared to the percentage of female-headed families with children under six, the percentages within EITC eligibility rises. And it rises dramatically for black female heads.

If the majority of EITC recipients fall in the phase-out range, the intended purpose behind the expansion is called into question. The problem with these studies which indicate that EITC disproportionately benefits the non-poor is that the data is aggregated. The percentage of those claiming the EITC will disproportionately fall in the phase-out range when considering the overall ratio of EITC filers to the total number of filers. But when the data is disaggregated within the group of EITC eligible families, we find the opposite to be the case. This is especially so if female-headed families are singled out as the primary target group. The percentage of families eligible for EITC falling in the phase-in and stationary ranges is below 50%. But for minorities it rises, and for blacks it rises to 63%. Among married couples, the percentage in these ranges falls to about 30% But when we look at female-headed families, the percentage within these ranges is consistently above 60%. It rises to 69.7% and 72.8% for hispanics and blacks respectively. When the data is disaggregated even further, we find that those eligible for EITC with children under six within these ranges increases on average 5-6%. And the increase is even greater for female-headed households with children under six. The only exception appears to be

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[21] Hoffman and Seidman, The ***Earned Income Tax Credit,*** pp. 25-32

among white female headed families with children under six. Here there is a 5.9% drop from the overall population of white female-headed families. These figures can be seen below in Table VIII.

Table VIII Percentage of those falling within phase-in and stationary ranges

	All	Married Couple	Female-hd w/ children < 6	All w/ w/ children <6	female-hd w/ children <6
All Families	47.9	30.5	66.3	52.6	75.7
White	42.7	29.1	62.2	48.0	56.3
Black	63.0	36.7	72.8	67.6	79.9
Hispanic	51.0	38.8	69.7	57.9	75.0

All in all, this would seem to suggest that the principal beneficiaries of the EITC will be minorities generally, and female-headed families particularly. For those groups, EITC might be deemed a benefit, and they are particularly the groups that might be overlapping with AFDC. This would especially be so if the majority of the AFDC caseload are mothers with children under six. As to whether the EITC can be said to be cost-effective, it would be contingent on just how much goes to a particular income distribution. But it is also contingent on what the benefits may be for particular income distributions. The effects of EITC will vary according to what specific income distribution individuals fall in.

Nevertheless, the problem with these participation figures, as well as estimates of eligibility, is that they are based on a simulated tax model which reflects the number of EITC filers along with those who submitted a tax return, but did not necessarily claim the credit. This model also

compares the number of filers with the numbers falling within the qualified income distribution based on data taken from CPS. It does not, however, necessarily reflect those who are on AFDC who, if they were working, might fall into the qualifying income ranges. Consider for a moment the fact that in 1988, according to the Survey of Income and Program Participation (SIPP), an average 27,027,000 individuals a month collected AFDC and other cash assistance programs.[22] In Fiscal Year 1993, 14,144,000 recipients collected $22,286,000,000 in AFDC benefits. On top of the benefits which were paid out, total administrative costs for AFDC were $2,955,500,000. When consolidated into family units, the number of families on AFDC were 4,981 ,000.[23] The CBO further estimates that in 1994, AFDC will pay out close to $23 billion, and that more than 27 million people in the average month will collect more than $24 billion in food stamps.[24] Although all of the AFDC recipients would qualify for food stamps, not all food stamp recipients would necessarily qualify for AFDC, although most would fall within the parameters of EITC eligibility. So in addition to the overlap between AFDC and food stamps, there is an overlap between EITC in the phase-in and stationary ranges -- and part of the phase-out -- and food stamps. The point is that those 4.981 million AFDC families are not individuals who would necessarily be working or filing tax returns, let alone claiming an EITC. The question to arise, then, is if these individuals were to be included among the eligible EITC population, just how many are we talking about and what would it do to current EITC budget projections?

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[22] See "Characteristics of Recipients and the Dynamics of Program Participation: 1987 and 1988," Survey of Income and Program Participation

[23] U.S House of Representatives, *The* Green Book, 1994, pp. 391-392

[24] CBO, *Reducing Entitlement Spending,* p. 21

Impact on Labor Incentive

Politically speaking, EITC, if it does make work more attractive than welfare, will **enjoy** broad support among the general population. But so far the effects of EITC are somewhat mixed. The impact of EITC on labor-market incentive has not been widely studied, but there is reason to believe that, at least among those within the phase-out range, it may offer incentive to work less in exchange for greater leisure time. As Hoffman and Seidman point out, it could quite possibly increase the labor supply of workers in low-income families. They estimated that the EITC reduced the number of hours recipients worked by at most **2-3%**.[25] Both the General Accounting office and the Congressional Budget Office also reasoned that the positive labor incentives would be found among those in the poverty or near-poverty range, but that the picture for those at the top of the eligible income distribution, the picture would be **different**.[26] And Kosters too holds that in the decision over whether or not to work, the EITC could be viewed as a bonus. For those who would be eligible, but are not working, the EITC might make work more attractive than it otherwise might be. But the effects on the work incentive for those already working are more complex. For eligible workers, the choice of whether to work is somewhat more or less, rather than whether or not to work at all. EITC payments reduce work effort through income effect because they lift incomes of eligible families. Still, how much work effort is reduced from the effect is contingent on the size of the payments -- hence the income level

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[25] Hoffman and Seidman, The *Earned Income Tax Credit,* p. *37*

[26] U.S. GAO, *Tax Policy: Earned Income Tax Credit;* and CBO, *Reducing Entitlement Spending*

of the beneficiary.[27]

Since the EITC changes both an individual's net wages and his/her total income, it may also provide a possible incentive for an individual to change the number of hours worked. Theoretically workers may work less as their earned incomes approach the full phase-out amount because their effective marginal tax rates increase. As a consequence of the last two budget reconciliation acts, the average marginal tax rate for those in the phase-in range has been reduced from 1.6% to -21.3%. For those in the stationary range, the marginal tax rate has remained between 17- 18%. But for those in the phase-out range, the marginal tax rate has increased from 36.6% to 44.4%.[28] The GAO regards this as generally conforming to the progressivity of the tax code.[29] But given the increase in marginal tax rates within the phase-out range, especially when coupled with the fact that a majority of recipients are in that range, there may be reason to believe that the EITC is not on the whole cost-effective. This isn't to say that EITC isn't beneficial. Even if it isn't necessarily lifting those under the poverty line above it, it certainly is offering some assistance to low income groups. For those who received the credit, it did offset about one half of their own shares and one quarter of combined payroll tax shares.[30]

As the stated purpose of the EITC expansion in OBRA 93 was to lift households above the poverty line, there should be a greater incentive to work. Theoretically, those falling within the stationary range should derive the greatest benefit. They are the ones who would qualify for

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[27] Marvin H. Kosters, "The Earned Income Tax Credit and the Working Poor," *The* American *Enterprise* (May/June 1993): pp. 66-67

[28] Holtzblatt et. al., "Promoting Work Through the EITC," p.6

[29] U.S. GAO, *Tax Policy: Earned Income Tax Credit*

[30] U.S. GAO, *Tax Policy: Earned Income Tax Credit*

the maximum benefit, and they are the ones whose effective earnings would be raised. Consider for a moment a single parent of two children earning minimum wages when fully phased-in in 1996. At a minimum wage of $4.25 an hour, this person would earn $8,840 for the year. When the full credit of $3370 is added, this person's income is effectively raised to $12,210. The credit effectively raises this person's income to $5.87 per hour. For those who have been arguing that the current welfare system actually encourages people to stay home and collect welfare,[31] this ought to provide the right incentive to work.[32] And yet, there is evidence which seems to suggest otherwise. Consider the following comparison figures from Pennsylvania:

Table IX Interaction Effect of EITC and other Assistance Programs

					Taxes				
Earnings	EITC	AFDC	Food stamps	Medicaid	Social security	Federal income	State income	Work expenses	"Disposable" income
					0			0	
0	0	$5,052	$2,496	yes	$153	0	0	$600	$7,548
$2,000	$600	4,892	2,184	yes		0	0		8,923
$4,000	1,200	3,292	2,304	yes	306	0	0	1,200	9,290
$5,000	1,500	2,492	2,364	yes	383	0	0	1,500	9,473
$6,000	1,800	1,692	2,424	yes	459	0	0	1,800	9,657
$7,000	2,100	892	2,484	yes	536	0	0	2,100	9,840

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[31] See, for example, Roy H. Kaplan and Curt Tausky, "Work and the Welfare Cadillac: The Function of and Commitments to Work Among the Hard Core Unemployed," **Social Problems** (1972):469-483; Edward C. Banfield, *The **Unheavenly City Revisited*** (Boston, Little, Brown & Co., 1974); Ken Auletta, The **Underclass (New** York, Vintage Books, 1982); Charles Murray, **Losing Ground: American Social Policy, *1950-1980* (New** York, Basic Books, 1984); Lawrence M. Mead, **Beyond Entitlement: The Social Obligations of Citizenship (New** York, The Free Press, 1986); and Richard B. Freeman and Harry Holzer, ed., The **Black Youth Employment Crisis** (Chicago, University of Chicago Press, 1986)

[32] See, for example, David, T. Ellwood, **Poor Support: Poverty in the American Family (New** York, Basic Books, 1988)

$8,000	2,400	0	2,568	yes	612	0	0	2,400	9,956
$9,000	2,528	0	2,388	yes	689	0	$4	2,700	10,523
$10,000	2,528	0	2,208	no	765	0	34	3,000	10,937
$15,000	1,820	0	1,308	no	1,148	0	174	4,200	12,606
$20,000	936	0	0	no	1,530	$58	314	5,200	13,834
$30,000	0	0	0	no	2,295	1,717	594	5,400	19,993
$50,000	0	0	0	no	3,825	5,569	1,154	5,400	34,052

This table represents the earnings of a mother with two children with day care and other related expenses after four months on a job.[33]

What becomes clear from this chart is that as one moves up the income latter, or through the EITC phase-in and stationary ranges, not only are AFDC benefits reduced, but the value of the EITC is completely absorbed by work and child care expenses. Once an income of $9,000 is achieved, social security and work expenses exceed the EITC. Initially, there might be incentive to work part-time and earn $2,000 a year where the gain will be $1,375. But the difference between earning $2,000 and $4,000 will yield a net gain of only $367. And for each increment of a $1,000 up to $8,000, the net gain is actually diminished from what it was with the previous increment. If there is any incentive to work, it actually decreases as one works more until an income of greater than $9,000 is achieved. But unless an employer is going to provide health insurance, working may actually become costly, for this is the point at which medicaid is lost. In narrow terms of who has more income, the worker, even at only $2,000 of earnings has more than the non-worker. At the same time, it becomes clear that the worker isn't necessarily better off. On the contrary, once she loses her medicaid she may indeed be worse off.

The CPS data presented earlier would seem to suggest that EITC would have the greatest benefit for minorities generally, and female-headed families particularly. But it cannot be

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[33] U.S House of Representatives, The *Green Book, 1994,* p. *335*

determined from that data that they are necessarily taking advantage of the EITC. Further CPS data shows that the percentages are similar to those falling below the poverty line, and those who are already taking advantage of other benefits. Table X shows the percentage of families falling below the poverty line, and Tables XI and XII show the participation in assistance programs, and that participation with its overlap with EITC eligibility respectively.

Table *X* Families below poverty *line*[34]

	Total	All	%	Married Couple	%	Female-hd	%
All Families	68,144	7,960	11.7	3,318	6.2	4,171	34.9
White	57,858	5,160	8.9	2,631	5.5	2,202	28.1
Black	7,888	2,435	30.9	486	13.0	1,835	49.8
Hispanic	5,318	1,395	26.2	680	18.5	604	48.8

Table XI Program Participation by Poverty Status (Percentage)*

	Assistance	Cash Assistance	Food Stamps	Medicaid
All	24.1	11.1	10.9	15.9
in families	18.1	9.7	5.0	12.2
w/children< 18	36.0	16.1	18.8	23.7
w/children<6	38.2	20.1	23.0	3 0 . 0
female hd	*57.7*	*34.9*	36.1	43.4
w/children< 18	*71.5*	*44.1*	49.1	54.5
w/children<6	*79.8*	*57.6*	62.1	69.2
White	*19.5*	*8.3*	8.1	12.5
female hd	*47.4*	*27.9*	27.8	35.3

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[34] This table and the one that follows are drawn from U.S Department of Commerce, Consumer Population Reports, P60-185 *Poverty* **in the United States: 1992** (Washington, Government Printing Office, 1993)

w/children< 18	60.9	35.8	40.0	45.1
w/children<6	71.6	50.5	54.1	61.8
Black	52.6	28.5	29.1	37.1
female hd	76.3	47.8	51.5	57.7
w/children< 18	86.4	56.1	63.2	67.3
w/children<6	89.8	66.3	72.1	78.1
Hispanic	50.2	19.7	21.7	32.9
female hd	73.9	47.1	46.7	59.1
w/children< 18	83.5	55.3	58.3	67.8
w/children<6	85.1	63.6	65.3	76.4

* These percentages refer to individuals out of the entire population of individuals in the U.S.

Table XII Program Participation and EITC Eligibility Overlap (percentage)

	Asst	Cash Asst.	Food stamps	Medicaid	Target group
All	*24.1*	11.1	10.9	15.9	
in families	*18.1*	9.7	5.0	12.2	
w/children< 18	*36.0*	16.1	18.8	23.7	
w/children<6	**38.2**	**20.1**	23.0	30.0	
female hd	*57.7*	*34.9*	36.1	43.4	
w/children<18	*71.5*	*44.1*	49.1	54.5	66.3
w/children<6	*79.8*	*57.6*	62.1	69.2	75.7
White	19.5	*8.3*	8.1	12.5	
female hd	47.4	*27.9*	27.8	35.3	
w/children< 18	60.9	*35.8*	40.0	45.1	62.2
w/children<6	71.6	*50.5*	54.1	61.8	56.3
Black	*52.6*	*28.5*	29.1	37.1	
female hd	*76.3*	*47.8*	51.5	57.7	
w/children<18	*86.4*	*56.1*	63.2	67.3	72.8
w/children<6	*89.8*	*66.3*	72.1	78.1	79.9
Hispanic	*50.2*	19.7	*21.7*	*32.9*	
female hd	*73.9*	47.1	*46.7*	*59.1*	
w/children< 18	*83.5*	55.3	*58.3*	*67.8*	69.7
w/children<6	*85.1*	63.6	*65.3*	*76.4*	75.0

The above data would seem to suggest that those groups most likely to benefit from the EITC are disproportionately among those participating in one or more public assistance programs. That is, there is an overlap between those participating in public assistance programs and those in the target group of EITC eligibility. Simply by comparing the numbers in the first column with those in the last in Table XII, we can see that the percentages for those in the target group of EITC eligibility are close to those receiving public assistance in one form or another. Similar to the trends among those within the parameters of EITC eligibility, we again see low program participation rates among whites generally, and married-couple families particularly. But increasingly higher participation rates are found among minorities, especially female-headed households within those groups. And as before, participation rates increase even more for those female-headed households with children under six. There would appear, then, to be some overlap between those falling within the parameters of EITC eligibility and those participating in public assistance programs. Ultimately, this would suggest the need for modification -- or greater synchronization between public assistance programs and refundable tax credits. This becomes abundantly clear as the interaction between EITC and the other programs reduces, if not entirely eliminates, the labor incentive at the bottom end of the distribution.

The system as it is currently structured would suggest that there is incentive to work if the measure is merely the narrow fact that there is greater income. But this does not make them better off.[35] One approach to this issue is to ask what is it about the EITC that it, in and of itself, is insufficient to motivate people to move off welfare? It may not be structured correctly.

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[35] See, for example, Mary Jo Bane and David T. Ellwood, *Welfare Realities: From Rhetoric to Reform* (Cambridge, MA; Harvard University Press, 1994)

It may in fact be too low to make any significant difference. The other approach is to ask what is it about the AFDC population that, assuming jobs exist (which is another issue altogether), that they are unable to take advantage of them? What, then, do we know about the demographics of the AFDC population? Table XIII shows the basic demographics of the AFDC population for 1992:

Table XIII Demographics of AFDC Population

Average Family Size (persons)	2.9
Number of child recipients (percent of AFDC cases	
One	42.5
Two	30.5
Three	15.5
Four or more	10.1
Unknown	.7
Basis for eligibility (percent children)	
Parents present:	
Incapacitated	4.1
Unemployed	8.2
Parents absent:	
Death	1.6
Divorce or separation	30.0
No marriage tie	53.1
Other reason	2.0
Unknown	.9
Education of mother (percent of mothers)	
8th Grade or less	*4.9*
1-3 years of HS	*18.8*
High School Degree	*6.8*
Some College	.5
Unknown	*46.6*
Age of mother (percent of mothers)	
Under 20	7.6
20 to 24	24.5
25 to 29	23.3
30 to 39	32.7
40 or over	11.8

Unknown	.1

Age of Children (percent of recipient children)

Under 3	24.6
3 to 5	21.7
6 to 11	32.4
12 and over	21.2
Unknown	.0

Mother's employment status (percent)

Full-time job	2.2
Part-time job	4.2

Presence of Income (percent families)

With earnings	7.4
No non-AFDC income	78.9

Median months on AFDC since most recent opening	22.5

Race (percent parents)

White	38.9
Black	37.2
Hispanic	17.8
Native American	1.4
Asian	2.8
Other or unknown	2.0

Incidence of households (percent)

Living in public housing	9.2
Participating in food stamps	
or donated food program	87.3
Including nonrecipient members	38.9

Father's relationship to youngest child (percent)

No father	89.4
Natural father	NA
Adoptive father	NA
Stepfather	NA[36]

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[36] This table is adapted from the one in U.S. House of Representatives, The **Green Book, 1994,** pp. 401-402

What stands out in this demographic distribution is that a considerable percentage of mothers are caring for young children under six -- 46.3% which corresponds to the CPS data of EITC eligibility of 40.6% -- and that 46.1% of these mothers have no more than a high school education, and many have less. In terms of what types of job they could expect to find, it is in the extremely low skill market which pays no more than minimum wages. Moreover, these same mothers are then going to have to pay child care. And as our earlier chart shows, if one is only to make minimum wage and incur child care expenses, there really is no incentive at all to move off of welfare, even with an EITC. All the EITC does in this wage market is cover the costs of child care. In a sense, it may only serve to bring the living standards of working mothers and welfare mothers to comparable levels, whereas without it, the working mother on minimum wage is clearly worse off. And if there is no dignity to be found in this low skill labor market, there really is no incentive to work.

EITC's Deficiency

The EITC, as it is currently structured, would appear to be out of sync with existing programs. At the low end of the income distribution there is little, if any, incentive to move from welfare to work. At the upper end of the distribution, it may adversely affect labor incentive, insofar as it enables workers to trade off some hours of work in exchange for greater leisure time. If the end result is that more people in the phase-out range receive the credit than those in the phase-in and stationary ranges, the EITC is effectively no more than tax relief for the lower middle class. What, then, is the value of the EITC? And in light of its costs, this is by no means a trivial question. If the goal were merely to reduce the poverty rate, there may be some evidence

that the EITC does reduce the poverty rate, albeit slightly. The GAO estimated that the poverty rate was reduced by as much as 0.7% in 199 1. The reduction in 1985 had only been 0.1% and 0.4% in 1988.[37] And according to the Center for Budget Priorities, the effect of the Clinton EITC proposal is to reduce the number of people in poverty by over 2 million people in 1994.[38] But this is merely playing with numbers. In 1993, the poverty line for a family of three was $11,572 and $14,763 for a family of four. But in 1993, the maximum credit was only $1,5 11, which when added to a yearly income at minimum wage would have only yielded $10,35 1. This family was still living below the poverty line, and even with food stamps would not have risen much above it. Even with OBRA 93, this family in 1994 with an income of $11,368 would still find itself below the poverty line. It would still need food stamps to find itself above the line. But in net terms -- in terms of "disposable income" -- this family would still effectively be living in poverty.

EITC, then, has to be targeted towards those in this particular market. This, in and of itself, raises serious questions. The first step in targeting is making people aware that a labor market subsidy does exist for their low wage labor. This would also involve making them aware that they can receive the EITC through their regular paychecks from their employers. Many do not take advantage of the credit because they are simply unaware of it. Others might fail to take advantage because of the complexity involved with the forms which need to be filed in order to

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[37] GAO, *Tax Policy: Earned Income Tax Credit,* p. *35*

[38] these figures were provided to me by the Center for Budget Priorities, whose source was the Congressional Budget Office

receive the credit.[39] But if such a knowledge campaign were to become successful, would employers not have incentive to maintain low wage rates? By the logic of rational activism, this would actually be a plausible inference. But it is extremely difficult, if not altogether impossible to measure. Given that the GAO found that 60% of employers surveyed knew little or nothing about EITC, it would be hard to make the case that it does provide incentive. But if the Clinton administration is successful in publicizing the advance payment option, which would require that employers pay out the credit in their employees' regular paychecks, the question is might employers not find themselves armed with a new mechanism for maintaining low wage rates? This is obviously a question which will warrant attention in the future. The question might just be whom is being subsidized? Workers, employers or both? But targeting also involves the coordination of EITC with other public assistance programs.

If there is no incentive to work because one will effectively be penalized with the loss of other benefits, what value is a labor market subsidy? The point here is that EITC is a $25 billion program, and the hope would be that its accomplishments would be real as opposed to rhetorical. It is one thing to say this program is intended to assist the working poor and possibly offer incentive to move from welfare to work. It is quite another to show that it actually accomplishes these objectives. The bottom line problem, then, would appear to be the lack of coordination in the delivery of assistance programs. None of this is to say that the EITC is in principle a bad program, but that 1) it may not be structured properly and 2) it isn't really coordinated with the other programs. If the EITC is merely viewed as a feasible and politically

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[39] Robert E. Nelson, "The New Earned Income Credit," Journal *of Accountancy* (January 1992):67-73

neutral program to be added to the current array of social programs, it isn't clear that it will accomplish any more than have previous social programs. And if it doesn't accomplish any more, we may be wasting money precisely at a time when we don't have resources to waste. It is true that greater expenditures for EITC -- if more welfare recipients would utilize it -- would be offset by reductions in other programs. But the issue is how to get them to forsake welfare and take greater advantage of the EITC? If people aren't working, the question in why not? What could be done to get them to work? Will EITC alone do it, or does more need to be done?

The problem which requires synchronization of benefits is one of overlap and/or coordination. Those falling into the income ranges which would qualify them for the maximum credit are already eligible for other assistance programs. In a very real sense, this overlap enables them to make a very rational choice as to whether it is worthwhile to work at all. Positive inducement to work will also vary regionally. AFDC benefits are set by the states, subject to some federal regulations, In 1991, for instance, the annual maximum AFDC cash benefit for a mother and two children and no other earnings ranged from $8,328 in California to $1,440 in Mississippi.[40] And according to the CBO, in 1994, maximum monthly benefit ranged from $120 in Mississippi to more than $900 in Alaska.[41] This being the case, EITC will provide greater positive inducement to work in those states which are least generous in their provision of AFDC. The second problem is that once the decision has been made to work, other benefits which may or may not be essential -- depending on individual family circumstances -- will either be reduced

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[40] June O'Neill, "Can Work and Training Programs Reform Welfare?" *Journal of Labor Research* 14,3 (Summer 1993), p. 266

[41] CBO, *Reducing Entitlement Spending,* p. 21

or cut altogether. The question is how can the assistance programs which make up the welfare state *be* better coordinated so that greater efficiency will be achieved?

According to the Congressional Budget Office, in 1994, AFDC costs $23 billion, Food stamps cost $24 billion, and Medicaid costs an additional $140 billion.[42] When the major public assistance programs -- which go primarily to the non-working poor -- are summed up, the cost to the treasury is $187 billion dollars in addition to the 24.5 billion projected for EITC in 1996. Spending on the poor is in excess of $210 billion, especially as this figure doesn't even begin to take into account any number of other assistance programs such as public housing, nutritional programs, educational programs, school lunches, etc. And yet, there is little by way of coordination between these programs. Not only is the federal government operating a multibillion dollar social welfare system, but it is providing social welfare benefits through a wide array of tax credits. And despite the development of these apparently parallel welfare systems, there has been relatively little coordination among the various welfare programs and tax expenditures. As a result, the current system has become "inequitable, inefficient, overly complicated, and expensive to administer."[43] The principal question is that given whom would derive the greatest benefit from EITC, how could it either be restructured or better synchronized with other programs so that 1) it will assist those who most need it; and 2) it creates a positive inducement to work so that individuals are able to achieve a degree of self-sufficiency? Or to put it another way, with this same $210 billion, could another, but better coordinated, set of policy strategies be devised

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[42] CBO, *Reducing Entitlement Spending*

[43] Jonathan Barry For-man, "Synchronizing Social Welfare Programs and Tax Provisions," *Tax Notes* (April 1993), p. 418

to accomplish these objectives?

Models of Synchronization

Synchronization would appear to be necessary because of the overlap between those falling within the range of EITC eligibility -- particularly those in the phase-in and stationary ranges -- and those who are participating in the major public assistance programs. Given that work would entail penalties in the reduction and/or loss of both cash and non-cash benefits, why would one necessarily want to work at such low wages? Just where is the incentive to work? Let's consider the following: In the state of New York, for instance, a single mother with two children will receive $6,924 in AFDC and approximately $1934 in food stamps. This person's income will equal $8,858. In calculating the value of food stamps, I am relying on the following formula: the food stamps benefit rate is equal to the Maximum allowable benefit ($295 for households containing three people) minus 30% of Counted Income. Counted Income is defined as Gross monthly income minus a standard deduction of $13 1 minus 20% of earned income minus dependent care expenses up to $175 per dependent and $210 for children under two.[44] It is on this basis that it can be determined that a single mother with two children in New York will receive $8,858. If the same mother were to work at minimum wage and get an EITC, her income on the basis of the same formula would be $14,097. But a simple comparison of gross amounts obscures the costs associated with work, which otherwise are not born by the mother who does not. The question isn't whether she has more income, but whether she is better off. And yet, the question might be a little different in Texas, for instance. In Texas, the monthly

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[44] U.S. House of Representatives, The Green *Book, 1994,* pp. 761-769

AFDC grant is $184, which will provide $2,208 over a twelve month period. This same mother in Texas, however, will receive more in food stamps. She will be entitled to $3,349 in food stamps yielding an income of $5,557. In Texas, she might be better off with an EITC in that there will be more income.

For the mother who works, we now have to add child care and other expenses to the calculation. For this we can rely on the yearly figure of $2,700 for work expenses contained in Table IX. For the purposes of calculating a food stamp benefit rate, it would be useful to divide these work expenses into two components: $2,000 for child care and $700 for other. We would also add in the cost of taxes which is about $678.[45] Therefore FS = $295 - .30(Income - $131 - (earned income x .20) - child care), Were we to now subtract the $2,000 of child care expenditures, the $700 for other and $678 from her income, our single mother with her two children will now have a net income of only $5,462. We can now add $2,017 in food stamps plus the EITC of $3,370, which will now yield a net income of $10,849. On the other hand, if we added the value of the medicaid which in New York is approximately $4790 ($2,214 per adult and $1,288 per child) and in Texas is $3,590 ($1,542 per adult and $725 per child), our non-working single mother has an income value equal to $13,648 in New York and $9,147 in Texas, compared to the income value of the working mother of $10,682. The comparison can be seen in the table below:

	Non-Working NY	Non-Working TX	Working
Minimum Wage	0	0	$8,840
AFDC	$6,924	$2,208	0

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[45] The tax figure comes from *Tax Policy Note No. 7 (July* 1994).

Food Stamps	$1,934	$3,349	$2,017
Taxes	0	0	-$ 678
Child Care	0	0	-$2,000
Other Expenses	0	0	-$ 700
EITC	0	0	$3,370
Medicaid	$4,790	$3,590	0
	$13,648	$9,147	$10,849

On the face of it, it would appear that our aggravating variable is medicaid. But that is really too simple, because it is an intangible non-cash benefit. It could easily be half the amount in another state, but there would be no real benefit to working if the difference between working and not working is that either medicaid is received or it is not. If this is case, some modification in AFDC would also be required. How, then, could these programs be synchronized so as to obtain the greatest efficiency? In the remainder of the this paper, I consider some hypothetical models, which when arrayed as a taxonomy, it becomes clear that it isn't merely enough to adjust one program. Rather modifications would have to be made in several. Ultimately, it should lead in the direction of consolidation.

Reduce *AFDC*. Conservatives have long argued that programs like AFDC encourage dependency because it offers mothers with children the option of staying home. Moreover, because AFDC benefits are cut when these women marry, the claim is often made that it encourages family breakup.[46] I am not inclined to deal with this position, but it is useful to

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[46] Murray, **Losing Ground**

consider what might happen if we simply reduced AFDC. As much as some would like to see it eliminated entirely, this isn't practical, as there will always be a group who for one reason or another will not be able to work and will thus need some nominal level of support. Gene Steuerle, for instance, has suggested that taxation of transfer benefits perhaps offers the best chance to creating an integrated system of information, for without it, a true long-term welfare reform process may never be possible. Taxation provides a very fair means of scaling back benefits when they become so large that they have exceeded income levels at which workers and others without welfare payments are paying taxes.[47] A reduction in benefits would accomplish the same ends. But what if we simply reduced it by half, as an incentive to take a minimum wage job which could then be supplemented with the EITC? According to rational activism, this person should opt to work because she will make more. As a result, we would see the following:

	Non-Working NY	Non-Working TX	Working
Minimum Wage	0	0	$8,840
AFDC	$3,462	$1,104	0
Food Stamps	$2,073	$3,540	$2,017
Taxes	0	0	-$ 678
Child care	0	0	$2,000
Other expenses	0	0	-$ 700
EITC	0	0	$3,370
	$6,435	$4,644	$10,849

Now what would happen if medicaid were thrown into the equation? Although the value of

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[47] Gene Steuerle, "Has the Time Come to Tax Welfare and Other Transfer Payments?" *Tax Notes* (June 6, 1994): 1365-1366

medicaid in New York and Texas would be $4,790 and $3,590 respectively, it does represent a dummy variable in that it isn't easily quantifiable to the recipient. The policymaker is likely to look at these columns and conclude that the working mother is still better off than the non-working mother because she is ahead by $4,414 in New York and $6,205 in Texas. Indeed, because AFDC is less generous in Texas, the EITC is of greater value. But I specifically left medicaid out of the table because mothers with children will not ask what is the value of medicaid and what does it do to the value of the income package? If they were to ask that question and factor it in, they would easily conclude that non-work even with reduced AFDC is still more profitable because the value is now $11,195 in New York and $8,234 in Texas. And as Blank has noted, the actual medicaid value has little impact on AFDC participation.[48] But this isn't the same as saying that the fact that medicaid is only available to AFDC participants will not have an impact on the decision whether to work in the minimum wage market over simply participating in AFDC. In other words, the value of the program may be of no consequence, but the program in and of itself is.[49] Rather the question is can this mother afford to work given that she will lose the medicaid once she earns in excess of $9,000? The question is no longer whether there is positive incentive to work, but whether she can afford to work. The other question is whether this would really create positive incentive to work, or would it simply be a penalty which would effectively force people to accept minimum wage jobs?

  Eliminate Medicaid. As the medicaid budget is approximately $140 billion and medicaid

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[48] Rebecca M. Blank, "The effect of Medicaid Need and Medicaid on AFDC Participation," The *Journal of Human Resources* 24,1(1989):54-87

[49] Bane & Ellwood, ***Welfare Realities;*** and Robert Moffitt and Barbara Wolfe, "The Effects of Medicaid on Welfare Dependency and Work," National Bureau of Economic Research 1989.

may well be a reason why many poor single mothers might feel that they cannot afford to work, a proposal to eliminate **medicaid** might be considered seriously by some in Congress. Assuming that **AFDC** was not reduced, but **medicaid** was not anything anybody could count on, our comparisons of net income would look as follows:

	Non-Working NY	Non-Working TX	Working
Minimum Wage	0	0	$8,840
AFDC	$6,924	$2,208	0
Food Stamps	$1,934	$3,349	$2,017
Taxes	0	0	-$ 678
Child Care	0	0	**-$2,000**
Other Expenses	0	0	-$ 700
EITC	0	0	$3,370
	$8,858	$5,557	$10,849

Under this scenario, the net gain of working in New York is only $1,824, but $5,292 in Texas. While the third column is greater, it isn't clear that it is great enough to motivate those who aren't working to actually do so in New York. Motivation to work will vary regionally, as in Texas there is greater incentive to work. But given that the work will be in the low skill market and will not carry a great deal of job satisfaction, some may concluded that it simply isn't worth the effort. Let's assume that this person doesn't really want to work and she demonstrates this with her attitude. If and when she gets into a fight with her boss, she may well conclude that her loss isn't that great if she either quits or is fired. It would appear that **medicaid** in and of itself may not be that critical in this scenario. People may still find that working isn't as profitable as not working. This would not be enough. Rather it might have to be done in conjunction with a

reduction in AFDC. But on another level, given that health care, or the lack of it, for many people is considered a problem, can we as a nation deprive poor people of their healthcare? If liberals will continue to have any voice at all in Congress, it is doubtful that this draconian a measure will be sought.

Reduce AFDC and Extend Medicaid. Let's assume that as a humane society, we aren't going to eliminate medicaid. But it also becomes clear that if medicaid wasn't a factor affecting individual decisions, a reduction in AFDC would make minimum wage work coupled with EITC more profitable than non-work. Therefore, it would make good public policy sense to allow those welfare mothers who go to work to carry their medicaid protection with them. This would eliminate the question of whether they could afford to work. We would be left with the same comparison between $6,435 for non-working mothers in New York, $4,644 in Texas and $10,849 for working mothers. But this could end up being more costly. On the one hand, those AFDC mothers who already receive medicaid would not be adding to the federal burden, as they would merely be continuing to receive what they have already been receiving. But the EITC becomes a more effective carrot for getting people to work. But what about those who have been working who don't have insurance? It hardly seems fair to extend it for one group of workers without extending it to others. This, however, could raise costs. Some cost would be offset by reductions in AFDC, but not all. Perhaps medicaid could simply be extended to cover all those whose income, whether they work or not, reaches the end of the stationary range at $11,000. Under the Family Support Act of 1988, those who go from welfare to work are entitled to receive medicaid protection for one year. So there is precedent. This will raise medicaid costs, but not nearly as much as would be the case if medicaid were to be extended to all those who fall within the full

parameters of EITC eligibility. If we begin from the premise that a reduction of AFDC by half of its $23 billion budget would save $11.5 billion and that if half of AFDC recipients would now be able to obtain jobs, and AFDC would effectively be reduced to $5.75 billion, the $17.25 billion savings from AFDC could be applied to the extension of medicaid. More people working would also result in some further savings in food stamps, which could also be applied. In fact, we could even reduce some of the food stamps benefits by including the EITC benefit within the calculations which determine the rate. As much as this might appear to be a penalty, there is still a considerable income gap between working and non-working. If we were to do this, the food stamps benefits would be reduced to $1,480. This can be seen in the following table:

	Non-Working NY	Non-Working TX	Working
Minimum Wage	0	0	$8,840
AFDC	$3,462	$1,104	0
Food Stamps	$2,073	$3,540	$1,480
Taxes	0	0	-$ 678
Child Care	0	0	-$2,000
Other Expenses	0	0	-$ 700
EITC	0	0	$3,370
	$6,435	$4,644	$10,312

The working mother still has a net gain of $3,877 in New York and $5,668 in Texas. Conservatives who argue that work should be rewarded should be willing to extend the medicaid so that not only is work rewarded with EITC, but it is not penalized with the loss of a significant intangible benefit.

Replace *AFDC* with Assured Child Support. Irwin Garfinkel, for instance has suggested

that we provide a minimum floor of support for children through a Child Support Assurance System (CSAS). Under this plan a uniform assured benefit of $2-2,500 would be set for the first child and $1,000 each for the second and third, and $500 each for the fourth, fifth and sixth. The system would function on the basis of cost sharing between known fathers and the state. For those children whose paternal child support is less than the assured benefit, the state makes up the difference. For those children whose paternal child support exceeds the assured benefit, they continue to pay their normal child support.[50] Although Garfinkel offers this as a proposal which could ultimately reduce the costs of AFDC, we might consider it as a complete replacement for AFDC. Moreover, a strong case could be made for the substitution of something else for AFDC on historical grounds. These are mainly that AFDC was principally conceived of as a children's program, originally titled Aid to Dependent Children (ADC). A coordination of benefits along these lines, which would include EITC within food stamps benefits calculations, might look as follows:

	Non- Working NY	Non-Working TX	Working
Minimum Wage Income	0	0	$8,840
Food Stamps	$2,961	$2,961	$1,480
Taxes	0	0	-$ 678
Child Care	0	0	$2,000
Other Expenses	0	0	-$ 700

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[50] Irwin Garfinkel, *Assuring Child Support: An Extension of Social Security (New* York, Russell Sage Foundation, 1992)

EITC	0	0	$3,370
CSAS	$3,500	$3,500	$3,500
	$6,461	$6,461	$13,812

What this scheme does is effectively provide a minimum income floor for the care of children and eliminates the penalty associated with the current AFDC program. Although critics might liken this to a negative income tax, it is questionable that the amount is large enough that one could afford the luxury of not working. In terms of whether our single mother is better off, she clearly has a net gain of more than $7,000. It should also be noted that we have equalized the disparities between the states. And it is a net gain which is derived from working. Even if we were to further reduce the food stamps benefits by adding the CSAS into the rate calculations, the working mother will still receive $430 in Food stamps benefits with a net income of $12,762. The net gain is still above $6,000. Overall, this would further reduce the food stamps budget, which would offset increases in EITC and/or medicaid. The effect might well be that the overall cost of the system remains the same, but that the system as a whole both encourages and rewards work. All of this raises the question as to whether the current system of AFDC and food stamps shouldn't be replaced with something else.

Making Work Pay? Bane and Ellwood have suggested that the current system be replaced with a system which makes work pay. They advocate tripling the EITC according to its 1992 value of $1,800, which would then be equal to $5,400. On top of this, the minimum wage should be raised to $5.50.[51] This would produce an income of approximately $16,840 without food stamps. An expanded EITC as an incentive to work would also make it reasonable to eliminate

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[51] Bane & Ellwood, *Welfare Realities,* pp. 148-150

food stamps for those who are working. This income could be supplemented even further through a system which assures child support from the non-residential parent. And for those who would be unable to find work, they would offer community assistance jobs which would offer them an opportunity to work. It should be remembered that between AFDC and food stamps, we are talking about $47 billion. Some of this money would be absorbed through the costs of an even more expanded EITC. But then, some of this money could be channeled into the creation of the community assistance positions.

The Bane and Ellwood plan looks impressive in its offer of positive incentive to work. But at the same time it is hard to avoid the conclusion that it would in fact be costly. The expanded EITC is already accounted for in the elimination of food stamps. As it is, in 1996 the maximum EITC is intended to be $3370. To expand it by another $2,000 dollars as they suggest -- which probably would make it more attractive -- is merely to absorb the food stamps the working poor are entitled to, with a little extra added on. But they are advocating a raise in the minimum wage. There are, of course, some very powerful arguments for it. One is that the minimum wage has simply failed to keep pace with inflation. According to this argument, had minimum wage been indexed to inflation, minimum wage earners would actually be above the poverty line, rather than below it. According to Spriggs and Klein, because the minimum wage was held constant from 198 1-1989, a full time worker heading a family of three and earning the minimum fell $2,300 below the poverty line in 1992. But this worker would have been above the poverty line in 1979. This same worker in a family of two would have fallen $606 below the poverty line. And if this worker was heading a family of four, s/he would have fallen $5,364

below the poverty line.[52]

The argument against raising the minimum wage is that it will do more harm than good, as it will result in a disemployment effect. But in a study on the effects of increasing minimum wages in California, Card showed that increases did not result in decreases in employment. During July of 1988, California's minimum wage was raised from $3.35 -- then the prevailing federal minimum -- to $4.25 -- now the current federal minimum. The unemployment rate in California fell from 5.8% to 5.1% from 1987-1989. During the same period, the national rate fell from 6.2% to 5.3%. Although this would suggest that economic growth in California was similar to, or maybe slightly slower than, the rest of the nation, the pattern was quite different for California teenagers. For teenagers, the unemployment rate fell 3% *from 16.9* to 13.9% But the average U.S. rate only fell by 1.9% from 16.9% to 15%. The rise in minimum wages raised the wages of low-wage workers, with no adverse effects on employment.[53] Similarly, Katz and Krueger found that in a study of the fast food industry, increases in the minimum wage showed little evidence of significant adverse effects of minimum wage increases on employment.[54] At the same time, however, these studies showed this to be the case for an incremental increase in the minimum wage. What Bane and Ellwood are proposing is a 29.4% increase. The movement from $4.25 to $5.50 might appear to be too radical for now. Moreover, it is politically unfeasible. It is for this reason that the EITC has been embraced by all sides of the political spectrum;

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[52] William E. Spriggs and Bruce W. Klein, **Raising the Floor: The** *Effects* **of the Minimum Wage on Low-Wage Workers** (Washington, Economic Policy Institute, 1994)

[53] David Card, "Do Minimum Wages Reduce Employment? A Case Study of California, 1987-1 989," **Industrial and Labor Relations Review** 46,1 (October 1992):38-54

[54] Lawrence F. Katz and Alan B. Krueger, "The Effect of the Minimum Wage on the Fast-Food Industry," **Industrial and Labor Relations Review** 46,1 (October 1992):6-2 1

because it subsidizes the minimal wages of the poor without imposing undue burden on employers.

Still, there is a virtue to the Bane and Ellwood plan which might be overlooked. It moves in the direction of consolidation of programs, and it is this consolidation which would in the end make for more efficient government, and perhaps more humane government. The reason they offer for eliminating food stamps is that many who would qualify for them don't because of the stigma attached to them. And yet, the goal is to build on the Family Support Act which reflected the consensus that welfare programs ought to move clients towards **self-sufficiency**.[55] But it perhaps doesn't go far enough.

Consolidated Assistance. The goal of a welfare reform proposal ought to be to assist the poor by enabling them to help themselves. To this end, self-sufficiency is key. The problem, as I have noted earlier, is that when the EITC in its current form interacts with the other assistance programs, the incentive to work is actually diminished, thereby creating a negative interaction. A more positive interaction might be achieved through the consolidation of these programs into one plan, which would be offered through the tax code and would in fact build on the models already presented. It is true that simply cutting the other programs can make the EITC more attractive and have the effect of making it appear to be a positive inducement to work. But in reality, it is simply a form of "tough love"[56] which assumes that the poor are lazy and that they

[55] Bane and Ellwood, Welfare *Realities*

[56] See, for example, Hugh Heclo, "Poverty Politics," in Sheldon H. Danziger, Gary D. Sandefur and Daniel H. Weinberg, ed., *Confronting Poverty: Prescriptions for Change* (Cambridge, MA; Harvard University Press, 1994)

don't work for what Mead has attributed to "mysterious" reasons." But as the demographics of the AFDC population show, it is highly unlikely that welfare mothers would be able to find the types of jobs which would enable them to earn more than they are currently receiving through transfer programs.[58] Moreover, it isn't entirely clear that the jobs exist. It really cannot be forgotten that it is because of the slow growth of the American economy since the early 1970s that the incomes of those at the top of the income distribution have risen while those at the bottom have actually fallen." Had there been economic growth, discussions of both minimum wage increases and EITC expansions would be moot points. It is only when the market place fails to produce, that the public sector is called upon to offer remedies as compensation for the private sector's deficiencies.[60] The point here is that in the absence of any empirical proof that employment opportunities exist for these welfare mothers, it would simply be cruel to cut their benefits and make them worse off.

While welfare reform should seek to move people off the rolls by making work pay, it

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[57] Lawrence M. Mead, *The* New ***Politics of Poverty: The Nonworking Poor in America (New*** York, Basic Books, 1992)

[58] Also see Gary Burtless, "Paychecks or Welfare Checks: Can AFDC Recipients Support Themselves?" ***Bookings Review*** (Fall 1994):34-37

[59] See Dimitri B. Papadimitriou and Edward N. Wolff, ed., ***Poverty and Prosperity in the USA in the Late Twentieth Century (New*** York, St. Martin's Press, 1993); Edward N. Wolff, "Trends in Household wealth in the United States, 1962-83 and 1983-89," ***Review of Income and Wealth*** 40,2 (1994):143-174; Thomas L. Hungerford, "U.S. Income Mobility in the Seventies and Eighties," ***Review of Income and Wealth 39, 4*** (1993):403-417; Kevin Phillips, The ***Politics of Rich and Poor: Wealth and the American Electorate in the Reagan Aftermath (New*** York, HarperCollins Publishers, 1990); and Frank Levy, Dollars and Dreams: *The* ***Changing American Income Distribution (New*** York, W.W. Norton & Co., 1988)

[60] See Stein Ringen, *The* ***Possibility of Politics: A Study in the Political Economy of the Welfare State*** (Oxford and New York, Claredon Books, 1987)

should also acknowledge the importance of basic assistance to those who, for whatever *reason,* **will** not be able to work. Welfare reform should be predicated on three principles: 1) Work is important as it both gives people dignity leading to self-sufficiency and socializes people into the common project of society. This is the idea that we are all working together as equal citizens. 2) It should seek to ensure that children are adequately provided for and that this support also come from their fathers. It must be predicated on the assumption that fathers have a responsibility to support their children, and thus a uniform system aimed at ensuring that they will contribute to their support must be established. And 3) one who goes to work should not be penalized for the decision to do so. And that if positive incentive is offered to work it should not vary regionally, but should be uniform throughout the country.

If we return to the income of the non-working mother in Pennsylvania, it was $7,548. This was based on $5,052 in AFDC and $2,496 in food stamps. A consolidated assistance (CA) plan would do away with these distinctions and focus on two basic categories: assistance and child support. The assistance component would be modeled on the same two tier structure as the current EITC program, but with significant differences. Instead of the maximum being determined by the number of children, it would be determined by whether one works or not. And the Child support component would simply follow the CSAS model proposed by **Garfinkel**. A maximum credit for those who do not work would be based on the annual median of the existing AFDC program. In 1994, the median state benefit was $366 which would yield an annual benefit of $4,392. This would be the basic credit for the nonworking mother with two children. To this would be added the same $3,500 in CSAS yielding a minimum income floor of $7,892. This then provides for the mother who cannot find work. But to offer positive incentive to move to work,

a maximum CA of $5,500 would be offered to anybody who works and earns between $8,425 and $11,000. And for those who have children, they too would get the same 3,500 (assuming two children) as those who are non-working. The CA would not have to be tied to the number of children, as the CSAS effectively is. Hence the effect can be seen below in the following chart:

	Non-working	Working
Minimum Wage Income	0	$8,840
CA	$4,392	$5,500
CSAS	$3,500	$3,500
Taxes	0	-$ 678
Child Care	0	-$2,000
Other Expenses	0	-$ 700
	$7,892	$15,162

The effect here is that one does not lose anything because one decided to go to work, and the net income gain of more than $7,000 means that this person will be better off from working. Although the working CA is considerably larger than the 1996 EITC, it would in part be paid for by a narrowing of the parameters. The mechanics would be very similar to those of the EITC, but it would phase in faster with an accelerated phase-out. Under this scheme, the phase-in would effectively be 6 1.1% and the phase out would be 65.3% ending completely at $20,000 instead of $27,000. The CA for nonworking mothers is essentially the same AFDC budget. What has been eliminated is the $24 billion in food stamps. This could be absorbed in the costs of the CSAS, which would also rely on some cost sharing with fathers who have been identified. The other feature of the non-working CA is that it would be administered through the same tax

system as the working CA. The non-working mother too would have to file a return in order to get the basic assistance. As this would effectively disband the current AFDC bureaucracy, we might see a savings in the $3 billion in federal administrative costs, not to mention the administrative costs associated with the administration of food stamps. As far as the medicaid is concerned, that could continue as it is with the extension of a year for those who go to work, as already provided for in the Family Support Act.

The one critical change in this plan is that it would include workers in the minimum wage market regardless of whether they have children or not. And here is where some real possibilities exist. What if the CA for non-parents could be tied to a training program? Might this not constitute real assistance? Income subsidies, in and of themselves, aren't necessarily going to lift people out of poverty, but education might. Several studies have been done on the relationship between school quality and earnings.[61] It should stand to reason, then, that training of some sort should have some impact. A CA for non-parents opting to enroll in training programs could make for an effective transitional program. For instance, Michael Sherraden has suggested that a whole new approach to the American welfare state would be to think less in terms of income sources and cash transfers and more in terms of assets, which would foster savings and investment. One thing we might do is create Individual Development Accounts (IDAs) which could be used for

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[61] See, for example, David Card and Alan B. Krueger, "School Quality and Black-White Relative earnings: A Direct Assessment," The *Quarterly Journal of Economics* (February 1992): 15 I-200; "Does School Quality Matter? Returns to Education and the Characteristics of Public Schools in the United States," *Journal of Political Economy* 100,1 (1992): l-40; and Card and Daniel Sullivan, "Measuring the Effect of Subsidized Training Programs on Movements In and Out of Employment," *Econometrica* 56,3 (May 1988):497-530

future use.[62] If the CA were to be offered to single teenagers and this money were to be deposited into an IDA, it could then be used for job or vocational training, and perhaps even college. Would this not offer hope for those living in typically "underclass" communities? And in the long run, this might reduce the costs of the welfare state.

Conclusion

What should become clear is that if the EITC were to be viewed as a staple of welfare reform, more is needed than simply its expansion and a two year time limit. Rather a synchronization of benefits is essential so that the system can achieve its intended goals: to move people from welfare to work, and ensure that they aren't penalized because they decided to do what society wants and demands of them. The goal of welfare reform is to make work pay without the effect being that those who opted for work are penalized. The taxonomy of models for synchronization does ultimately lead in the direction of the Consolidated Assistance plan. Moreover, as it effectively collapses other programs into it, the end result should be that this is done without expanding the budget any more. And if it succeeds in offering positive inducement to work, it also ensures that those who cannot find work will still be provided for. Although it is true that it may not take into account regional differences in the cost of living, the goal is to encourage work. It is along these lines that the EITC needs to be modified if it is truly to be a staple of welfare reform, as suggested by the Clinton administration. And unless synchronization is undertaken, the EITC is simply another program added onto the current litany of programs,

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[62] Michael Sherraden, *Assets and the Poor: A New American Welfare Policy* (Armonk, NY; M.E. Sharpe, Inc., 1991)

which fails to do little else than offer some tax relief to the lower middle class.