

National Economic Trends

The Earned Income Tax Credit at Work

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 has been praised for achieving record reductions in poverty rates and for increasing the labor force participation of women, especially single women with children. This reform replaced the Aid to Families with Dependent Children (AFDC) program, which had unambiguous work disincentives, with the Temporary Assistance for Needy Families (TANF) program. TANF has eligibility criteria similar to AFDC, such as income thresholds and the presence of related children, but imposes a lifetime limit on the receipt of welfare benefits and includes work requirements to provide employment incentives.

In addition to TANF, the Earned Income Tax Credit (EITC) has played an important role in raising employment among low-income individuals and alleviating poverty through wage subsidies to low-income individuals and families. During the 1990s, the EITC was expanded significantly on several occasions, and today it provides as much in payments—about \$31 billion in 1999—as TANF and the Food Stamp program combined. Since more than half of the EITC payments go to families with wage incomes below the poverty line, the program has also become an important instrument for reducing poverty, lifting 4.1 million people out of poverty in 1999 according to the Economic Report of the President, January 2001.

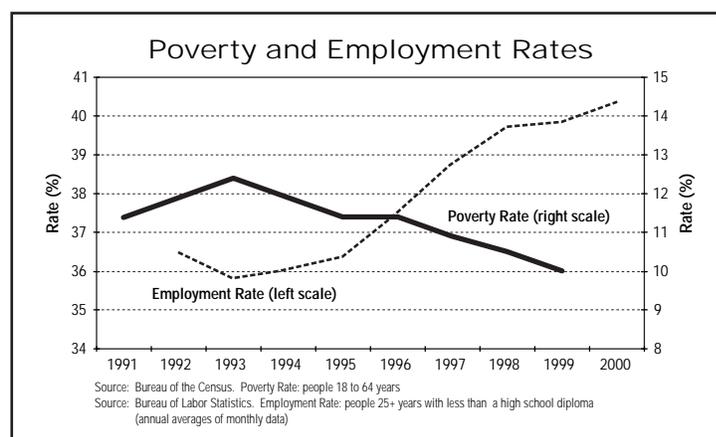
Less-educated individuals are predominant among low-income workers. The accompanying chart compares the employment-to-population ratio, or employment rate, of individuals 25 years and older with less than a high school education with the fraction of individuals of working age (18 to 64 years) with incomes below the poverty line, as compiled in the Current Population Survey. A decline in the poverty rate since 1993—when the EITC was expanded—has coincided

with a rise in the employment rate, and both trends have accelerated since welfare reform was enacted in 1996. In contrast, the employment rate among individuals who completed a high school education has remained fairly constant at 62 percent during the same time period. Thus, while the TANF time limits may have pushed welfare recipients to work, the strong economy and the EITC may have done more to pull them into jobs and lift them out of poverty.

This conclusion is consistent with existing evidence on employment and poverty rates for single mothers—who have been the focus of analysis by economists, because the size of the wage subsidy adjusts for the number of children in a family. In a recent study, for example, Meyer and Rosenbaum provide evidence showing that, among several alternative explanations, the EITC has been crucial in raising the employment rate for single mothers, while its effectiveness with other low-income groups, such as single women without children, has been moderate at best.¹ This contrast in results suggests that the EITC has benefited families, in particular, at the bottom of the income ladder.

—Rubén Hernández-Murillo

¹ Meyer, Bruce D., and Dan T. Rosenbaum. "Making Single Mothers Work: Recent Tax and Welfare Policy and Its Effects." *National Tax Journal*. Part 2, December 2000, 53(4), pp. 1027-61.



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