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THE EARNED INCOME TAX CREDIT AT 50: PAST, PRESENT, AND FUTURE

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WELCOME AND MODERATOR

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DISCUSSION:

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WESSEL: Good morning. Thank you for coming, and for those online, thank you for joining us online. I'm David Wessel, director of the Hutchins Center on Fiscal and Monetary Policy for the Brookings Institution. And it was actually Jacob Bastian and I had coffee about a year ago, and he pointed out to me that this was the 50th year of the Earned Income Tax Credit, which began small and has become, as you'll hear, perhaps the most important need-based, the largest need-based anti-poverty program in the country. And so we thought it would be a good time to think about what we've learned about the EITC and also to look forward a bit. There are some provisions in the reconciliation bill that would make some small changes in the EITC, but fundamentally the reconciliation would leave the structure of the earned income tax credit, which is basically a wage bonus we pay low-income workers, mainly workers with children, leave it largely intact.

So I'm very pleased to be joined today by Jacob Bastian who's an assistant professor of economics at Rutgers. Prior to joining Rutgers, he was a postdoc at the University Chicago's Harris School. His PhD is from the University of Michigan and he spent a year in the White House at the Council of Economic Advisers from 2023 to 2024. And Jacob’s done a lot of work on the earned income tax credit and he happens to be a nonresident fellow in our Tax Policy Center. Hilary Hoynes is the chancellor's professor of economics and public policy at the University of California at Berkeley, where she directs the Berkeley Opportunity Lab, and she's also for some reason an associate Dean. I don't know why you decided to do that. She's done a lot of work on how access to social safety nets in early life affects how children turn out later in life. Her PhD in economics is from Stanford. Henrik Kleven is professor of economics and public affairs at Princeton. Before that he was at the London School of Economics and the University of Copenhagen. He's done a lot of work combining empirical evidence in economic theory to think about ways to define, devise more effective public policies. Henrik's PhD is from the University of Copenhagan. And Jim Sullivan is professor pf economics at Notre Dame and Director of its Wilson Sheehan Lab for Economic Opportunity. It says on the website the acronym is LEO, so was that some sort of predictor of who, the pope's name?

SULLIVAN: No relation to the pope.

WESSEL: That work, the center works with service providers and policymakers to identify effective and importantly scalable solutions to poverty. And just to prove we have diversity, his PhD is from Northwestern so we do not, diversity at Brookings means four different PhD programs. So what we're going to do, I'm going to ask each of the panelists to speak about something we've agreed on in advance, and then we have time for some questions from you. And I know there's some people in the audience who could easily be on this panel, and I welcome you to contribute. So Jacob, let me start with you. And can you just give people who don't know what is the EITC, how big is it, and what do we think about its effect on whether people, more people just choose to work.

BASTIAN: Thanks David. Well good morning everybody here and watching online. My name is Jacob Bastian and so I'm going to in a few minutes try to talk about the structure of the EITC fifty years of history and then a little bit of evidence on the labor supply. So the earned income tax credit has really grown a lot over its fifty-year history. So it started as a relatively small wage subsidy in 1975 designed to help offset the Social Security payroll tax. It was a time of high inflation, trying to help lower income working families. The program has expanded in the 80s, massively expanded in 1990s, expanded again in the 2000s. And the idea, big picture, is that it's a wage subsidy. So for lower income, working families, this is a major program worth about $70 billion a year today. And if you do not work, there are no benefits for you. If you earn too much, there are no benefits for you, and benefits depend on how many kids you have as well as marital status.

And so to give some trends over time, when the program started in the 70s, it helped about six to seven million families per year. As it expanded, the program now serves about 30 million families a year. When the program started in 1970s it was worth less than ten billion dollars a year, about six to seven billion dollars here in today's dollars. Today benefits are worth about seventy or eighty billion dollars the year. And conditional on getting benefits in the 70s and 80s, the average recipient received about a thousand dollars per year, whereas now it's about three thousand dollars a per year. And again part of the policy variation is it really matters how many kids you have. So today, if you have one child, benefits are worth up to about $4,500. If you have two children, benefits are worth about $7,000 a year. If you are three or more children, the benefits are about $8,000. So 2025, we also have a number of states and localities that top up the federal program. There are about 31 states, DC, a couple of cities, also have their own EITC. So put it all together, and tax credits can be worth over $10,000 a year for lower-income working families. So imagine you're working, you have two children, you're earning $20,000, $25,000 dollars a year. Once a year, a tax refund comes to you for $10,000. Whether that's the most efficient way of designing our safety net, that's what we do today: we give people a big infusion of cash once a year.

And it does a lot of good so there's a lot evidence on this and part of the reason why economists, people in this room, people on the stage have studied these policies because there's a lot of variation. Economists like myself, we love policy variation, helps us estimate difference in differences, different types of outcomes. And so if you zoom out on the focus on labor supply now for a minute if you do not over the last fifty sixty years look at women's labor supply. The reason why I'm gonna focus on unmarried parents is because the structure of the EITC, it depends on family income. So if you're married, your spouse is already working. There's not really an additional incentive for the secondary spouse to work. So the major incentives are for single parents. So if look at single mother's employment over the last 50, 60 years, it's been increasing because we know employment increased for women in the 60s, 70s, 80s, 90s. But for women with kids relative to women without kids there's a little increase in the seventies and a massive increase in the nineties so i have research showing that the 70s yet you see increased labor supply in the 1990s there's lot going on there was a big yet you seek expansion but there is also welfare reform a strong economy changing norms and so a lot of research suggest that uh... Of the big twelve fourteen percentage point increase of working mothers the ATC is responsible for about a third. So, final points. EITC and welfare reform, can we disentangle those two? They both happened in the 1990s. There's a lot of evidence suggesting yes, you can disentangle them. You can look at states before they pass welfare waivers. You can use the age of youngest kids. And then something new I'm working on is thinking about evidence from other countries that have similar type of policies. And we see that they also lead to generally an increase of labor supply. So EITC at 50 helps a lot Uh... Tens of millions of low-income families and has done a lot of good

WESSEL: So, Henrik, you shook up the economics profession by suggesting that maybe the EITC didn't have as big an effect on drawing people, unmarried women, or single-parent women, as Jacob said, into the labor force. So what do you think the labor-force impact of the EITC is? And then also, I think you can also talk, well, I have a follow-up question, but let's, let's start with that.

KLEVEN: Well, first of all, thanks for having me here. It's a delight to be here and talk about this important policy. So Jacob did a really good job of explaining what this program is doing and what some of the literature has been showing in terms of the labor supply impacts. Let me talk a little bit about the work I did, but maybe try and sort of look for places where I think we're most likely to find a common ground. In terms of what the evidence is saying. So I wrote this fairly comprehensive reappraisal of the literature on the labor market impacts of the EITC focusing especially on something that's been very central in this debate, namely the impact of the program on the employment rates of single mothers. And so I took a very comprehensive approach looking at every single EITC reform over the last 50 years at both the federal and the state level. In that paper, you know, I argued that, you know, we should be a little cautious, more cautious about how we interpret the evidence. In a nutshell, rather than insisting that the effect on labor supply is necessarily very small or zero, what I really highlighted in that paper is that the estimates are not very robust. I literally, you showed hundreds, more than 500 difference in differences and events that he estimates in that paper, showing that overall, the estimated effects on employment of single mothers are clustered around zero. But at the same time, it is possible to find specifications that suggest large effects. So what this means is that saying that the EITC necessarily have large effects on employment requires want to take a... Strong stand on certain empirical specifications when there are many other specifications out there to produce very different results. Now I want to sort of highlight two or three other points that are important for interpreting the implications of this evidence from my paper as well as the literature before that.

So the first thing that's really important to keep in mind here is that what we can estimate in this literature, well, is the observable short run response on employment. Now, short run responses may be different, very different potentially from long run responses due to the fact that there are a bunch of optimization frictions as we tend to call them in economics that attenuate labor supply responses in the short run. These types of optimization friction have always been central to discussions about the EITC program due to the fact it's a fairly complicated nonlinear trapezoid tax refund that you get a year after with certain types of rules for claiming it, etc., etc. And that raises, you know, concerns both about informational frictions and behavioral or psychological frictions that may lower its impact on labor supply. Um, another point that I want to emphasize that I always emphasize, and I think often gets lost in the empirical debate about this, is that employment effects are not synonymous with whether or not this program is desirable. I'm personally a fan of the EITC as a piece of policy making, but I'm just a fan of it for slightly different reasons than some. So I want to try and see if I can persuade people to be fans of the program for the right reasons. So, I think the should be viewed as a poverty alleviation program that distorts labor supply. So it provides support to a needy group, single parents, working single parents at the low end of the earnings distribution, but it potentially distorts labor supply by introducing negative tax rates, sometimes strongly negative tax rates at the bottom of the distribution. To give you an example. A single mom with two kids and earnings around the interval where the EITC is maximized currently face an average tax rate of about minus 40 percent. This means that the policy that includes not just the EITC but the entire tax and welfare system, that means that U.S. tax policy is currently incentivizing such mothers to work too much. That's a distortion and the greater the behavioral response, the greater employment response is, the bigger is that distortion. The fact that responses are lower than we previously thought, as I have argued, is actually a good thing. So many people viewed my work as an anti-EITC paper when in fact its implications are the opposite. If there's no behavioral response, that's good news for the program.

The third point I wanted to mention that relates to this is regarding a critique uh that's against the program that sometimes leveraged from the left okay and so this is the idea that the EITC doesn't really benefit workers it benefits firms through lower wages, okay, so uh, it’s not the workers but it's Walmart getting greater profits uh because of the EITC --

WESSEL: Because they can pay lower wages to them.

KLEVEN: -- because they can pay lower wages. So I think it's important to know at least, certainly I think from an economist perspective that is fundamentally, it's a conceptually misleading point. It's misleading conceptually as well as empirical. Let's start with the empirical point. So first of all, the reason why firms might be able to pay lower wages relies on the existence of a positive employment response. If employment responds, sizable employment responses. Is if those responses are small as zero. As some recent work has argued, then the wage effect is not even there and we can totally forget about this issue. The second point is that even if labor supply responses are in fact large and lower the wages that firms pay to their employees, then we have other policy instruments that are better suited for dealing with that. So if Walmart gets greater profits, due to EITC driven reductions in the wage, we could adjust the corporate income tax or we could adjust the top rate of income tax uh that's relevant for privately held companies and pass-throughs. And in fact those are the policies that should be used for that they're the appropriate targeted policies for that uh tor that purpose that might not be politically feasible but the conceptual points that remain center would you say well by reveal preference policy makers are apparently happy with the profits they see, with the income distribution they see. It's conceptually not a reason for scaling back the EITC. That discussion should be about the corporate income tax and the top rate of income tax.

WESSEL: Thanks. So, Jim, I'm hoping you can talk a little bit about what impact has the Earned Income Tax Credit had on reducing poverty in the United States over the last half century.

SULLIVAN: Sure, and thank you, David, for bringing attention to this really important policy issue and to Brookings for hosting this. To think about the impacts, I think it's helpful to start with what the original goals of the program were to support low-income working families and to encourage work. And if you assess the EITC on those margins, on those goals, the consensus from a very, very large literature is it's been wildly successful. And successful on both margins, which explains in large part why it has enjoyed bipartisan support historically. But it's also been titled as one of the most successful anti-poverty programs that we have. And the reason why it's titled is if you just look at the effect it has on the income distribution. Comparing with and without the dollars that are distributed by the Earned Income Tax Credit, you see very clearly its impact on poverty. So if you look at, for example, if you were to take away EITC dollars, it would increase poverty by 20%. The best estimates are lifting about six million individuals out of poverty, three million children. And that is, the only programs that lift more, based on the most recent evidence, are Social Security, disability, and SNAP, the food stamp program. Because of the structure of the program, the way Jacob talked about it, the dollars are really focused at families around the poverty line, which is why it has this impact. So, a little bit less, if you go to 150% of the poverty line, uh... taking away the EITC would increase poverty by sixteen percent but if you go to the very bottom so say people below fifty percent uh... Of the poverty line uh, you take away the EITC and it increase deep poverty by about seven point six percent. It has less of an effect on the bottom because of the fact that it's targeted towards uh those that, it increases, it phases in, and the generosity of the EITC increases as you have higher earnings. The other important thing to note about this is which families near the poverty line are benefiting from the EITC. Because of the nature of the program that you get a more generous credit if you have more kids and because at higher incomes it phases out and they count the income of the entire household. The majority of the dollars go to unmarried parents and uh particularly uh single moms who uh and low educated single mothers. And you know these are the children that are the most vulnerable. You know, there, there's lots of research right at the higher highest risk facing high risk of of uh not finishing high school, of you know growing up in poverty themselves, etc. I think we'll talk a little bit about that the benefits the EITC had had on kids, but so it's important to recognize the EITC is verily, very effective at targeting these vulnerable families. And the last thing I'll just say is that if you're emphasizing who's benefiting, it's also important to highlight who's not, right? So, and Jacob mentioned this, it is not a social safety net program because you don't get the EITC if you don't work. So it's a wage subsidy for the working poor. And uh and there is a subsidy for uh workers who are not raising children but it's very modest. So so not much of the EITC is going uh, to, say, the you know the non-custodial parent or those those without children. There's also a non-trivial fraction who are eligible for for the EITC and don't get it so, the best estimates are about twenty percent of those eligible don't receive the ETC. And if you look at who those people are, uh, you know, Hispanics are are disproportionately represented. Eligible, they're eligible but don't receive it. Um, it's also uh, it's focused on the very bottom of the earnings distribution those in the phase-in range of the EITC, the the idea is that a lot of them don't file taxes, are not required to file taxes, and so they don't they don't see the benefit of the EITC and it's important recognize that if we were to get the EITC to more of those people that are eligible, it would have an even bigger impact on poverty.

WESSEL: So just to underscore something you said. One, you don't get the EITC if you don't file an income tax return. And secondly, I know everybody here on the panel knows this. It's described probably because of its origins, as Jacob says, as a way to reduce the social security tax burden on low-income people as a tax credit. But the way it works today is if it wipes out all your federal taxes, you get cash in return, which is sometimes the target of. Criticism of the program from some people on the right. So, Hilary, as Jim set you up nicely, okay, you give people a lot of money. They're not as poor as they would have been otherwise. You don't need a Ph.D. For that one. But you and others have done a lot work talking about the benefits of the EITC, particularly to children in these families that are not so obvious, it's not just a question of money.

HOYNES: Yeah, thank you so much, David. It's great to be here to talk about the EITC on its big anniversary. Very exciting. So the research on the EITC started sort of in the mid-90s, some decades after the program was introduced. And for the first 20 years of research, it was very focused on what's just been discussed. Primarily, a lot of attention to the structure of the program, how it affects labor supply, for whom calculating anti-poverty effects, really important work. And that was really the focus for the first couple of decades after people started turning their attention to trying to understand this program. And after that first wave, if you want to call it that, of research, there's been some real expansion and extension of that work to try to understand what, what happens when you provide a big anti-poverty boost? For families with children, what difference does it make for what's happening in those families in the short run, or maybe most impressively, what potential it has to change children's life trajectories and change their long-term outcomes and change intergenerational mobility and transmission of poverty in America. So it's a newer literature with tons of coming out all the time, telling us more and more about what I think is a really centrally important question. And so the work I would just summarize briefly as follows. There's some evidence that in the short run things look better in the household. Mom's mental health is a bit better. There's less evidence of housing insecurity and the need to have families doubling up in order to save on housing costs. There's sort of shorter-term evidence of slightly better financial situations at the household level. Some evidence that there's less violence in the household in various ways. And so there's this kind of short-term that things are just going a bit better in the household. There's also quite a lot of evidence that the trajectories of children... Are benefited by the presence of this Earned Income Tax Credit and the combination of the income and possibly changes in the work of the parents. And so we know that this starts in the very beginning of life. So when women are pregnant and have access to a more generous Earned Income Tax Credit, their births are healthier. Kids have a lower rate of low birth weight at birth. This extends, there's evidence that children's health and childhood is improved when they have access to the EITC in their childhood. They do better in school based on test scores. And then we also see this quite consistent evidence that in the long term, children who through their childhood have more access to earned income tax credit, in part due work by Jacob show. Their completed education is higher. Their earnings in adulthood is higher, their poverty rates themselves in adulthood are lower. And there's a sort of broad characterization of this that we can think about this program which was designed to try to supplement low earnings, a work credit. You can also think of as an investment in children. And you can think about, and that's good for those families, obviously. But it also generates a kind of return on the investment for the taxpayers. So the more you spend when children are young, the less you spend as a society when children are older, they pay more taxes, they're perhaps using less benefits themselves in adulthood. And this pattern we see replicated in other settings. In fact, settings that are much more at threat in the current reconciliation bill. Including the long-term benefits of kids having access to SNAP, food stamps, and also to Medicaid, show really quite significant improvements in kids' outcomes in the long run. So that's sort of the complement to this deep understanding about effects on employment and poverty, is these potentially transformative effects for children.

WESSEL: So there's been some erosion of the bipartisan support for the Earned Income Tax Credit. Some, as Hedrick said, is a view on the left that somehow the benefits go to Walmart because they can pay lower wages than otherwise, which I think in general economists don't agree with. But you also hear a lot of criticism, particularly on the Hill at the moment, that somehow a lot the people who are getting the earned tax credit are not playing by the rules. Sometimes it's called fraud although actually a lot of it is improper payments like uh... Money went to the wrong custodial parent or something like that and wonder if any of you could talk a little bit about what to what extent you think that's a big problem that we should worry about or is that just a necessary part of any big government program that has extraordinarily complicated rules

KLEVEN: I mean, my high level view on that is that compliance issues are not specific to the EITC. Any piece of tax legislation have compliance issues. The way we want to think about that is in terms of tax enforcement. The most important aspect of tax is about information, third party information on the things, in this case children. Resident at home and so on so a strange discussion for the lack of a better term to have in the context of the UTC if there are compliance issues in the U.S. tax system which there are then we should think about how to get rid of that with third-party information, audits, penalties, staffing irs

WESSEL: Jacob, you can respond to anything anybody said but I'd like you to explain what's the difference between – why do we have a child tax credit if we have an earned income tax credit that goes to families with children? What's difference between the two, does this make any sense?

BASTIAN: Thanks, David. So I just also want to say something on the last point, and agree with Henrik. There's a trade-off with social programs, administrative costs, and trying to reduce fraud. And sometimes when you try to reduce fraud, you're actually keeping out people who are actually eligible. The EITC administrative cost is about 0.3% of the program. That's a lot lower than basically anything else. You know, you can think about housing assistance or, you know. TANF or different things where the administrative cost could be like four or five percent of the program. So the EITC, maybe there are some improper payments maybe to the wrong parent or a grandparent or something like that, but I agree that this is not a major thing. And also it's an aspect of any part of the tax code, who's taking deductions and exemptions and things like that. So I think it's not specific to the EITC. On the CTC. The CTC, the child tax credit, started in 1997. It was a small policy mostly aimed at upper middle income households. Up until recently, it wasn't refundable at all, which meant you had to have a positive tax liability, which meant that you were probably earning at least 50 or 60 thousand dollars. And so now we have a child tax credit that's partially refundable. And I kind of like to refer to it as in a way, the cousin of the EITC where, at least for lower income families, the benefits are smaller. And so, you can kind of like mentally compartmentalize the earned income tax credit is for low-income workers and the child tax credit for families. The thing is after the tax change in 2017, benefits of the child's tax credit go up to families earning up to half a million dollars. So, people think of the Child Tax Credit and they think, oh, we're helping. You know low-income working families but actually the child tax credit goes to almost everybody, uh you know up to like that you know except for maybe the top two percent and so uh... I think --

HOYNES: Not everybody at the bottom.

BASTIAN: That's --

HOYNES: Everybody at the top but not at the bottom.

BASTIAN: Thank you for pointing that out

WESSEL: You have to have $2,500 in earnings, right?

BASTIAN: Yeah, absolutely. Yeah, yeah, and it phases in. And 100%, you know, 2021, we had for one year a child tax credit where benefits went to everybody at the bottom and it did a lot of good but that was a temporary program that lasted for one year.

WESSEL: So, just to illustrate a point you made marrying the two things, one of the things I learned at a little seminar we had yesterday is that when people talk about fraud in the EITC, they mean that's shorthand for somebody who got the money who wasn't supposed to get the money. But that might mean that the family made a decision to let the grandmother take the, get the EITC rather than the mother, or if the family was separated, which parent got it. And the EITC is very strict about that and there's all sorts of rules. The child tax credit, it goes with the child. It doesn't matter who the custodial parent is. And one of the veterans of the Treasury who was at a seminar we had yesterday said it was the divorce lawyers who were responsible for that particular provision of law. So there's less concern about which parent has the kid in the child tax credits because the rules don't care, where the EITC does. I think that there's one of the things that comes up a lot in the current discussion is should we have work requirements for everything? I think there's a political view that somehow the people who deserve help are the people who are working and so we need to like put work requirements on everything, Medicaid, food stamps, just like we do with EITC. And I wonder if any of you have any thoughts on A, is that a good idea, and B, do learned anything from the EITC about that, that should inform that debate.

HOYNES: I'm happy to start that.

WESSEL: Thank you

HOYNES: I mean, I think that it is indisputable that there's a lot of interest in targeting benefits to the deserving poor and different people have different mindsets about what the deserving poor is, and there's certainly a long history in the United States of the idea that working is one aspect of deservingness, and then there might be carve outs from that. Maybe you have children, maybe you have young children, or maybe you are not able to work, and so you kind of get down this sort of in the weeds kind of proposition. I don't think we need to go to the EITC to get evidence on what imposing work requirements for SNAP and Medicaid would do. We have evidence from those programs. And I think what's very clear from that evidence is that imposing work requirements doesn't change work, but reduces the number of people who are able to comply with those new burdens. So if you have to do various kinds of reporting to show that you're working 20 hours per week, You've got to coordinate that, get into the office to do that reporting when you've got a job that isn't flexible or you don't have documentation. You can see how all these additional steps and bureaucratic hoops that you have to jump through could make it difficult to stay in compliance even when you're working. And the vast majority of folks on SNAP or Medicaid are in fact working. And so we have evidence from the work requirements that exist today in SNAP for older workers, I mean for prime age workers that don't have children, and as well evidence from Medicaid and some state waivers that show pretty clearly that imposing work requirements is not a good way to increase work in those programs. But it's a good to reduce participation in those programs.

WESSEL: Henrik.

KLEVEN: I wanted to just sort of make a high-level point, which is --

WESSEL: All the points we're making are high level.

KLEVEN: I'm going to stay at the same high level that we've been so far and make the following point. So whether or not work requirements impact labor supply, the idea that we want work requirements for everything comes from something which I think is a bit of a fallacy and I want to say it here because I'm out of my academic ivory tower here in D.C. where people are thinking about the real world. It comes from the idea, the social objective in this world is higher employment, quote, number of jobs created. Higher employment is always better. So whatever we can do to increase employment must be a good thing. Employment is a good all else equal, but there are trade-offs here. So for example, do we want a single mother with four kids to have employment rates of 100%? I'm not sure that that's the socially most appropriate use of that person's time. The optimal employment rate is not 100 percent. There are tradeoffs. And so that's sort of just another sort of conceptual reason why we shouldn't be thinking about work requirements for everything.

WESSEL: Thanks. Jim, you mentioned something but I'd like to go out a little so as you pointed out the earned income tax credit almost all goes to families with children, there's a very small benefit for people who either don't have kids or the kids are out of the house or whatever uh... There have been a number of proposals to change that including one that where Barack Obama and Paul Ryan, the president and speaker of the House, both agreed that we should do this. So, I wonder if you could talk a little bit about, is that a hole in our safety net? To what extent are people who don't have kids somehow left out of this massive anti-poverty program?

SULLIVAN: Yeah, no, to a tremendous extent. One of the most glaring holes in our safety net is for those who aren't raising children. And you also see very high poverty rates for these groups.

WESSEL: Even though they're working?

SULLIVAN: Even though they’re working. And a lot of the benefits are just attached to children. And so as a result, they tend not to be the beneficiaries. And, you know, many of them do have children. You know, they might be the non-custodial parent. And there have been some proposals that would perhaps have the EITC available to the non-custodial parents as well. The other big concern about this is, you now, there's increasing disengagement from this group, from the labor market. In particular, young adult males where we've seen that the fraction that are out of the labor force has doubled over the past four decades. Now we have one in five from 25 to 40-year-old males who are not working full time. And so there's lots of reasons why and there's a lot of research on that. But low returns to work uh is one of those and um and, you know, increasing the incentives to work through a wage subsidy could go a long ways.

WESSEL: Jacob, let me ask you one question before we turn to the audience. Today, most people who get the Earned Income Tax Credit, as you said, get a check. It's like getting your tax refund. You get a lot of money. We've toyed over time with giving people the option of getting it every month and all, which has some appeal if you're short of money, but doesn't seem very popular. So what's going on here?

BASTIAN: It's interesting, the earned income tax credit, up until about 2008, you could opt in to get it monthly. And do you know how many people did it? Less than 1%. So the thinking is that people, either they didn't know about it, they didn't want to alert their employer, maybe they didn't want to over collect on the EITC and then they have to pay it back when they file their taxes. And so, you know, one thing we learned during the temporary 2021 child tax credit is that monthly benefits can be a really good thing for families. And so if you ask people do you want your EITC monthly or annually, a lot of them will say annually but a lot of them also benefit from monthly benefits. So in my perfect world both are important and so whether it's we split the EITC or maybe we have the CTC doing one and the EITC doing the other. I think monthly benefits are important but also people see this big tax refund is like a forced savings aspect, you know, you get eight thousand dollars and now you're able to pay rent, buy a used car, you know, kind of make these big durable goods purchases and so I think, uh, you know I think monthly and annually both provide a benefit.

WESSEL: Here we have the perfect two-handed economist. The answer is both. There's a question here. So here's the deal. Stand up, tell us who you are, and remember that questions end with a question mark.

AUDIENCE QUESTION: A high-level question. Gerald Chandler, I'd like you just to talk about the crosstalk, if that's the right word, between the EITC and Medicaid. Do they affect each other?

WESSEL: Thanks. There's one over here, a woman in the aisle and then the gentleman in the front.

AUDIENCE QUESTION: Hello, my name is Laila Aghabian. I work at Economic Security Project. We focus on the CTC and EITC. And so in this reconciliation package, they are making changes to the EITC and CTC. For the EITC, it's a pre-certification process. I do know during the Bush era, they tried this through a pilot. It didn't work. So I was hoping you could actually speak to that pilot, why it didn't, work and then also the impacts this pre-certification process will have on our families that are trying to claim the EITC. Particularly in rural areas, if you know anything about that.

WESSEL: Thanks. And in the front.

AUDIENCE QUESTION: Bob Wyman. I'm curious, you spoke a lot about the absence of behavioral response to the EITC. It seems to me that would imply that sort of workers' demand for work is largely inelastic and that it would appear then that those who can work are working at any, whatever wage they can get. In a situation like that, If Walmart isn't exploiting the fact that the federal government is paying a large part of the living wage of their, whatever it takes to support their workers, shouldn't Walmart's shareholders object and insist, in fact, that Walmart do take advantage of it and lower their wages? Because it appears that the demand for jobs at Walmart is inelastic, so why doesn't Walmart take advantage of it?

WESSEL: Okay, let's start with the question about pre-certification on the EITC. So the reconciliation bill says that you have to provide some documentation to prove you're eligible for the EITC in order to get it. And there's some provisions that would make it harder for people who are not, as I understand it, citizens to get it. So does anybody want to take that one? Jim?

SULLIVAN: I'll say something about that. You know, one of the long-running benefits of the EITC, and Jacob alluded to it, was that it's run through the tax system and the administrative costs are really low. You don't have this pre-certification process that you might have if you're applying for TANF, or SNAP, or Medicaid, and so it simplifies the process tremendously. You know, I have a lot of concerns about turning the IRS into a welfare office to try and process who's eligible, particularly when, you know, IRS is not, there's no talk of giving them additional funds at this point to be able to process that. And I would just highlight the trade-off that Jacob mentioned, which is that, sure, there will be some benefits in terms of some EITC recipients who weren't necessarily eligible will not receive it. But there also will surely be recipients who are eligible who no longer receive it. And I think that that's a very important trade-off to consider.

BASTIAN: I just want to say, too, the IRS has a very limited budget, and so if we ask the IRS to do this EITC pre-certification, that's likely less hours going towards, you know, auditing higher-income individuals, and, so, you, know, the pilot programs were alluded to during the George W. Bush era. They didn't do a lot of good and so it would basically be taking hours doing less efficient things and less audits for higher income and maybe more efficient uses of the IRS's time.

WESSEL: Hilary, I'm not sure exactly what the gentleman meant between the interplay between the EITC and Medicaid, but can you take that as a starting off point to say something?

HOYNES: One thing that always comes up is, is the benefit that you get from the EITC counted as income for other things? Does it affect your eligibility for other programs? And the answer is no, because in the legal regulatory setting, it's like any other tax, and taxes don't have direct impacts on your eligibility of other programs. So that's one potential answer to your question. It is true that there's a lot of overlap in those that receive the EITC and those that receive Medicaid, particularly for the children. So in many states, your family, your children, can have access. This is pre-ACA Medicaid expansions. These were expansions that started under the Bush I administration and then kind of cascaded through the 90s, expanding eligibility for children up to, in many states, up to like 200 percent of the poverty line. So the majority of children in America get their health insurance through Medicaid. And so there's a lot of overlap in the family income that would make you eligible for the EITC and the family income that would be make your child eligible for Medicaid. So the reality is the United States does kind of have a patchwork of programs that do act together for many families.

WESSEL: Henrik, you want to take the argumentative question about the Walmart shareholders?

KLEVEN: Yeah, absolutely. So my response to that is that Walmart can't reduce wages in a vacuum. There is a labor market equilibrium. So in the case of the EITC, like, so something needs to change to change that equilibrium. In the case the EITC, that would be the labor supply response. If there is no labor supply response, there is no change in market wages. If Walmart tries to lower their wages, in that situation, their workers would go to Home Depot or Amazon or Best Buy or something like that. So the idea that the EITC lowers wages is through the channel of labor supply. If the EITC does indeed increase labor supply, yeah, then we would expect equilibrium wages to go down. My point then is that even in that scenario, the policy response is not to say, well, then the EITC is not a good idea. All tax policies, all welfare policies have, we call it incidence effects. It's just they change equilibrium prices and equilibrium wages, and that is sort of a side effect of the program. We need to think about that, but we have other policy instruments to address it. Right? But if Walmart can lower their wages without a labor supply response with the EITC, then they could have lowered the wages anyway. So why didn't it just do it? And if they came with the idea now, it didn't have anything to do with the EITC. And that holds whether there is competition.

WESSEL: You can argue with him afterwards, I'm not taking... In the back?

AUDIENCE QUESTION: Good morning, Daryl Cooper. I just wanted to.

WESSEL: Hold the mic a little closer to your mouth.

AUDIENCE QUESTION: I just wanted to hear what you guys think about the idea of the substitution effect versus the income effect regarding EITC? I saw a really good study on this before I came here. I just wanna hear what y'all think about that.

WESSEL: Do you understand how much you are making economists on the panel just like --

HOYNES: We're so excited you asked that question.

WESSEL: They wanna like just go hug you. Diane in the front and then over here.

AUDIENCE QUESTION: A related question --

WESSEL: Diane Schanzenbach.

AUDIENCE QUESTION: Oh, yeah. Thank you. To the Walmart point, does Walmart pay different wages to women with kids, single mothers with kids versus married mothers and people without children? I assume not. So that helps with the equilibrium wage. But how would that change if we really split this into a worker credit versus a child credit like we were talking about yesterday.

WESSEL: In other words, we had two credits. One was pegged to whether you work, and another one just given to kids.

AUDIENCE QUESTION: Yeah, would Walmart take more of it in that case?

WESSEL: And over here.

AUDIENCE QUESTION: Good morning, Lindsay Cooper-Martin. In your question regarding the certifications, there was also a discussion of the impact on ITIN holders of the pending legislation, and I'd like to hear the group's thoughts on that.

WESSEL: OK, who wants to do the labor and substitution? Want to do that? Oh, Jim, you want to take it?

SULLIVAN: I think we all do. I was fascinated by your reference to a really interesting paper because I'm trying to think of which of the 20 papers or more that have been written on this are you referring to?

WESSEL: Can you start by defining income and substitution effects?

SULLIVAN: Yeah, so there's this idea that you could transfer income not conditional on the wage that you're paying and that would be the income effect. What is the response of labor supply decisions to just increasing income without changing, the return to work without changing wage rate. The substitution effect is looking at what if we change the return to the work? What if we subsidize the wage? That would be in the example of the EITC. If we provide a 40% subsidy, that's changing the wage rate after tax that an individual faces. And increases the return to work, and in that example would be an incentive. The substitution, in fact, would incentivize work. There's been a lot of research on this, many of which, I guess all of my fellow panel members have contributed to this. And let me broadly summarize the literatures, some of which Jacob and Heinrich already cover, but the broader -- Again, there's big confidence intervals around these things, but I would say if I were to characterize a consensus, it would be that the income effects tend to be small and the substitution effects, particularly on the decision of whether or not to work for some groups tend to be large. And so in particular, the particular group that gets a lot of attention is low educated unmarried mothers, where, you know, we significantly increase the returns to work through the EITC and work requirements and other changes in welfare reform in the 1990s, and we saw a dramatic increase in labor supply for that particular group relative to some other groups.

HOYNES: I'll respond to Diane's question about, so you raise a really good point in this kind of discussion about what happens to wages when you have a policy that promotes work and moves people into the labor market. Generally speaking, the eligible EITC folks aren't necessarily atomistically working by themselves at employers. So Diane brings up the point that single women with children, if they're the ones that are responding the most to the EITC are working in a workplace alongside maybe men without children, maybe some retirees if we're thinking about Walmart, and other folks. So I think that the extent to which that mixing exists, then that's certainly going to dull any impact on equilibrium wages. But the flip side of that is that if in fact there is a smaller but present effect on wages, that has negative spillover effects on those. So, I'm the childless worker working alongside the EITC recipient. My wages go down, but I don't get the EITC. So I'm sort of a net loser. Whereas the EITC recipients themselves, that if it exists, which we no evidence that it does, would kind of eat away a little bit at my EITC benefits. So I think that's the kind of context for that.

WESSEL: But Diane mentioned something that's been discussed, like, okay, we have created the world's most complicated system of helping people who are poor, where, like the number of programs we've just devised, and Henrik will tell you it would be easy to fix, we should just have universal pre-K, universal health care, but that's because he's from Copenhagen. Until we annex Greenland and get them to vote in American elections, we're kind of stuck with our politics. But would it make sense to have two completely separate credits, one which is a wage bonus that could go to anybody? You have kids, you don't have kids, whatever, and the other is a child credit which goes to people who have kids presumably targeted at lower income. We're not going to get there because there's all this inertia and path dependency, but does that make some sense in some conceptual sense, some economic sense? Guess not.

KLEVEN: Yes. Yeah, I mean, it makes sense, but it also comes from actually how you motivated it out, like in some sense. There's a sense of which is almost a moot point. It comes from the artifact that the U.S. has 500 programs to support low-income people. These are just labels, right? We could build it all into one program that depends on earnings and kids and where you live and all the things we care about. And that's just some function of all of those things, and that spits out a number for each individual. Conceptually, we could do it that way. So part of this, I think, is about how we just label different programs. Could I say something about the income and substitution effect, because there was a little interest in that? Because I think there is something important about it.

WESSEL: OK, as long as Jacob doesn’t.

KLEVEN: Because i think it's one of the uh one of the reasons why we might see different impacts of EITC and welfare reform. So that's, I think, why it might, so we talk about employment effects, which is what we've mostly discussed here in as far as the labor supply stuff goes. The EITC is a pure substitution effect. There is no income effect. That is, you can't say, oh, you know, because there's now an EITC, through an income effect, I'm gonna enter the labor market. I'm going to exit the labor market, because you only get it when you're in the labor market. It is really the relative price between being in work and out of work. It's a pure substitution effect. Welfare is different. So when you scale back welfare, as this country did in the 90s, people on welfare had to find work to sustain the same living standard. That was a pure income effect. It also had a substitution effect on top of that. So welfare reform was an income plus substitution effect, EITC a pure substitution effect. My reappraisal that I talked a little bit about earlier, that was one of the potential reasons why I argued that welfare reform could have had a bigger impact. Because I think – and this is where my reading of the evidence is a little different – I think it's just very hard to estimate. I think income effects are more important than substitution effects. Here's the most important argument. It's not based on fancy empirical studies. It is based on a very simple logical inference. Over the last 200 years in this country, there's been enormous real wage growth, enormous productivity growth. If substitution effect were bigger than income effects in the long run, we should all be working 24-7, 52 weeks per year. We should all, you know, but we're not. In fact, working hours are lower now. So in the longer run, income effects must have dominated. It's the fact that we're so much richer now and we're spending some of that income to buy ourselves a little bit of leisure.

WESSEL: Does anybody, so the ITIN question, ITIN is, I can't remember what it stands for, but it's the number that you get if you're an immigrant that you can't get a Social Security number and it's used to get some benefit programs and clearly there's, in the current animosity towards immigrants, there's an attempt to use that as a way to winnow out some immigrants who are getting benefits. I think I did that right, right? Close enough. So, and there's some language in the reconciliation bill that would point. But that does anybody have thoughts on that?

BASTIAN: Big picture, big picture thoughts is, you know a lot of immigrants file taxes in this country. They pay more taxes into the federal system than the benefits that they get, so we want immigrants to file taxes, pay payroll taxes, pay income taxes. And what we're seeing is, tax revenue, look for immigrants, and that's going to discourage immigrants from filing taxes in the future which i think is going to hurt our ability to collect revenue, so I think that's a bad thing. And I will let somebody else dive into more of the details of ITINs.

WESSEL: All right, I think we have time for another one if there is one. All right, please join me in thanking Jim, Henrik, Hilary, and Jacob for a great discussion. And thank you all for your attention.