

SHOULD EITC BENEFITS BE ENLARGED FOR FAMILIES WITH THREE OR MORE CHILDREN?

The idea of providing a somewhat larger Earned Income Tax Credit for families with three or more children is beginning to attract attention and support. The Administration's fiscal year 2001 budget includes such a proposal. So does the Tax Relief for Working Families Act (S. 2825), recently introduced by Senators Jay Rockefeller (D-WV), Jim Jeffords (R-VT), and John Breaux (D-LA). Broader tax legislation that Senator Orrin Hatch (R-UT) has introduced (S. 2642) also contains such a provision.

The idea of providing a larger EITC benefit for families with three or more children is not a new one. In Wisconsin, a bipartisan group of state legislators designed and secured passage of a substantially larger state EITC for families with three or more children a decade ago. Governor Tommy Thompson signed that legislation into law.

Moreover, in the late 1980s, a number of Members of Congress of both parties — including Republican members such as then-House minority leader Bob Michel and current House minority leader Dick Armey, as well as Senator Hatch — proposed higher EITC benefits either for families with three or more children or for both families with three children and families with four or more children.

Today, we have much more evidence about the EITC's effects on employment and poverty than we did a decade ago when those bills were introduced. The case for an enlarged EITC benefit for families with three or more children is considerably stronger than it was a decade ago.

Recent research indicates that the EITC has a powerful effect in increasing employment among single female parents and also that the EITC lifts more children out of poverty than any other

program or category of programs. Nevertheless, the official poverty rate remains a stunning 29 percent for children in families with three or more children and 23 percent when the EITC and various non-cash benefits are counted. In both cases, this is more than double the poverty rate among children in smaller families.

Furthermore, larger families have experienced more difficulty in moving from welfare to work in recent years. Family expenditures and the poverty line rise with family size, as do welfare benefits. So do the child care costs of a parent seeking to work. But wages do not rise with family size. Although the combination of minimum wage work, the EITC, and food stamps raises a family of four with a full-time year-round minimum wage worker close to the poverty line, it leaves families of five or more well below the poverty line.

The research suggests that a larger EITC benefit for families with three or more children would reduce poverty among a group of children and families for which poverty rates remain quite high, while encouraging increased employment among parents in large families and furthering welfare reform goals. This benefit expansion would be of particular benefit to married families; a significant majority of low-income working families with three or more children are married.

What We Know About the EITC's Effects

A substantial body of research has been conducted on the EITC in recent years. The research, by some of the nation's leading labor economists, finds that the EITC has had a powerful effect in increasing substantially the proportion of single mothers who

Earlier Legislation to Establish Additional EITC Benefit Tiers for Families with More Children

At least three pieces of legislation were introduced in 1989 either to establish an EITC benefit tier for families with three or more children or to establish both a benefit tier for families with three children and an additional benefit tier for families with four or more children.

Senator Orrin Hatch introduced a bill to establish a benefit tier for families with three or more children. Senators Dodd, Mikulski and Kasten co-sponsored it.

Senator Rudy Boschwitz introduced a bill to create both a benefit tier for families with three children and a benefit tier for families with four or more children. Senators Jeffords and Sanford were co-sponsors.

In the House, Rep. Thomas Petri introduced legislation that year with benefit tiers for families with three children and for families with four or more children. The bill's mostly Republican group of 17 co-sponsors included Reps. Michel, Sundquist, Armev, Fawell, Grandy, Ballenger, Green, Hiler, Boehlert, and Stenholm, among others. Finally, in 1991, Rep. Downey and Senator Gore introduced a bill that included an EITC benefit tier for families with three or more children.

Wisconsin EITC

In addition, as noted on page 1, in the late 1980s Wisconsin established a state EITC that has a substantially larger benefit for families with three or more children than for smaller families. The Wisconsin EITC for families with three or more children exceeds the state EITC for families with two children by as much as \$1,100. This is more than twice the added benefit the current proposals would provide for these families; the Administration's budget and S. 2825 (the Rockefeller-Jeffords-Breaux bill) propose an added EITC of up to \$486 for families with three or more children. The bill Senator Hatch recently introduced would increase the EITC by up to \$292 for these families.

work. This finding is strong and consistent across all of the studies that have examined this matter.

One of the two leading studies of this issue examined the large increase between 1984 and 1996 in the proportion of single mothers who work. It found that the EITC expansions implemented in this period were responsible for inducing more than half of this increase in employment. The study found that the EITC expansions had a stronger effect in increasing work than welfare policy changes did.¹ The other leading study examined a shorter time-period, from 1992 to 1996. It found that both welfare policy changes and EITC expansions had large effects in increasing the employment of single mothers during this period, with welfare changes being the largest factor and EITC expansions the second largest.² No matter which study one considers, the EITC impacts are big.

Treasury Secretary Larry Summers, a noted economist, recently alluded to this research in stressing that EITC expansions could benefit the U.S. economy. Summers said that to maintain robust economic growth rates without igniting inflationary pressures, we need to keep enlarging the number of people in the labor force. He described increased labor force participation by "people at the lower end of the income spectrum" as "an economic imperative" and noted that this is one reason why welfare reform and EITC expansion are so important.

Similarly, a report on welfare reform issued last winter by the Committee for Economic Development, an organization of 250 corporate executives and university presidents, stated that "The EITC has become a powerful force in dramatically raising the employment of low-income women in recent years."³

The CED report urged consideration of further EITC expansion.

Recent research also documents another powerful effect of the EITC — its effect in reducing poverty. Analysis of Census data shows that in 1998, the EITC lifted 4.8 million people out of poverty, including 2.6 million children. These data show that *the EITC now lifts more children out of poverty than any other program or category of programs*. The EITC lifts more children out of poverty than all other means-tested benefit programs (including food stamps and housing subsidies) combined.⁴

Establishing an EITC Tier for Families with Three or More Children

Research findings suggest there is a strong need to establish an EITC benefit tier for families with three or more children. Children in these families have very high poverty rates. Nearly three of every five poor children live in families with three or more children.

- Census data show that in 1998, the official poverty rate was 13.5 percent for

children

in families with one child and 12.4 percent for children in families with two children.

- But the poverty rate was 22.4 percent for children in families with three children and 33.8 percent for children in families with four children.
- For children in families with three or more children, the poverty rate was 28.6 percent. This is *more than twice* as high as the poverty rate for children in smaller families.
- Looked at another way, children in families with three or more children constituted 37 percent of all children in the nation in 1998. But they made up *57 percent* of the children living in poverty.

The problems that many of these families face are growing in this era of welfare reform. The poverty line rises with family size, as it should; families with more children have greater needs and greater expenses. Thus, the poverty line for a family of five (two parents and three children) is about \$3,000 higher than the poverty line for a family of four (two parents and two

Child Poverty Rates, 1998

	Official Poverty Rate	Poverty Rate Including Non-Cash Benefits (except medical benefits) and Taxes
Children in Families with:		
One child	13.5%	10.3%
Two children	12.4%	8.6%
Three children	22.4%	17.3%
Four children	33.8%	27.5%
Three or more children	28.6%	22.8%

Source: CBPP tabulations of Census Data from March 1999 Current Population Survey

children).

Welfare benefits also rise with family size. But wages do not. Thus, moving from welfare to work produces diminishing gains — or can even produce losses — as family size increases. This problem is aggravated by the fact that families with more children face greater obstacles in moving from welfare to work because there are more children for whom child care must be arranged and paid.

Given these problems, it may not be surprising that larger families are encountering greater problems in moving from welfare to work than smaller families.

- Researchers recently found that despite the robust economic growth of the past few years, the poorest fifth of female-headed families with children lost some ground between 1995 and 1998. The average income of these families, even after counting the EITC and other non-cash benefits, was *lower* in 1998 than in 1995.⁵
- Recent analysis of Census data shows that this income decline is most marked among large families. Among the bottom fifth of female-headed families with *fewer than* three children, average income fell a modest two percent, or \$170, between 1995 and 1998. But income fell 8.5 percent, or \$750, among the bottom fifth of female-headed families with three or more children. (These figures are adjusted for inflation.)
- Poor female-headed families with three or more children have fared worse in recent years primarily because their average earnings failed to grow. Among the bottom fifth of families with *fewer than three* children, average earnings rose 18 percent between 1995 and 1998, after adjusting for inflation. By contrast, average earnings edged down a bit among the bottom fifth of families with *three or more* children.⁶

Research findings indicate that a larger EITC for families with three or more children should strengthen welfare reform efforts. It also would be of particular benefit to married families.

These data strongly indicate that to help welfare reform succeed, a larger EITC is needed for families with three or more children. A larger EITC for these families would encourage more of them to go to work (or to work more hours) and also would raise their incomes when they do work so they can meet more of their expenses.

A larger EITC for families with three or more children would promote work and self-sufficiency for other reasons as well. The current EITC levels were designed so a family of *four* with a parent working full-time year-round at the minimum wage would be raised to the poverty line, when wages, the EITC, and food stamps are counted and payroll taxes are subtracted. But families of *five or more* with a full-time minimum wage worker remain well below the poverty line. Although most proposals for a bigger EITC for families with three or more children would not bring these larger minimum-wage families all of the way to the poverty line, the expanded EITC would reduce the amount by which such families fall below it.

In addition, recent academic research that has examined what families do with their EITC payments finds that a substantial proportion of smaller families use at least a portion of their EITC for upward mobility or asset-building purposes, such as for acquiring or repairing a car to commute to work or to search for and accept a better job, making capital repairs on a home (such as fixing a leaking roof), or paying for tuition for training or education. The proportion of families that use part of their EITCs for such purpose declines significantly, however, as the number of children in the family increases. The researchers concluded that larger families have a greater need to use their EITCs to “make ends meet”

(i.e., to help cover current and overdue bills) and consequently have less ability to use part of their EITCs to improve their circumstances and boost their chances of escaping poverty and low-income status.⁷

Another Attraction of the Proposal: Help to Married Families

Low-income working families with three or more children are more likely to be married than low-income working families with fewer than three children. Census data show that among working families with one or two children and incomes below twice the poverty line, there are about the same number of married families and female-headed families. Among working families with three or more children and incomes below twice the poverty line, however, 61 percent are married and only 35 percent are female-headed. An EITC benefit tier for families with three or more children would be of particular benefit to low-income working families that are married.

Limited Cost

An EITC tier for families with three or more children is not costly. This is because only about 15 percent of EITC families with children have three or more children. The proposal in the Administration's budget and the Rockefeller-Jeffords-Breaux bill to establish a third tier appears to cost about \$700 million or \$800 million a year, although a precise cost estimate is needed.

Work, Marriage, and Living Arrangements, November 1999.

3. Committee for Economic Development, *Welfare and Beyond: Making Work Work*, February 2000.
4. Center on Budget and Policy Priorities, Tabulations of Census Data from March 1999 Current Population Survey. See also Kathryn Porter, Wendell Primus, Lynette Rawlings, and Esther Rosenbaum, *Strengths of the Safety Net: How the EITC, Social Security and Other Government Programs Affect Poverty*, Center on Budget and Policy Priorities, March 1998.
5. Wendell Primus, Lynette Rawlings, Kathy Larin and Kathryn Porter, *Initial Impacts of Welfare Reform on the Incomes of Single-Mother Families*, Center on Budget and Policy Priorities, August 1999, supplemented by additional analysis by Primus incorporating Census data from the March 1999 Current Population Survey.
6. *Ibid.*
7. These findings led the researchers to conclude: "We should consider expanding the EITC for families with three or four children, just as there is now a difference between one and two children." Timothy M. Smeeding, Katherin E. Ross, Michael O'Connor, and Michael Simon, "The Economic Impact of the Earned Income Tax Credit (EITC): Consumption, Savings, and Debt," prepared for Northwestern University conference on EITC Research, September 1999.

1. Bruce D. Meyer and Dan T. Rosenbaum, *Welfare, the Earned Income Tax Credit, and the Labor Supply of Single Mothers*, National Bureau of Economic Research, Working Paper 7363, September 1999.

2. David T. Ellwood, *The Impact of the Earned Income Tax Credit and Social Policy Reforms on*