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Effectiveness and limitations of the Earned Income Tax Credit for reducing child poverty in the United States

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ABSTRACT

Based on international comparisons, the United States has a high child poverty rate. The Earned Income Tax Credit (EITC), which provides a tax benefit to low-income working households and was expanded after the 1990s welfare reform, is currently this country's largest cash transfer program for low-income families with children. This article examines the historical components of the EITC. We then analyze the program's child poverty reduction effectiveness by comparing the percent and percentage point declines in the child poverty rate accounted for by the EITC benefit for six years between 1996 and 2005. Figures for the first four years were drawn from previous studies, while figures for the final two years were estimated with a U.S. Census Bureau calculator. All of the analyses used Current Population Survey data. We determined that the percent decline in the child poverty rate attributed to the EITC generally increased during this period (highest percent was 19.5 in 2005), while the percentage point decline remained relatively stable. We then critically examine four poverty reduction assumptions of the EITC that limit its ability to further reduce child poverty and draw social policy implications.

1. Introduction

Among wealthy nations, the United States (U.S.) has the unenviable recognition of having an exceptionally high child poverty rate. Using a relative definition of poverty (defined for each country as below half of the median equivalent after-tax income, including cash and near-cash government benefits), a recent report on 13 of the 30 members of the Organization for Economic Co-operation and Development (OECD) revealed that 21.9% of U.S. children live in poverty. This poverty rate is surpassed only by Mexico's 27.7%, is 24% higher than the next highest rate of Italy, and compares particularly unfavorably with Nordic countries (Denmark, Finland, Norway, and Sweden), all of which have child poverty rates under 4.3% (UNICEF, 2005). Even measured by the federal government's official absolute poverty definition (defines a child as poor if the family's gross cash income, excluding non-cash government benefits and tax credits, falls below the relevant threshold based on families of various sizes and composition), 18% of U.S. children live in poverty (U.S. Census Bureau, 2008).

Without government intervention, children in all industrialized nations would face an even higher risk of living in poverty (Weinshenker & Heuveline, 2006). To reduce this risk, these countries have developed unique combinations of social policies to assist workers in avoiding economic hardship (e.g., unemployment compensation, a minimum wage) and households in reducing economic hardship as a result of family income falling below a government's established minimum (e.g., welfare payments, food assistance) (Rainwater & Smeeding, 2003). As part of these poverty reduction strategies, at least ten countries have implemented income tax credit programs. The U.S., the United Kingdom (UK), Canada, Ireland, and New Zealand established their income tax credit programs in the 1970s and 1980s. Finland began its program in the 1990s, while Belgium, France, Netherlands, and Denmark launched their programs at the beginning of the 21st century (Banks, Disney, Duncan, & Van Reenen, 2005). The U.S. Earned Income Tax Credit (EITC) provides cash benefits to low-income working families (approximately 200% of the federal poverty line) by reducing the federal tax the family owes and by refunding any of the tax credit remaining after the tax liability is reduced to zero. The latter amount is referred to as the "refundable" part of the credit (Berube & Forman, 2001).

The EITC has garnered wide political support from both major political parties in this country, as well as praise from economist of various political persuasions (Greenstein, 2005). Since 1993, when President Clinton declared that the EITC would become a major component of income support programs to assist working families with children, the EITC shifted from a "work bonus" to an anti-poverty strategy (Hotz & Scholz, 2003). The EITC is currently the largest cash transfer program for U.S. low-income families with children (U.S. Government Accountability Office [USGAO], 2005). Despite the poverty reduction intentions of the EITC and its wide political support,

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two important questions remain: To what extent does the EITC reduce child poverty in the U.S.? What factors limit its poverty reduction effectiveness? By examining the EITC program and its effectiveness for reducing child poverty in a historical context, critically analyzing four limitations of the program's ability to further reduce child poverty, and providing an international and a broad U.S. policy framework for analyzing these limitations, this article goes beyond previous research and makes a significant contribution to answering these two questions.

In this article, we first discuss the evolution and current configuration of the EITC. Second, we analyze the program's child poverty reduction effectiveness for six years between 1996 and 2005 using estimates from other studies and conducting our own calculations. Third, we critically examine four limitations of the EITC that restrict its ability to further reduce child poverty. Finally, we draw social policy implications from our analysis.

Analyzing the effectiveness of the EITC in reducing child poverty is important for a number of reasons. The social work profession historically has been concerned about the inequitable distribution of income and the adverse effects of economic hardship on individuals and families (Brieland, 1995). The National Association of Social Workers Code of Ethics (1999) reflects these concerns within the core value of social justice. The Code challenges social workers to advocate for social policies that enhance the economic well-being of all individuals and to assist clients in obtaining needed resources. Research also indicates that continuing high child poverty rates incurs individual, family, and social costs. Children growing up in poverty are at higher risk of numerous negative outcomes, including child maltreatment (Pelton, 1994), poor health, socio-emotional problems, impaired cognitive development, and low educational attainment, and, as adults, at risk of low earnings, poor health, and engaging in criminal activity (Duncan & Brooks-Gunn, 1997; Holzer, Schanzenbach, Duncan, & Ludwig, 2007). An international comparison of child well-being measures also demonstrates that U.S. children are at a disadvantage (UNICEF, 2007). The U.S. ranked next to the bottom among 21 industrialized countries on an average ranking position for six dimensions of child well-being, including material, health and safety, educational, family and peer relations, behaviors and risks, and subjective well-being.

These previously cited studies and results from recent research (USGAO, 2007a; Holzer et al., 2007) also suggest that poverty is costly to the U.S. economy. Poverty can impede economic growth by reducing accumulation of human capital in the workforce (e.g., education, work experience, training, health) and increasing crime and social unrest (USGAO, 2007a). The economic costs of child poverty associated with future earnings, health problems, and crime have been estimated at $500 billion per year or approximately 4% of gross domestic product (Holzer et al., 2007). By critically evaluating the EITC, this article assists social workers in understanding the strengths and limitations of this program for assisting children living in families with economic disadvantage, and suggests avenues for social policy advocacy. The latter are discussed in the final section of this article.

2. History and current configuration of the EITC

The EITC was established in 1975 as part of an economic stimulus package to offset an economic recession and to reduce the disproportionate Social Security Tax burden of low-income working parents (Liebman, 1998; Scott, 2007). The EITC underwent major expansions in 1979, 1985, and three more times beginning with the Tax Reform Act of 1986. In 1986, credit amounts were increased and indexed to inflation. In addition to increasing the credit rates over several years, the 1990 tax bill provided slightly larger credit rates for working families with more than one child. As a result of the 1993 tax bill, childless taxpayers became eligible for a small credit; and for families with children, the credit rates continued to increase through 1996 to their current rates of 34% for families with one child and 40% for families with more than one child (Scholz, 2007; Urban-Brookings Tax Policy Center, 2007).

The most recent EITC expansion must be understood in the context of President Clinton's welfare reform, which began in 1992 by granting states exemptions to laws governing Aid to Families with Dependent Children (AFDC). The purpose of the exemptions was to identify innovative methods to encourage self-sufficiency and employment among low-income families receiving AFDC. In 1996, President Clinton signed the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) into law. The legislation replaced the AFDC entitlement program with Temporary Assistance to Needy Families (TANF), which provides employment-based, time-limited cash benefits to families with children (Noonan, Smith, & Corcoran, 2007). The EITC was expected to reduce welfare roles and increase employment, thus assisting families in becoming self-sufficient and in lifting children out of poverty.

Finally, beginning in 2002, income amounts for the beginning and ending points of the phase-out range for married taxpayers filing jointly were increased by $1000 in 2002 to $3000 in 2008 (Urban-Brookings Tax Policy Center, 2007). In 2006, 22.4 million taxpayers received a total of $43.7 billion of EITC benefits (Internal Revenue Service, 2008).

Beginning in 1994, the EITC has had a separate tax schedule for three types of families (childless, one child, and more than one child). Each tax schedule has a different phase-in and phase-out stage and corresponding credit rate. Table 1 presents figures for the three tax schedules for 2008 and for the years in which major changes in the EITC were initiated.

In 2008, childless families have the lowest maximum tax credit ($438); families with more than one child have the highest ($4824), while families with one child have a mid-range maximum credit ($2917). Tax filers determine their tax credit by using figures in the phase-in, plateau, and phase-out stages for their respective family type. In the phase-in stage, the tax credit is calculated by multiplying family income not exceeding the ending income by the credit rate. Following

Table 1
Major changes in the Earned Income Tax Credit and current parameters.

Calendar Year	Phase-in stage			Phase-out stage		
	Credit rate (%)	Ending income ($)	Maximum credit ($)	Credit rate (%)	Beginning income ($)	Ending income ($)
1975	10.0	4000	400	10.0	4000	8000
1987	14.0	6080	851	10.0	6920	15,432
1991						
One child	16.7	7140	1192	11.9	11,250	21,250
More than one child	17.3	7140	1235	12.4	11,250	21,250
1994						
Childless	7.7	4000	306	7.7	5000	9000
One child	26.3	7750	2038	16.0	11,000	23,755
More than one child	30.0	8425	2528	17.7	11,000	25,296
1996						
Childless	7.7	4220	323	7.7	5280	9500
One child	34.0	6330	2152	16.0	11,610	25,078
More than one child	40.0	8890	3556	21.1	11,610	28,495
2002[a]						
Childless	7.7	4910	376	7.7	6150	11,060
One child	34.0	7370	2506	16.0	13,520	29,201
More than one child	40.0	10,350	4140	21.1	13,520	33,178
2008						
Childless	7.7	5720	438	7.7	7160	12,880
One child	34.0	8580	2917	16.0	15,740	33,995
More than one child	40.0	12,060	4824	21.1	15,740	38,646

Source: Urban-Brookings Tax Policy Center, 2007.
[a] Beginning in 2002, the values of the beginning and ending points of the phase-out range were increased for married taxpayers filing jointly. The values for these taxpayers were $1000 higher than the listed values from 2002–2004, $2000 higher from 2005–2007, and $3000 higher in 2008.