Metro Raise: Boosting the Earned Income Tax Credit to Help Metropolitan Workers and Families

Alan Berube, David Park, and Elizabeth Kneebone

To alleviate poverty, make work pay, and help low-wage workers and lower-income families meet rising costs of living, the federal government should expand the **Earned Income Tax Credit (EITC).**

Targeted expansions to the credit and new options for workers to receive the EITC over the course of a year (rather than in a lump sum) would ensure more economically inclusive growth, particularly in the major metropolitan areas where the bulk of America's working poor resides.

America's Challenge

Even as the U.S. economy was growing strongly in recent years, median household incomes and average hourly wages stagnated. Today, about one-quarter of the nation's workforce is employed in low-wage jobs, and low-wage occupations are projected to account for 30 percent of U.S. job growth in the coming years. Meanwhile, prices for necessities such as housing, transportation, and child care have continued to rise for lower-income workers and families. Slowing economic growth and a potential recession place additional, immediate pressures on the nation's less-skilled, lower-wage workforce.

Limitations of Existing Federal Policy

Because it reduces poverty and inequality while promoting work, the EITC is widely acknowledged as one of the singular successes of American social policy in recent decades. Yet the EITC could do more for certain workers and families to help make work pay and to close the growing gap between stagnant wages and rising prices. Moreover, the annual lump sum in which nearly all EITC is delivered is not well timed to help low-income families meet their year-round needs.

A New Federal Approach

The federal government should expand and modernize the EITC, and in doing so help an estimated 8.4 million tax filers in the nation's 100 largest metropolitan areas, and 14.5 million nationwide, by:

- ***Tripling the maximum EITC for low-income, childless workers*** to about $1,300 in tax year 2008, boosting the financial return to work and ensuring that the federal government does not tax these workers into deeper poverty;
- ***Allowing married couples to exclude one-half of a second earner's income*** when calculating the EITC, thus reducing economic disincentives for low-income couples to marry and for spouses to join the labor force;
- ***Expanding the EITC for working families with three or more children;*** these families are twice as likely as smaller families to have low incomes, but they receive no incremental assistance under the current EITC;
- ***Creating a new, streamlined periodic payment option*** that would provide eligible tax filers with a portion of the credit's proceeds directly from the IRS throughout the year, as other countries with similar tax credits do

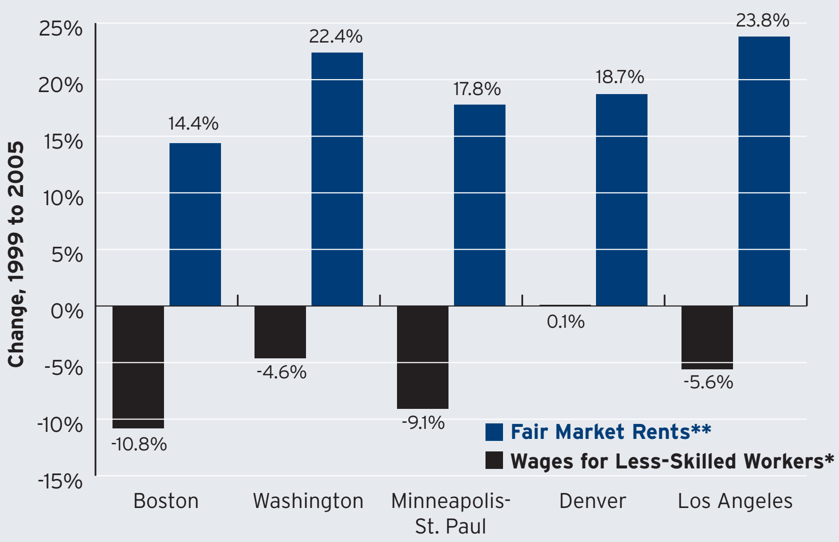
America's Challenge

Economic growth in recent years has not improved wages for most American workers, particularly those near the middle and bottom of the earnings distribution. Meanwhile, rising costs of housing, energy, and child care further strain lower-income families' budgets. This widening gap between wages and prices and the growing likelihood of an economic downturn threaten to exacerbate record-high levels of inequality in the United States.

American workers are already feeling the effects of a slowdown. Workers are experiencing longer periods of unemployment. Nearly one in five is still looking for a job after 27 weeks of being unemployed. Evidence also points to falling wages in recent months. Moreover, workers who lost their full-time jobs in the early 2000s were not always able to find new full-time work or a job that offered the same pay. Economist Henry Farber finds that 13 percent of these workers ended up taking part-time jobs, while those who managed to find full-time work earned about 13 percent less, on average, in their new positions.

The economic issues facing many workers predate the current slowdown. Despite overall economic growth of nearly 3 percent annually between 2002 and 2006, real average hourly earnings for private-sector workers failed to grow. The gap between productivity growth and median family income has reached its widest point in the postwar era. Over the longer term, economic forces such as technological change and globalizing trade have depressed wage gains for less-educated workers. Between 1975 and 2005, average hourly wages for workers without a high school diploma dropped precipitously, and stagnated for workers with just a high school diploma. Today, at least one-quarter of the U.S. workforce is employed in low-wage jobs.

In most major metro areas wages have slipped, while rents have continued to rise



*Wages at 20th percentile of all wages earned in metro area
** HUD fair market rent for 2-bedroom apartment
All amounts adjusted for inflation
Source: Brookings analysis of Census Bureau and HUD data

Costs of living continue to rise for lower-income, working families. Between 2000 and 2006, median rents increased 5 percent, even as median family income declined by more than 3 percent. The disparity was even larger in major metro areas such as Washington and Los Angeles, where rents grew by more than 20 percent amid falling wages for less-skilled workers. Although lower-income workers depend more heavily on public transportation than other groups, fully 72 percent still rely on private vehicles for their commutes, and thus contend with gas prices that rose at three times the overall rate of inflation. And the inflation-adjusted price of child care rose 14 percent from 2000 to 2007.

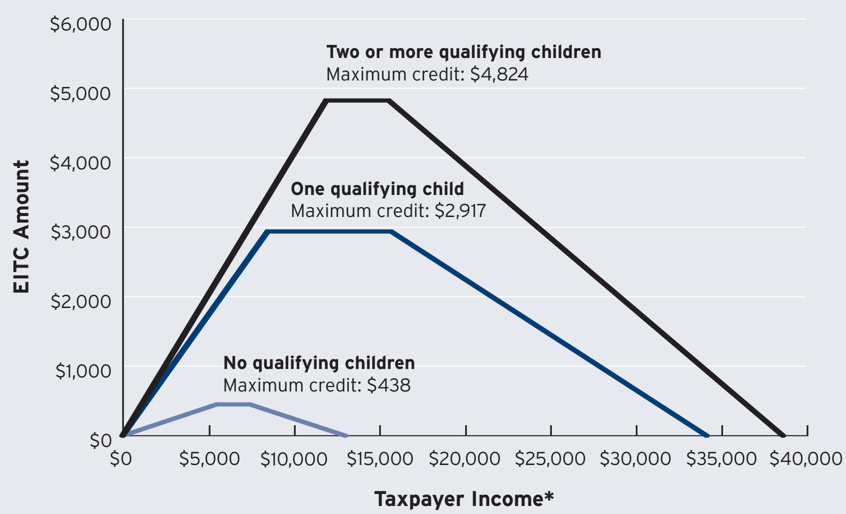
In short, the nation's low-income workers—particularly those in major metropolitan areas—are swimming upstream against rising costs for basic necessities as their earnings flatten and as the labor market picture sours further.

Limitations of Existing Federal Policy

The U.S. federal government—like other governments around the globe—has created policies to support low-income workers and their families. Chief among them is the Earned Income Tax Credit (EITC), which provided more than $43 billion to more than 22 million low-income filers in tax year 2006. Despite its success, the federal government could make the EITC even more effective for certain workers and families.

The EITC addresses a number of problems that lower-income workers face. The EITC reduces poverty. According to the Center on Budget and Policy Priorities, in 2003, the EITC lifted 4.4 million people out of poverty, including 2.4 million children—more than any other single program or category of programs. The credit also promotes work. Economists Nada Eissa and Jeffrey Liebman estimate that the EITC and other tax changes accounted for more than 60 percent of the increase in single mothers' work between 1984 and 1996. The credit also helps to mitigate rising income inequality. The Congressional Budget Office finds that the EITC and related tax credits boost by 1.2 percent the share of total income received by lower-income households with children.

The Earned Income Tax Credit provides up to $4,800 to working families in 2008



**Phase-out begins at $3,000 higher income level for married joint filers*
Source: Internal Revenue Service

Yet the EITC could do more to help America's low-income workforce. Four areas for improvement stand out:

- **The EITC for childless workers is very small.** At a maximum value of $438, the EITC for workers without qualifying children (including noncustodial parents) provides a modest boost, at best, to the wages of workers earning the least. Many of these workers—particularly less-educated young men—face significant labor market challenges yet do not benefit from the incentives and support that single mothers receive through the tax code. As a result, low-income, childless workers face much higher tax burdens than low-income families with children, and those at the poverty line are taxed deeper into poverty by federal income and payroll taxes, even after accounting for the EITC.

- **The EITC creates an implicit tax penalty on low-income, dual-earner couples.** Most EITC recipients are working, single parents with children. Yet they face the prospect of losing most, if not all, of their EITC if they marry another low earner. By marrying, two $15,000 earners—one of whom has two children—would see their combined EITC drop by about $2,400 in 2008. By the same token, the phase out of the EITC with increasing earnings may create disincentives for work among potential second earners in lower-income married-couple households.

- **The EITC offers no incremental assistance to large families, who are more likely to have low incomes.** The EITC has tiers of increasing support for childless workers, families with one child, and families with two or more children. Yet working families with three or more children—who are twice as likely as those with one or two children to have incomes below 150 percent of the federal poverty line—qualify for no additional EITC benefits. Moreover, certain costs of living (such as housing, child care, and food) are greater for larger families, although wages generally are not.

- **The benefits of the EITC are not timed to coincide with household needs.** Because the EITC is part of the federal income tax code, the overwhelming majority of recipients receive the credit via an annual tax refund. Only a very small share uses the Advance EITC option, which transfers a portion of the credit to workers through their paychecks. Although most EITC recipients prefer to receive their payments in a lump sum, research suggests that they use the bulk of their EITC refunds to cover ongoing expenses, paying bills such as rent and utilities. A better-designed periodic payment system could enable a larger share of EITC recipients to exercise greater choice in their purchase of day-to-day, month-to-month necessities such as housing or child care. Most other nations that provide so-called "in-work" tax credits like the EITC deliver a significant proportion of their credits periodically to recipients.

The federal government has not expanded the EITC significantly since 1993. During that time, 16 states created their own versions of the EITC through their income tax codes, and six expanded existing EITCs.

Nearly all of these states piggyback on the federal EITC by providing low-income residents a portion of the federal credit. These state-level versions of the credit help address the wide gap between wages and prices in higher-cost areas of the country, but they leave ample room for the federal government to address the serious challenges that face low-income workers nationwide.

A New Federal Approach

The federal government should build on the success of the EITC by improving the credit's design and augmenting its impact for childless workers; low-income, dual-earner couples; and families with three or more children.

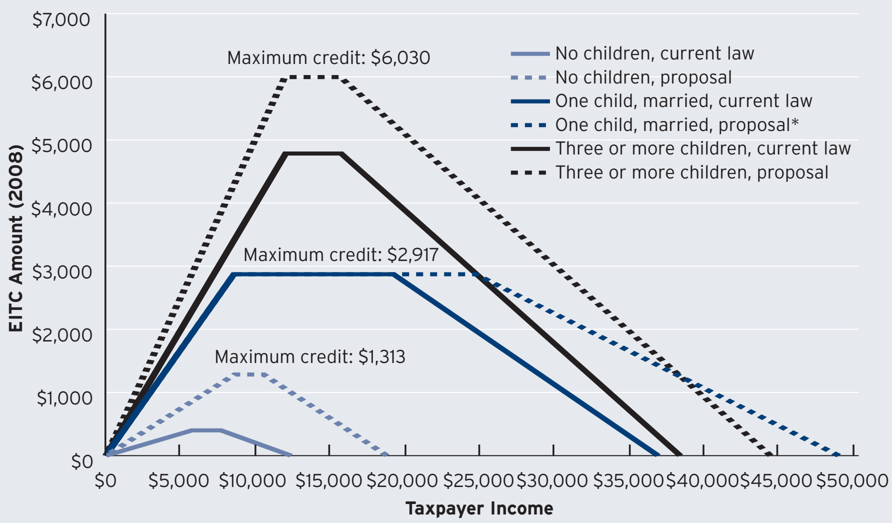
Along with a new federal effort to provide a portion of taxpayers' EITC proceeds throughout the year, these enhancements—while benefiting workers and families everywhere—would be particularly helpful to those living in the nation's major metropolitan areas, where the gap between wages and prices looms large. Moreover, expanding the EITC would also provide a useful fiscal jolt to the metro areas where low-income filers are geographically concentrated, particularly during a slowing economy.

Specifically, we recommend that the federal government:

- **Triple the maximum EITC for low-income, childless workers.** To improve incentives for these workers and relieve their federal tax burden, the federal government should double the rate at which the EITC for workers without qualifying children phases in, from 7.65 percent to 15.3 percent. It should also triple the maximum credit value, from $438 to $1,313 in 2008.

  We find that 4.1 million workers in the nation's 100 largest metro areas (and 7.1 million nationwide) would benefit from this expansion, either by becoming newly eligible for the EITC or by receiving a larger credit. These workers would qual-

Proposals to expand the EITC would benefit childless workers, dual-earner married couples, and families with three or more children



**Structure shown for married spouses with equal incomes. Proposal shown for families with one child, but applies to all filer types*
Source: Internal Revenue Service and Brookings analysis

ify for an additional $2.3 billion in credits ($4.0 billion nationwide). Metro areas with larger populations of younger workers, such as Madison, WI, Portland (OR and ME), and Boise, ID, would see significant increases in the amount of EITC their residents receive, as would older industrial metro areas with more workers at the margins of the labor market, such as Springfield, MA, Buffalo, NY, and Syracuse, NY.

- **Allow married couples to exclude one-half of a second earner's income when calculating the EITC.** This "married earnings deduction" would reduce the marriage penalty that affects some EITC earners and promote work among both spouses in low-income, married households. This proposal would extend the maximum income at which equal-earning spouses with one child could earn the credit in 2008 from about $37,000 to just shy of $50,000 (those with two children and incomes up to about $55,000 could qualify).

  An estimated 1.8 million married-couple tax filers in the nation's 100 largest metro areas (and 3.3 million nationwide) would gain an additional $1.3 billion in EITC benefits ($2.3 billion nationwide) under this proposal. Several moderately sized metro areas would derive particular benefit from this proposal, including Oxnard, CA, Salt Lake City, UT, Omaha, NE, Tulsa, OK, and Greensboro, NC. In these regions, married couples represent an above-average share of the EITC-eligible population.

- **Expand the EITC for workers with three or more children.** An additional "tier" in the EITC specifically for larger working families would help address the greater cost burdens that these families bear and help alleviate their more frequent poverty. This specific proposal would increase the EITC phase-in rate for these families from 40 to 50 percent, thereby increasing the maximum credit for which they could qualify by roughly $1,500.

  This proposal would result in new or higher EITC eligibility for 2.9 million working families in the 100 largest metro areas (and 4.8 million nationwide), and it would boost the credit amount for which they qualify by $2.6 billion ($4.3 billion nationwide). The regions of the country that would benefit most from this proposal include several with large Latino populations, which have larger average family sizes. These regions include Riverside and Fresno, CA; Phoenix, AZ; and Houston, TX. Also poised to gain significantly are some smaller metro areas in the Northeast, including Lancaster and Harrisburg, PA, and New Haven, CT.

These enhancements to the EITC—while benefiting workers and families everywhere—would be particularly helpful to those living in the nation's major metropolitan areas, where the gap between wages and prices looms large.

If these three proposals were adopted together as a package, we estimate that 8.4 million tax filers in the nation's 100 largest metro areas would qualify for an additional $6.4 billion in EITC. Nationwide, 14.5 million filers could see a credit increase of roughly $11 billion. More-

Expanding the EITC would benefit millions of workers and families in the largest metropolitan areas, and nationwide

Proposal	Taxpayers Benefiting (1,000s)		Additional Federal EITC ($millions)		Additional State EITC ($millions)	
	100 metros	Nation	100 metros	Nation	100 metros	Nation
Triple maximum credit for childless workers	4,074	7,113	$2,271	$3,996	$116	$168
Allow lower-earning spouse to exclude one-half of income	1,789	3,277	$1,301	$2,332	$60	$101
Expand credit for families with three or more children	2,901	4,729	$2,632	$4,266	$137	$199
All 3 proposals combined*	**8,389**	**14,451**	**$6,445**	**$11,032**	**$324**	**$485**

**Three-proposal combination estimates differ from sums of individual proposals because some taxpayers benefit from more than one proposal*

Source: Brookings analysis, based on 2005 American Community Survey data

over, these proposals would generate an automatic state-level response because nearly all states with EITCs tie their benefits directly to the federal credit. In 39 of the 100 largest metro areas, families could claim an additional $324 million through state versions of the EITC ($485 million nationwide), and those in the New York and Washington metro areas could reap an additional $16 million via local versions of the credit, if these proposals were adopted.

These proposals would effectively target three groups of workers and families who need particular help: those with low incomes, those earning low wages, and those bearing severe housing-cost burdens. Among those tax filers in major metro areas who would benefit from the enactment of all three proposals:

- Fully 71 percent have incomes below 150 percent of the federal poverty line (roughly $31,000 for a family of four)

- One-third earn family wages of less than $9 an hour, as do nearly one-half of those who would benefit from the EITC expansion for childless workers

- More than one-third live in households that spend at least one-half their incomes on housing costs. That percentage is much higher in regions such as the San Francisco Bay Area, New York, Boston, Chicago, Denver, and San Diego, where credit expansions would help large shares of working families who struggle to keep up with rising housing costs

Furthermore, the federal government should create a more viable periodic payment option so workers and families can access the proceeds of the EITC throughout the year. Such an option would be particularly valuable to the estimated 37 percent of major-metro EITC recipients for whom the credit represents at least 20 percent of their annual income. A few key principles should guide the design of this option:

- **Make periodic payment an "opt-in" at first.** The design for a new system should aim to give recipients a viable choice between lump-sum and periodic payments, as exists in many other countries with similar tax credits

- **Retain the IRS as the administrative agency.** Expanding advanced payment of the EITC would inevitably increase its administrative costs; therefore the system's design should build on existing IRS processes to minimize additional expenditures

- **Make payments directly to recipients, not through employers.** Direct deposit would be the best method for making periodic EITC payments if the many "unbanked" households who qualify for the credit were provided viable options for receiving their benefits in this way

- **Take steps to minimize repayment obligations.** The federal government should adopt reasonable tolerances for small overpayments, provide opportunities for taxpayers to communicate with the IRS regarding changes that might affect their eligibility, and limit to 50 percent the amount of expected EITC that can be claimed throughout the year

- **Balance competing priorities in payment frequency.** A quarterly payment system for the EITC would build on existing IRS processes, allow recipients a degree of forced savings, and deliver additional income to families to help them finance ongoing consumption needs

A better-designed periodic payment system could enable a larger share of EITC recipients to exercise greater choice in their purchase of day-to-day, month-to-month necessities such as housing or child care.

The estimated combined cost of the three expansion proposals in 2008 is roughly $12 billion. The ultimate cost of administering a new periodic payment system for the EITC would depend on the specifics of system design, and the share of eligible taxpayers who chose to receive payments periodically. However, costs could likely be kept well under $1 billion annually. Costs would be lower, of course, if only one or two of the three credit expansion proposals were adopted. We believe that the expansion for childless workers should be the highest priority. Because that change alone could exacerbate the "marriage penalty" problem in the EITC, however, the dual-earner deduction proposal deserves nearly equal consideration.

Even if these are judged to be modest expenditures in light of the pressing problems facing low-income workers and families, the nation's precarious fiscal situation nonetheless obligates the federal government to consider ways to offset these costs and ensure they do not add to the long-run budget deficit. Notably, the major income tax cuts enacted in 2001—including across-the-board marginal rate reductions—are scheduled to expire in 2010. Overall, these cuts disproportionately benefited high-income taxpayers and exacerbated the trend in after-tax income inequality. With mounting challenges facing low-income workers and families, and the wealthiest taxpayers now holding a larger share of income than at any time since the Great Depression, the next Congress and Administration should consider enacting these EITC expansions as part of broader efforts to restore greater progressivity to the federal tax code.

Making the EITC work better for certain types of workers and families, and giving its recipients greater access to the benefits throughout the year, should be a top priority for the next Administration and Congress as our nation charts uncertain economic waters ahead.

Lower-income workers and families in the United States, and particularly in its major metropolitan areas, face twin challenges of stagnating earnings and rising prices. The current economic slowdown, and possible downturn ahead could exacerbate those challenges. Fortunately, the federal government has a proven tool for alleviating poverty, making work pay, and reducing income inequality in the Earned Income Tax Credit. Making the EITC work better for certain types of workers and families, and giving its recipients greater access to the benefits throughout the year, should be a top priority for the next Administration and Congress as our nation charts uncertain economic waters ahead.

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For More Information

The full paper from which this brief is drawn, and an accompanying paper by Steve Holt on "Periodic Payment of the EITC," are available at
www.blueprintprosperity.org

Alan Berube
Research Director and Fellow
Metropolitan Policy Program at Brookings
aberube@brookings.edu

David Park
Senior Research Assistant and Data Coordinator
Metropolitan Policy Program at Brookings
dpark@brookings.edu

Elizabeth Kneebone
Research Analyst
Metropolitan Policy Program at Brookings
ekneebone@brookings.edu

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1775 Massachusetts Avenue, NW
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at BROOKINGS

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