

## A Payday Bonus

The Earned Income Tax Credit helps “make work pay” for millions of hard-pressed families. Despite some blemishes that need fixing, on the whole it’s a real success.

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Russell Long was hardly the darling of liberal tax reformers when he chaired the Senate Finance Committee in the 1970s. In fact, we usually saw him as a toady for corporate special interests. But as the genial Louisiana Democrat liked to say, even a blind hog finds an acorn once in awhile.

The Earned Income Tax Credit (EITC), first adopted at Long’s instigation in 1975, was the late senator’s acorn. And like an acorn, the EITC has become a mighty oak. Today, it is the federal government’s largest cash-assistance program for low- and moderate-income families with children. It enjoys broad popular support, in large part because, unlike welfare, you have to work to get it. (Contrary to the myth that the EITC enjoys bipartisan support, that feature doesn’t always impress GOP lawmakers in Washington.) Like any program, the EITC has its problems, but overall it’s one of the big success stories of the past quarter-century in making life better for hard-pressed working families.

Back in 1976 when it first took effect, Senator Long’s EITC offered low-income working families with children a tax break equal to 10 percent of their earnings. The credit, worth as much as \$1,300 per family, was phased out between \$13,000 and \$26,000 of income (all figures here and later are in today’s dollars). That sounds pretty good, but coming from a poor state, Long understood that tax breaks aren’t much use to families that don’t owe any income tax. So he made his EITC “refundable” -- meaning the Internal Revenue Service sends people a check for any credit left over after they’ve cut their income tax to zero. As Long surely expected, this innovation proved a particular boon to his state. This year, 23 percent of Louisiana taxpayers will claim the EITC, second only to Mississippi at 25 percent. (In comparison, just 7 percent of taxpayers in a wealthy state like Massachusetts get the credit.)

To assuage members of Congress worried about “handouts,” Long’s committee reports justified the EITC refunds in part as “offset[ting] social security payroll taxes.” But they also defended the tax credit as “an effective way to provide work incentives,” and, more generally, as simply helping “a hard-pressed group in the population -- the lower income worker.”

As inflation raged in the late '70s, the Democratic Congress adjusted the EITC to maintain its purchasing power. But in 1981, Ronald Reagan passed his huge corporate and upper-income tax-cut bill, and he let the EITC languish. Soon, inflation had eroded the credit’s value by a third -- a loss that wasn’t reversed until the 1986 Tax Reform Act, when Democrats insisted on restoring the EITC to its earlier level and indexing it for inflation thereafter. Reagan, who had tired of supply-side-ism, went along -- despite vociferous opposition from most House Republicans.

The EITC's biggest increase came in 1990 under George Bush Senior. Led by Newt Gingrich, House Republicans rejected Bush's deficit-reduction program and forced him to negotiate exclusively with Democrats over details of the tax increase that all responsible people agreed was necessary. After most matters were resolved, the fight came down to this: Bush wanted to sweeten the bill for his wealthy constituents with a capital-gains tax cut, while Democrats wanted a big EITC boost to offset the bill's regressive excise-tax increases on the poor. The Democrats prevailed, and the EITC was almost doubled, to a maximum of \$2,550.

In 1993, Bill Clinton boosted the EITC by about 25 percent more, making the maximum credit \$2,600 for one-child families and \$4,300 for larger ones. This improvement was coupled with Clinton's deficit-reducing tax increases on the wealthy, which passed the Congress without a single Republican vote.

Eight years later, George W. Bush pushed through a tax package overwhelmingly tilted toward the rich. But like his father, Bush Junior reluctantly accepted a progressive idea from congressional Democrats, who insisted that low-income working families should get something from Bush's increase in the per-child tax credit from \$500 to \$1,000. As a result, the per-child credit, like the EITC, can now be "refundable."

This year, 16 million families will share \$35 billion from the EITC, plus another \$10 billion in child credits. On average, those credits will be almost exactly enough to bring these families' combined federal income and payroll taxes down to zero. EITC families making less than \$20,000 will do much better than that, with credits averaging 167 percent of their income and payroll taxes. EITC families making more than \$20,000 will get about three-fifths of their income and payroll taxes eliminated.

As a wage supplement, the credit is quite powerful. The 3.3 million EITC families making less than \$10,000 a year, for example, take home about \$19 billion before income taxes. Their EITC and child credits raise that by \$7 billion -- a 38 percent increase. For EITC families making between \$10,000 and \$20,000, the wage supplement is 25 percent. In both cases, it's like a \$2 an hour wage boost, tax-free.

Fortunately, 17 states and the District of Columbia now augment the federal EITC with their own piggyback versions. These initiatives range from Vermont's refundable credit (equal to a third of the federal amount) down to Maine's 5-percent nonrefundable credit. Advocates continue to press other states to sign on. And while more states should surely do so, they should keep in mind that unless its cost is paid for fairly -- i.e., not with regressive tax increases or cuts in low-income programs -- a state-level EITC's advantages can be undermined.

Overall, the EITC is a great program. But it does have a problem that my friends rarely want to talk about: a strong bias against parents getting married. On talk shows, I often get calls from women complaining about how "my foolish daughter and her good-for-nothing boyfriend won't give my grandchildren a normal married home because they'd pay so much more in taxes." It's a valid concern.

Consider, for example, a couple with two kids, each partner making \$18,000 a year. As unmarried parents, each partner can claim a credit of about \$2,000. But should this couple marry, they would lose their EITC eligibility -- representing a \$4,000 marriage penalty! Or take a couple with two children in which one partner earns \$60,000 and the other \$10,750. Hardly poor, you might say. Yet unwed, this couple is entitled to a \$4,300 credit. Married, they get zero. And overall, families with more kids forfeit the most.

What to do? One cheap solution would be to allow only one credit per household, and to base it on what the higher-income parent earns. Such restrictions used to apply but were dropped because many people simply ignored the rules and took credits they legally shouldn't have. Given that the old rules were so hard to enforce, abandoning them arguably made sense. More important, the changes dealt with nasty Republican attacks on the EITC, which claimed the program is permeated with cheating. Those complaints were hypocritical -- they occurred even as GOP lawmakers were browbeating the IRS to scale back its efforts to stop much broader tax evasion committed by the unscrupulous rich -- but they did have enough validity to gain political traction.

Another solution to the EITC's bias against marriage would be to let married couples take the same tax credits as unwed ones. This wouldn't be hard to administer, but it would be very expensive.

I suppose one could argue that the EITC marriage penalty isn't much of a problem, as couples can simply avoid marriage if they want to take full advantage of the credit. But I find that argument unpersuasive. Someday, when a strong economy and sound fiscal policies put our government back in the black, the EITC's marriage-penalty problem will need to be addressed.

For all its virtues, does the EITC, as a taxpayer-financed wage subsidy, perversely allow employers to pay lower wages by "subsidizing" work? It's a reasonable question, but it seems unlikely. After all, two-thirds of single-parent workers get the credit, but only a tiny fraction of other workers do. It's hard to imagine that employers, however nefarious, could arrange to pay their single-parent employees less than their married or childless ones.

And given practical political and fiscal realities, could the EITC's hefty cost be better spent on other strategies to help the working poor? Should we rely more on a higher minimum wage than the EITC, for example, thereby shifting costs away from federal coffers and saving public resources for other uses? Well, privatizing wage subsidies does have the notable advantage of not showing up in the budget. But a minimum-wage increase would likely fall short of the EITC in important ways. It would directly help far fewer families than the EITC, because most EITC recipients make well over the minimum now. And any minimum-wage raise would be less targeted than the tax credit to working families, because so many students and low-wage singles earn the minimum. Of course, that doesn't mean that the minimum wage shouldn't be increased. It *should* -- but as a complement to the EITC, not a substitute.

In a \$12 trillion economy, you might think that a \$45 billion federal program wouldn't have all that much impact. Yet the Earned Income Tax Credit offers an awful lot of bang for those bucks. On average, it adds about \$2 an hour to the wages of 10 million low-income families with children, and about a buck and a half an hour to the wages of

6 million slightly better-off families. It provides a template for states to easily augment that assistance. And because it's inherently linked to work, it resonates positively with the general public.

Russell Long may not have quite delivered on his father Huey's promise to make "every man a king," but he left a bigger legacy for working families than he probably ever dreamed.

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