

Employment-Based Tax Credits

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This paper is concerned with three interrelated problems. First, unemployment rates for men with low levels of education (hereafter, low-skilled men) are high. Second, incarceration rates of low-skilled men are high. And third, a large fraction of children in low-income communities are being raised in single-parent households. The premise of my work is simple: improving employment opportunities is the best way to reduce incarceration rates and increase marriage. Others share my concerns about these issues. Richard Freeman (1996), for example, writes “How to improve the job market for less skilled young American men, and reverse the huge decline in their earnings and employment opportunities, is *the problem* of our times, with implications both for crime and many other social ills” (italics in the original).

There is no single, universally applied definition of the low-skilled labor market. For this paper, I will generally focus on people with a high school diploma or less, between the ages 18 and 64, and not in school full time. I have two reasons for paying particular attention to the employment problems of men. First, the literature discussing policy initiatives targeting low-skilled men is considerably smaller than the literature on welfare reform and the employment of women.¹ Second, U.S. social policy is, for understandable reasons, focused on children. The core safety net programs—those operated under the TANF program and food stamps—provide most benefits to families with children. Childless families generally are not able to receive benefits under TANF. The food stamp program limits benefits to able-bodied childless individuals to 3 out of 36 months.² The earned income tax credit overwhelmingly goes to families with children,

¹For example, an *Econlit* search on “male employment” yields 29 hits, whereas “welfare reform” yields 652 hits.

²The restriction does not apply for those who work at least 20 hours per week or who take part in an approved work or training program.

as do Medicaid and housing benefits. Because women are almost always caretakers of children, men receive very few direct benefits from the safety net unless they have children and live with them.

Table 1 gives some simple statistics about the portion of the labor market of primary concern to this paper and the policy proposals that follow. In 2003, the most recent year of available data from the Survey of Income and Program Participation (SIPP), 48 percent of males between the ages 18 to 40 (again, excluding full-time students) had only a high school diploma or less.³ Their employment rate, defined as the percentage employed out of the population, was 81.3 percent. Their average wage was \$12.95 an hour. Not surprisingly, these figures are considerably lower than those of men and women with higher levels of education.⁴

The longer-run trends are disturbing. Overall employment rates of low-skilled workers fell 3 to 4 percentage points between 1990 and 2003. The employment rates for low-skilled black men, however, fell by 9 percentage points for both high school dropouts and high school graduates. Longer run trends data on data presented in Juhn (1992) show even greater labor market deterioration for low-skilled workers. Between 1967 and 1987, for example, weekly labor market participation fell 14.4 percentage points for high school dropouts, 7.5 points for high school graduates, and only 2.9 points for college graduates. For black high school dropouts, weekly

³ Unless stated otherwise, I use data from the 2001 panel of the Survey of Income and Program Participation (SIPP) throughout the paper. The SIPP has been conducted by the Census Bureau since 1984. The survey design is a continuous series of national panels that gather information on income, demographics, and monthly program participation, with sample sizes ranging from approximately 14,000 to 41,000 interviewed households. The duration of each panel ranges from 2.5 years to 4 years.

⁴The figures in this paragraph are population-weighted averages of the less than high school and high school graduate groups shown in Table 1.

labor market participation fell 20.2 percentage points. The reductions in labor force attachment are even larger for younger men, who have less prior labor market experience.

Incarceration rates are very high for men. In 2001 4.9 percent of all adult males had spent time in a state or federal prison, compared to 2.3 percent in 1974. The rates were 16.6 percent for black men in 2001. Statistics are even more extreme for black men with low levels of education.⁵ Among black men without a college education and born between 1965 and 1969, 30 percent had been in prison by 1999; among those in this cohort without high school diplomas, the proportion is nearly 60 percent (Pettit and Western, 2004).

Marriage rates are also low for low-skilled men, relative to population-wide averages. The result is not surprising: ethnographic work (see, for example, Edin and Lein, 1997) often suggests that poor women cite “having a good job” as being among the most important characteristics of a man they would consider marrying. This led to a substantial decline in the fraction of children living in households with two married parents. In 1970 85 percent of children lived with two married parents. In 2004, the corresponding figure was only 68 percent.⁶

There is considerable evidence that different aspects of behavior are responsive to economic incentives. First, and perhaps most important, employment is responsive to wages. Heckman (1993), for example, writes “A major lesson of the past 20 years is that the strongest empirical effects of wages and nonlabor income on labor supply are to be found at the extensive margin—at the margin of entry and exit—where the elasticities definitely are not zero” (p.188). Many studies conclude that the Earned Income Tax Credit (EITC), which is described in greater detail below,

⁵Data from “Prevalence of Imprisonment in the U.S. Population, 1974-2001,” Bureau of Justice Statistics,

has had a substantial effect on decreasing welfare use and increasing employment and earnings among female-headed families in recent years. Second, there is also solid evidence from Grogger (1998); Gould, Weinberg, and Mustard (2002); and Machin and Meghir (2004) that wages changes over the past several decades had an important effect on crime.

In this paper I explore the costs and potential effects of two policies designed to increase the return to work. The first is an expanded earned income tax credit for low-income, childless taxpayers. The second is a targeted wage subsidy for selected low-wage workers, whereby a government agency would pay subsidies of 50 percent of the *difference* between the worker's market wage and a specified target wage, say, \$10 per hour. Both proposals would raise the after-tax return to work for individuals in the targeted group and thus reduce incentives to commit crimes and increase incentives to work in the formal labor market. With greater labor market earnings, it seems likely that marriage prospects will improve.

In the remainder of this paper, I give more details on the proposals, describe the demographic characteristics of the target population, provide cost estimates, and discuss the antipoverty effectiveness of the proposed policies. I also discuss administrative considerations and the likely effects of each policy on behavior.

I. The Proposals and Principles to Assess Them

In this section I elaborate briefly on the labor market problems confronting low-skilled workers and the policy proposals and the principles I will use to discuss them.

<http://www.ojp.usdoj.gov/bjs/abstract/piusp01.htm>

A. Factors Affecting Employment of Low-Skilled Workers

Figure 1 shows average weekly earnings for private sector workers in constant 1982 dollars over the last 40 years. The stagnation of wages for working families over the last 25 years is widely commented on. Low market wages for low-skilled individuals is surely one factor accounting for declining employment rates and increasing incarceration rates of low-skilled men.

Child-based provisions of the tax code, such as the child credit and earned income tax credit, ensure that families with children do not have positive federal tax liabilities until their incomes are well in excess of poverty. A married couple with one child, for example, does not have positive individual income tax liabilities until their income exceeds \$28,426 (in 2004). The poverty line for these families is \$15,205. The corresponding figure for a married couple with two children is \$33,369, while their poverty line is \$19,157.

In contrast, the individual income tax is considerably less generous to workers without children. A married couple without children begins to pay taxes with income of \$13,853 in 2004. The poverty line for a married childless couple is \$12,649. The tax threshold for a single childless worker is \$9,159. Their poverty line is \$9,060. The tax system, therefore, likely contributes to the employment problems of low-skilled workers. Marginal tax rates from state and local individual income taxes and payroll taxes range from 25 percent to 41 percent for childless low-income individuals—those with incomes between \$10,000 and \$25,000. For example, in a relatively high tax state like Maryland or Wisconsin, marginal tax rates range from 30 percent to 38 percent (in Wisconsin) or from 30 percent to 41 percent (in Maryland) on

⁶ See http://www.childtrendsdatbank.org/pdf/59_PDF.pdf.

workers in this income range with no dependents (assuming the payroll tax is borne fully by workers). Marginal tax rates will be (roughly) 5 percentage points lower in states (like Texas) without a state income tax.

Low-skilled *men* who have fathered a child outside of marriage also have child support obligations.⁷ In Wisconsin, for example, child support obligations are 17 percent of father's income for the first child, 25 percent for the second, 29 percent for three children, and 34 percent for five or more children. Child support debts are incurred even when the father is unemployed or unable to work, for example, because he is in prison.⁸

If men fail to pay their child support obligations, they accumulate child support debt (commonly called “arrearages”). These debts accumulate regardless of the reason the obligation is unpaid. This is an empirically important issue. While there are no credible national estimates of the fraction of those with child support obligations who are fully compliant with their orders, Primus (undated) reports that 82 percent of men in Maryland with a child support obligation had arrearages, and the average liability was \$6,834. In Oregon, 84 percent of fathers with an order owed child support and the average liability was \$6,301. Child support experts Maria Cancian and Daniel Meyer at the University of Wisconsin–Madison suggest that no more than 30 percent of those in the child support compliance system are fully compliant. Like high marginal tax rates, substantial arrearages may influence men to take jobs in informal sectors of the economy where

⁷About 88 percent of noncustodial parents are fathers, so I sometimes use gender-specific language when referring to all noncustodial parents.

⁸The reason that child support rules work the way they do is clear—both parents are expected to contribute to the material well-being of their children. It is not the fault of the child if the father is unemployed or commits a crime that results in a prison sentence. So the system does not penalize children for the inability of fathers to meet their obligations.

earnings are not subject to wage garnishment.

To summarize, low and stagnant wages, taxes, and financial obligations placed on the noncustodial parent may, in some cases, have the unintended consequence of driving people from the formal to the informal sectors of the economy. Factors influencing these decisions, of course, go well beyond these. Opportunities in the formal sector may be meager, particularly in geographic areas with high concentrations of poor people. Informal sector activities may be more remunerative, or may convey nonfinancial benefits that enhance their attractiveness relative to low-wage work.

B. Expand the EITC for childless taxpayers

My first policy initiative would be modeled along the lines of the EITC that is part of the federal income tax. In particular, I would expand the EITC available to childless taxpayers.

In fiscal 2004, the EITC is expected to cost \$38.4 billion, or about 1.7 percent of federal spending.⁹ It is the largest cash or near-cash antipoverty program in the U.S. budget. As shown in Table 2, the EITC provides a subsidy to earnings up to a specific income threshold. For example, consider taxpayers with two or more children. In 2004 the EITC gave a 40 percent earnings subsidy up to \$10,750. Taxpayers with earnings between \$10,750 and \$14,040 received the maximum credit of \$4,300.¹⁰ The credit was reduced by 21.06 percent of earnings between \$14,040 and \$34,458. Hence, there are three distinct ranges of the EITC: the subsidy, flat, and

⁹Holtzblatt (2004). In comparison, it cost roughly \$4.3 billion in 1975 (in 2004 dollars).

¹⁰The maximum credit for families with one child in 2004 was \$2,604; for childless workers it was \$390.

phase-out ranges of the credit. The EITC is refundable, meaning that the Treasury pays it whether or not the taxpayer has any other tax liability.¹¹

With its income limits, the EITC is well-targeted to low-income families. Participation rates appear high, with most estimates suggesting that at least 80 percent of eligible taxpayers actually receive the credit (Scholz, 1994; Internal Revenue Service, 2002a). Most important, analyses of the effects of the EITC on labor market participation come to a consistent conclusion: it has a statistically significant and large effect on labor force participation of single women with children.¹²

I would alter the age restriction of the childless EITC, no longer excluding low-income, childless taxpayers between the ages of 18 and 24. This change balances two considerations. Allowing 18 to 24 year olds to receiving the credit will lower target efficiency: a substantial number of young people with high lifetime incomes will have low incomes at this stage of their lifecycle.¹³ At the same time, a substantial amount of career development and crime occurs for this age cohort.¹⁴ Given the concerns motivating my proposals, I tolerate some resources going to households with high lifetime incomes in order to reach low-skilled workers at a critical time in their careers. All low-income childless taxpayers are eligible. I look at two policy variants – one increases the childless EITC credit rate and income thresholds and provides a larger credit for married childless taxpayers than for single childless taxpayers. The second distinguishes the

¹¹ Seventeen states currently also have earned income tax credits, though 5 of the state credits are not refundable.

¹²See Dickert, Houser, and Scholz (1995), Eissa and Liebman (1996), Keane and Moffitt (1998), Ellwood (2000), Meyer and Rosenbaum (2000, 2001), Grogger (2003), and Hotz, Mullin, and Scholz (2005). Eissa and Hoynes (2004) document a small, negative effect on employment of secondary workers in two-adult households. Hotz and Scholz (2003) survey EITC research.

¹³ I describe how I attempt to minimize payments going to individuals with high lifetime incomes below.

available credit both by marital status, and by age. Specifically, taxpayers younger than 30 would be eligible for a larger credit than older, childless taxpayers. The idea is to provide a substantial early career employment incentive, with the intention of drawing young people into the formal labor market at an important time of career development.

C. Targeted wage subsidies for low-income workers

The premise underlying this paper is that low wages are a major source of problems for low-skilled individuals and poor communities. My third policy idea directly influences the after-tax wage received by selected individuals. The idea would be for a government agency to pay subsidies of 50 percent of the *difference* between the worker's market wage and a specified target wage, say, \$10 per hour. Thus, for example, if the market wage for a low-skilled worker is \$7 an hour, his or her effective, subsidized wage would be \$8.50 an hour. This variant is related to the wage subsidies that were part of the Canadian Self-Sufficiency Project, though the Canadian experiment targeted primarily women with children and with prior welfare history. A universal wage subsidy proposal was made by Edmund Phelps in *Rewarding Work* (1997).

D. Principles for designing and evaluating the proposals

I organize my discussion of the proposals around three core evaluation principles. Other considerations surely come into play, and some will be noted in the following discussion. But it is essential that adopted policies are cost effective, can be administered, and have desirable behavioral incentives.

¹⁴ See Topel and Ward (1992) and Neal (1999) for studies of early career job mobility for young men.

Principle 1: Policies must be cost effective

Cost effectiveness can mean different things to different people. For my purposes, I am taking a narrow view, in which the first element of cost effectiveness is that scarce federal resources must be targeted on needy populations. The policies I discuss do not, generally, spend large amounts on families or individuals that have incomes well above the poverty line. But this raises a tension. We would like to minimize costs by directing subsidies either to those most in need or to those who will respond most positively to the incentive. But targeting may discourage people from moving out of a targeted group, or encourage others to adopt the behaviors or characteristics needed to receive subsidies. Moreover, one way that benefits can be tightly targeted is by imposing high implicit (or explicit) tax rates, so that benefits are quickly clawed back as incomes increase over particular ranges. High marginal tax rates, however, as noted above, may discourage people from working additional hours or seeking a higher-paying job.

More broadly, safety net programs, particularly those directed at the able-bodied, face an inherent tension between three policy goals: providing adequate benefit levels; targeting benefits on the truly needy; and maintaining positive incentives for households to meet society's expectations about work, marriage, and other behaviors. Generous programs that are tightly targeted must have high (often implicit) tax rates to limit benefits to the least needy. Low benefit levels can be tightly targeted and will provide modest disincentives to work, but may not meet basic needs. Generous benefits with low clawback rates (also called implicit marginal tax rates) will typically be quite costly. My proposals, therefore, must balance the tradeoffs among targeting, generosity, and minimizing undesirable incentives.

I assess cost effectiveness by examining the fraction of the total costs of the proposal that

goes to families or individuals with incomes below the poverty line and the degree to which the policy closes the poverty gap – the difference between income after taxes and transfers and the poverty line.

Principle 2: The policies should be as easy to administer as possible

It is difficult to come up with precise, quantitative measures of the degree to which different policy proposals can be implemented and administered. Nevertheless, proposals that do not consider administrative issues will likely be less effective than they otherwise could be. My discussion of this principle, therefore, will highlight issues that would arise in administering the programs. I also make some speculative comments about program takeup (or participation) by eligible and ineligible individuals. Takeup and noncompliance are tightly linked to administrative issues.

Principle 3: Policies should have desirable behavioral incentives

The policies discussed in the paper are designed to increase the after-tax return to work and in doing so, increase employment. By increasing employment, they should reduce crime and they may increase marriage. But, because the policies target different groups and cost different amounts, their incentive effects will likely differ.

A different aspect of principle 3 is that the policies may embody different marriage penalties and marriage bonuses. Marriage penalties are most frequently discussed in the context of the tax system:¹⁵ the tax treatment of married couples is different from that of single parents or individuals, so the married couple may face larger total tax liabilities than they would

¹⁵See Feenberg and Rosen (1995), Alm and Whittington (1995), U.S. Congressional Budget Office (1997), Bull et al.

collectively as individuals if they were separated or never married. It is a problem if policies create substantial disincentives for people to marry.

A final aspect of principle 3 is that I want to minimize harmful effects of the subsidies on employment and wages of groups not targeted by the subsidies. I also want to minimize incentives for people to alter behavior in socially undesirable ways in order to receive benefits.

II. Expand the EITC Available to Childless Taxpayers

Childless taxpayers in 2004 were eligible for an EITC if their income was between \$1 and \$11,490 and the taxpayer was between the ages of 25 and 64 (parameters are shown in Table 2). The age restriction excludes students and other younger adults with low current income but high lifetime income and the ability to borrow from parents or financial institutions. Taxpayers must have asset income less than \$2,650 (again in 2004).

In Table 3, I look at statistics for the existing childless EITC and two proposed modifications. The first modification (Option 1 in Table 3) is designed to mitigate marriage penalties that may arise from an expansion of the childless EITC. Childless taxpayers filing as singles would be eligible for a 15.3 percent credit on incomes from \$1 to \$5,000. The percentage is equal to the combined employee and employer share of taxes for social security and Medicare. The credit would phase out at a 19.125 percent rate on incomes between \$6,000 and \$10,000. The credit for married childless taxpayers would have income thresholds that are twice as large—the 15.3 percent phase-in credit would apply to incomes from \$1 to \$10,000. The 19.125 percent phase-out rate would apply to incomes between \$12,000 and \$20,000.

(1999). The general statement of the problem is that the tax system cannot simultaneously be progressive, treat the

The second policy (Option 2 in Table 3) is identical to option 1 for taxpayers 30 years old or older (for married childless couples, both partners need to be 30 or older). The policy gives a larger credit for younger, childless taxpayers. Specifically, it provides a 25 percent credit on incomes from \$1 to \$5,000. The credit would phase out at a 31.25 percent rate on incomes between \$6,000 and \$10,000. The credit for younger married childless taxpayers would have income thresholds that are twice as large.

Both variants would extend the childless EITC to taxpayers who are aged 18 to 24 and who are not full-time students. It is difficult administratively for the Internal Revenue Service to identify full-time students. Hence, as an administratively practical alternative, the childless EITC would not be given to any taxpayer claiming the HOPE or lifelong learning educational tax credits, or who are the person that allows another taxpayer (generally a parent) to claim the credit.

A. Cost effectiveness of making the EITC for childless taxpayers more generous

My SIPP-based numerical estimates of the expanded childless EITC are given in Table 3. The existing childless EITC (Column 1) would cost \$1.21 billion, if every one of the 5.87 million eligible taxpayers actually filed and made the claim.¹⁶ Of these eligible taxpayers, 44 percent are male. Twenty-one percent of eligibles are black and 68 percent have a high school education or less. The childless EITC is tightly targeted to low-income taxpayers: the average hourly wage of recipients is \$8.62, the average annual income is \$6,418. Seventy-seven percent of the tax filers have income below the poverty line, and 91 percent of the expenditures close the

family as the unit of taxation, and be neutral with respect to marriage.

poverty gap.¹⁷ In comparison, Scholz and Levine (2001) report that 83.9 percent of AFDC-TANF benefits, 69.1 percent of SSI benefits, 53.9 percent of EITC benefits, and 26.6 percent of workers' compensation close the poverty gap.

One of the ways that low-income families make ends meet is by residing with other families or individuals. Consequently, for each proposal I calculate the number of eligible individuals (or families) with incomes below the poverty line based on the income (and family size) of the tax filing unit and based on the income of all family members. The two concepts will differ, for example, when an adult child co-resides with his or her parents. I also compute two analogous measures of the fraction of total expenditures that close the “poverty gap.” The usefulness of each measure depends on the degree to which family members share resources. If sharing is common, the “family basis” estimates will better reflect reality. If families do not share resources, the “tax filer basis” will provide a better measure of expenditure targeting.

When I instead focus on the family, rather than the tax filer, 47 percent have income below the poverty line and the childless EITC closes 54 percent of the poverty gap.

The alternative policy—it provides a larger credit for younger childless taxpayers—has identical income phasein and phaseout ranges as option 1. Consequently, the demographic characteristics of the eligible population are identical. The difference is that Option 2 costs \$6.5 billion (for an average credit of \$684) rather than \$5.1 billion (or \$542 as an average credit),

¹⁶The childless EITC actually cost \$0.9 billion in 2002, which is consistent with participation among eligibles being well below 100 percent.

¹⁷The poverty gap is defined as the difference between market income and the poverty line: it identifies the smallest amount of money that could eliminate poverty for the affected population, absent any behavioral response.

which is the cost of Option 1.¹⁸

The labor market effects of the credit will depend, in part, on the distribution of individuals along the credit schedule. Any household fully out of the labor market has an unambiguous incentive to enter the labor market as a consequence of the EITC. For people already working, the credit provides mixed incentives. The increase in the after-tax wage creates an incentive for recipients in the phase-in range to work more hours (this is the substitution effect).¹⁹ Roughly 39 percent of taxpayers under the policy options are in the phase-in range. For households in the plateau and phase-out ranges of the credit (roughly 61 percent of the affected population), the EITC provides unambiguous negative incentives on hours although, as noted below, there is little empirical evidence that households respond to these incentives.

B. Administrative considerations with an expanded childless EITC

Expanding the childless EITC does not require a new administrative apparatus, unlike the other proposal discussed later, since it builds on a policy that has been part of the tax code since 1994. Consequently, the two major administrative concerns have to do with noncompliance—would payments go to taxpayers who are not eligible for the credit—and with participation—would eligible taxpayers file returns and receive the credit?

A large fraction of EITC payments (particularly for families with children) appear to go to taxpayers who are ineligible for the credit. The most recent study of EITC noncompliance

¹⁸The cost of option 1 decreases by \$1.4 billion, if childless families and individuals who are aged 18–24 (and not full-time students) are excluded. The baseline statistics shown in column two otherwise do not change substantially, though the fraction with less than a high school diploma increases by 3 percentage points, the fraction with exactly a high school diploma increases 1 percentage point, and the fraction of total payments that directly close the poverty gap falls somewhat.

¹⁹But the income generated by the EITC creates an incentive to work fewer hours (assuming leisure is a normal

examined returns filed in 2000 (for tax year 1999) and found that of the \$31.3 billion claimed in EITC payments, between \$8.5 and \$9.9 billion, or 27.0 to 31.7 percent of the total, exceeded the amount for which taxpayers were eligible (Internal Revenue Service, 2002b). Of the errors the IRS was able to classify, roughly one-half arose because of qualifying-child errors and one-half of those (or 25 percent of the total) arose because the child claimed was not the taxpayer's qualifying child.²⁰ Of these errors, the most common problem was that EITC-qualifying children failed to live for at least six months with the taxpayer claiming the child. Mistakes of this type can run the gamut from innocent taxpayers running afoul of complex IRS rules to fraud. Tax returns do not collect information on the *location* of children during the year. Consequently, absent additional information, the IRS has little ability to scrutinize EITC qualifying-child claims before the EITC is paid out. These child-related issues, of course, do not apply to the EITC available for childless taxpayers.

Holtzblatt and McCubbin (2004) analyze data from the most recent IRS EITC compliance study and find the EITC noncompliance rate for childless taxpayers (before enforcement actions) are 39.3 percent to 44.6 percent; these are even higher than the error rates for families with children. The reason is not clear and the results need to be viewed with caution, because of a fairly small number of childless taxpayers in the study sample. In principle, the IRS has third-party reports of the two key issues affecting childless taxpayer claims—both age and income

good). This is referred to as the “income effect.”

²⁰Holtzblatt and McCubbin (2004) provide a good discussion of the results of the EITC compliance study and broader tax compliance issues for low-income households. Also see Holtzblatt (1991), U.S. General Accounting Office (1998), and McCubbin (2001) for discussions of earlier EITC compliance studies. Hotz and Scholz (2005) examine how child support data might be used to reduce noncompliance among EITC claimants with children. See Hotz and Scholz (2003) for a more detailed discussion of EITC compliance and other EITC-related issues.

claims can be verified from social security data and employer wage and salary reports. And a taxpayer with a child would not find it advantageous to file instead for a childless EITC, even with an expanded credit. Thus, an expanded childless EITC can be administered with tolerable error rates.

There have been no empirical studies of EITC participation among eligible childless taxpayers. Scholz (1994) and Blumenthal, Erard, and Ho (2005) both examine tax years prior to the inception of the credit for childless taxpayers. The Internal Revenue Service (2002a) examines EITC participation among eligibles in 1996, but focuses only on families with children, presumably because the EITC available to childless taxpayers is only a small part of overall EITC spending. One factor influencing the credit take-up of families with children, however, is the size of the available credit. Given that the maximum childless EITC under current law is only \$390, I expect the childless taxpayer participation rate to be less than the 80 percent rates found for taxpayers with children.²¹

Using data from the SIPP, I calculated the number of childless families and individuals with incomes in the EITC-eligible range who were between the ages 25 and 64 and had asset income less than \$2,600. Using the tax topical module of the SIPP, I find that 65–70 percent of EITC-eligible taxpayers without children actually filed returns. Although there is little empirical evidence on the matter, my best guess is that with a larger available credit that extends further up into the income distribution, participation rates for the expanded EITC for childless taxpayers would resemble the participation rates that obtain for the EITC available for taxpayers with

²¹Childless taxpayers can receive the EITC when using the 1040-EZ form, however. The simplicity of this filing

children.

C. Behavioral incentives of the expanded childless EITC

I briefly examine the effects of the expanded childless EITC on employment, marriage, and crime.

Employment

A back-of-the-envelope calculation illustrates the potential employment effect of the childless EITC. There are 10,833,415 childless individuals and couples out of the labor market who would be eligible for Option 2 if they had income in the designated range. Those already in the labor market who are eligible for the credit have an average wage of \$8.16 an hour and earn \$7,234, implying that they work 887 hours a year. The expanded childless EITC (option 2) of \$683.92, implies a 9.45 percent increase in the after-tax return to work. The smallest employment elasticity with respect to the after-tax return to work in the Hotz and Scholz (2003) EITC survey is 0.69. Suppose those out of the labor market would have the same earnings as those eligible for the credit.²² This would imply a 6.52 percent increase in employment (off a base of 53.3 percent)—this is 3.5 percentage points or 706,339 individuals out of the pool of 20,316,966.

I have two reactions to employment responses of this magnitude. First, given the steady declines in employment rates of low-skilled males over the past few decades, administrable policies that can augment incomes while at the same time increase employment, deserve

approach should improve participation relative to an arrangement where the credit can only be claimed on the 1040-A or 1040 forms.

²² They likely would have lower earnings, which would result in the EITC having a larger potential effect on the after-tax return to work.

consideration. An expansion of the childless EITC would transfer a substantial amount of money to low-skilled workers, and do so in a way that likely will *increase* employment rates. Second, the magnitude of this expected response is fairly small in percentage-point terms. This is an inevitable consequence of the fact that employment elasticities for low-skilled individuals are not huge and policies that balance the tradeoffs between generosity, targeting, and desirable incentives can not sharply increase the return to work. I briefly return to this issue in the last section of the paper.

It is unlikely that the expansion of the childless EITC will have a substantial positive or negative effect on hours of work. In one sense, this might seem like a surprising statement. As shown in Table 3, over 60 percent of recipients will be in the flat or the phase-out ranges of the credit, where the incentives are unambiguously to work less. But studies estimating the effects of the EITC on hours of work for those households that are working find only small negative effects. Liebman (1997), for example, shows no bunching of taxpayers at the beginning and end of the phase-out range, as might be expected if the EITC significantly affects hours and taxpayers are cognizant of the discontinuities in implied marginal tax rates generated by the credit. As Liebman notes, it is not surprising that negative effects on hours for people already in the labor market are small, because the precise relationship between the EITC and hours worked is likely to be poorly understood by most taxpayers. Effects on hours will depend, at least in part, on taxpayers recognizing the effect of incremental decisions made during the calendar year on the tax returns they likely will not file until April in the following year. The majority of EITC recipients also pay a third party to prepare their tax returns, and it is difficult to infer the implicit tax rates embodied in the credit from the look-up table that accompanies the EITC instructions.

This confusion is less likely to cut into positive participation effects, which require only that taxpayers understand that there is some tax-related bonus to work. Abundant anecdotal evidence indicates that taxpayers have this understanding (see, for example, DeParle, 1999).

Marriage

The “marriage penalty” refers to a situation where the after-tax and after-transfer resources are lower for a couple after marriage, relative to their collective resources as unmarried individuals. An expanded EITC for childless taxpayers would raise incomes of those in a marriage who, if the marriage dissolved, would become noncustodial parents. By increasing the value of the alternative outside of marriage, the proposal may increase the incentive for married couples to split.²³ Given that household income generally increases when two individuals marry, it is also likely that marriage will reduce the combined tax credits available to the household. Hence, an expanded EITC may also reduce the incentive for single people to marry.

I quantify the marriage penalties and bonuses of the expanded childless EITC in Table 4. I use all the waves of the 2001 SIPP (starting in January, 2001) to calculate marriage penalties and bonuses. I assume all taxpayers take the EITC when eligible, the female takes the children when a separation occurs, and taxpayers use the standard deduction (so I limit the analysis to taxpayers with incomes under \$50,000). I make these calculations for two groups. The left panel of the table shows penalties and bonuses for single people who get married in later waves of the 2001 SIPP panel (using the income of the original SIPP respondent in 2001, and the income of the spouse in the year they marry). The right panel of the table shows penalties and bonuses for

²³Alternatively, improving options outside of marriage could increase the incentives facing both partners to make

married couples in the 2001 SIPP.

The top panel of Table 4 shows marriage penalties and bonuses for taxpayers in the current income tax. For single taxpayers who get married in the SIPP, more than half of those with incomes under \$30,000 have marriage bonuses, though the size of the penalties conditional on having a penalty tend to be larger than the conditional bonuses. Married couples are more likely to have marriage penalties.

The Option 1 proposal (the second panel of the table), while modestly increasing penalties for some taxpayers, has larger beneficial effects on bonuses, particularly for taxpayers with incomes under \$20,000. Option 2 is even more favorable: it slightly increases the magnitude of marriage penalties for a small number of taxpayers relative to current law. For households receiving marriage bonuses (and this is the majority of households), it substantially increases the financial benefit of marriage.

The existence, in certain circumstances, of some marriage penalties does not necessarily mean that the expanded childless EITC is irreparably flawed. First, as Primus (undated) emphasizes, two separate households must be maintained if parents or childless individuals decide not to live together. The magnitude of the relevant economies of scale can be inferred by the differences in poverty lines for families of different sizes. Consider first the poverty line for a family of three—in this example, a married couple with one child—of \$14,776 (in 2004). If the parents separate, the poverty line for the custodial parent and child is \$12,649, and for the noncustodial parent it is \$9,827. The combined poverty income for the two separate households

sure the marriage works well. Consequently, it could lead to stronger marriages.

is \$22,476, or 52 percent more than the poverty line for the intact couple. The comparable calculation for a married couple with two children is that the economy of scale associated with joint living is 26 percent, or several thousand dollars. Regardless of whether an expanded EITC exists for childless taxpayers, couples are financially better off married (or at least living together) than they are maintaining separate residences.

While couples may lose childless EITC benefits upon marriage, many will eventually have a child and thus become eligible for the (more generous) EITC for families with children. Consequently, the “penalty” to marriage is likely to be less severe than it would be if the couple never had children and could receive the expanded childless EITC for many years. This is one example of a broader reason why the careful studies of marriage penalties mentioned above generally find no effect of marriage penalties on family structure:²⁴ family circumstances can change fairly rapidly. Children are born, one partner may leave the labor market, and there are substantial scale economies to coresidence. These factors may mitigate the effects of marriage penalties, as typically measured.

Both policy options introduced here, of course, increases marriage bonuses by substantially more than they increase marriage penalties. The fact that a policy provides an incentive, however, does not necessarily mean that it actually affects behavior. Incentives can be important as a *political* matter—one might have a hard time enacting policies that appear on the surface to promote undesirable behaviors. But the empirical evidence on the EITC does not lead me to

²⁴See Dickert-Conlin and Houser (2002), Eissa and Hoynes (1999), and Ellwood (2000).

expect that the incentives noted above will have a discernable, empirical effect on marriage.²⁵

Crime

From the mid-1970s to the mid-1990s the number of men in prison or jail in the United States roughly tripled, so that by 1993, one man was incarcerated for every 50 in the workplace. In 1995, 72 percent of those arrested were between the ages of 13 and 34, yet this age group accounts for only 32 percent of the population. Most criminals have limited education and limited labor market skills. A 1991 Survey of State Prison Inmates reports that two-thirds had not graduated from high school.

The literature finds a strong relationship between labor market factors and crime rates.²⁶ In the following brief survey I focus on the evidence on wage rates, because the policies I am suggesting directly affect the after-tax returns to working. Grogger (1998), examining the relationship between wages and youth crime, suggests that much of the increase in the youth arrest rates between 1970 and 1980 can be attributed to the fall in their real wages. Moreover, movements in real wages can explain a substantial component of both the racial differential in criminal participation and the age distribution of crime. He estimates an elasticity of youth crime participation with respect to the wage rate of around 0.6 to 0.9.

Gould, Weinberg, and Mustard (2002) find similar evidence, concluding that both wages

²⁵ Three papers examine whether the EITC encourages the existence of female-headed families. Dickert-Conlin and Houser (2002) look at correlations between EITC changes and female headship. They account for the fact that couples affect their EITC through their marital and labor supply choices, and find little effect of the EITC on marriage decisions. Eissa and Hoynes (1999) and Ellwood (2000) also find little or no evidence that EITC marriage penalties or bonuses affected marriage.

²⁶ Levitt (2004) is a notable exception, though he focuses on unemployment rates in his discussion of the minor role that unemployment and wages play in understanding changes in crime rates. He does not present any new empirical evidence on this issue. The existing literature points to wages as being a more important factor than local unemployment rates in understanding changes in crime over time and across demographic groups.

and unemployment are significantly related to crime for males with low levels of education, but that wages have played a more important role over the last few decades. They estimate an elasticity of property crime to the wages of low-skilled workers ranging between 0.31 and 1.0. Machin and Meghir (2004) provide additional evidence consistent with an important effect of wages on crime, using data from England and Wales between 1975 and 1996.

The upshot of this evidence is that the wages available to people, particularly young men, in the labor market appear to affect crime rates. The expanded childless EITC affecting individuals aged 18 to 64 would increase the returns to formal labor market participation.²⁷ From column 3 of Table 4, the average hourly wage of eligible taxpayers is \$8.16 and average annual income is \$7,234 (some earnings could be contributed by other family members, but most are single individuals), implying they work roughly 887 hours a year. The average EITC entitlement is \$684, or \$0.77 a hour. This is, on average, a 9.45 percent increase in wages. Using the range of wage elasticities found in the literature, such an increase would reduce crime rates by between 2.9 and 9.45 percent, a substantial decrease. Freeman (1996) calculates that there were roughly 33 million crimes committed in 1992, at a cost of \$532 per crime. Some crime is surely committed by people with children, who would be unaffected by this policy. But suppose the expanded childless EITC reduced the number of crimes by the bottom range of the back-of-the-envelope estimates, 2.9 percent, or by 957,000 crimes. By one estimate, this would have a monetary value of \$509 million, or 7.8 percent of the total cost of the expanded childless EITC.

²⁷Excluding 18–24-year-olds would leave their after-tax return to work unchanged or even reduce it if there is a substantial labor supply response to the expanded credit. The policy would have no (or possibly a small negative) effect on crime, employment, and marriage for these younger households.

Other considerations

Other considerations sometimes arise with employment-based credits. For example, if employment responses to the credit are large enough, the supply response may cause wages to fall, thus reducing the incomes of low-skilled workers not eligible for the credit. Given the relatively modest employment responses to the expanded childless EITC, it seems unlikely that it will have broader effects on market wages.

Another issue has to do with the incidence of the proposed credits: Can employers capture some of the benefit of the credit by paying workers less than they otherwise would in the absence of the intervention? There is little evidence in the EITC literature that employers are able to capture part of the benefit of the credit (see, for example, Rothstein, 2005). Because it may be difficult for employers to accurately identify which of their employees might be eligible for the expanded childless EITC, it is unlikely that anyone other than the recipient would benefit from it.

The expanded EITC for childless taxpayers increases marriage bonuses for low-income households and so has pro-marriage incentives. It delivers roughly \$6.5 billion (or \$5.1 billion, depending on which variant is used) to working poor and near-poor individuals and married couples. It likely would increase employment and reduce crime. The targeting of the proposal is not airtight: It would provide benefits to many young people who have low incomes while working in jobs between college and graduate school, or in other jobs that invest in human capital or combine leisure with employment (such as working as a lifeguard or camp counselor). But it would be straightforward to administer and it would increase the incomes and positively affect the behavior of low-income childless individuals and couples.

III. Targeted Wage Subsidies for Disadvantaged Workers

The United States has a long history of experimentation with targeted wage subsidies to aid disadvantaged workers. The distinguishing feature of these subsidies is that they are payments to employers. The payments are generally made for hiring disadvantaged workers from targeted groups. In one case, the subsidies were designed in a way that attempted to subsidize the hiring of *incremental* workers. Bartik (2001, particularly chapter 8) provides a detailed discussion of these policies.

The empirical evidence on the efficacy of employer-based credits is weak. Burtless (1985) shows, using data from a well-designed experiment, that job seekers given vouchers that indicate to employers that they are eligible for a generous wage subsidy were significantly *less* likely to find employment than were job seekers without vouchers. It appears that the label “disadvantaged worker” is very harmful to low-skilled workers, even when accompanied by payments to offset additional hiring costs of the workers. Subsidy take-up also appears to be exceptionally low over the years. Katz (1998) estimates that in the mid-to-late 1980s, only 9 percent of the eligible youth hired were claimed by employers to receive the TJTC. Hamersma (2003) shows that takeup of the WOTC and WtW credits is less than 17 percent for disadvantaged youth and less than 33 percent for welfare recipients. She notes the actual take-up rates may be much lower than these figures. The credits also appear to have small to negligible beneficial effects on low-wage labor markets. Hamersma (2005), for example, using administrative data from Wisconsin on earnings, found that the WOTC credit and WOTC/WtW eligibility and certifications had no positive effect on employment. Subsidized workers do appear to have slightly higher earnings because of the credits, but she estimates that only one-

quarter of the credit is passed on to workers in higher wages. This implies that employers of low-wage workers have a considerable degree of market power.

Given the dismal history of employer-based tax credits, my proposal differs from previous credits. First and most importantly, to avoid stigma and to lessen concerns that employers would receive the bulk of the benefit from employer-based subsidies, a new delivery mechanism would be developed whereby *workers would receive subsidy checks directly*, after submitting pay stubs to the program administrators. Thus, employers will not know whether or not a given worker receives a subsidy, so there will be no stigma. I also think employers are likely to be less able to capture a portion of the subsidy benefit when payments go directly to workers. Employers will need to pay comparable workers similar wages for doing the same job. If employers have a mixture of subsidized and unsubsidized workers (and are not aware who received the subsidy), they will have a hard time paying the workers different amounts. Moreover, if workers are not being paid the value of their marginal product of labor, they can find employment elsewhere. It will be in employers' interests to hire workers as long as wages are equal to the value of the worker's productivity to the firm. Consequently, competitive labor markets should ensure that much, if not all, of the earnings subsidies paid to workers will accrue to the worker.

Second, my proposed credit differs from those actually put into law. My policy would pay 50 percent of the difference between market wages and the target wage of \$10 an hour. A worker earning \$6 an hour, for example, would receive a subsidy of \$2 an hour. Third, unlike the universal wage subsidy proposed by Phelps (1997), which he estimates would cost over \$125 billion annually, my policy is targeted to individuals living in federally designated Renewal Communities, Empowerment Zones, or Enterprise Communities (RC/EZ/ECs).

In Table 5 I examine the effect of the wage subsidy program based on targeting the subsidy to workers living in federally designated RC/EZ/ECs.²⁸ My first task was to identify the characteristics of the individuals living in these designated areas. To do so, I compiled the 2,601 census tracts that make up the specific RC/EZ/EC areas. Then, using the product “Census CD + Maps 1990-2000” I convert the 1990 census tracts to 2000 census tracts and compile the year 2000 characteristics of these tracts. Because the SIPP does not have detailed geographic identifiers and is a random, stratified data file, I could not simply draw a sample based on the designated census tracts. Rather, I drew a SIPP proxy sample that matches important characteristics of the population in RC/EZ/ECs (Table 5, top panel).

Table 5 also includes results for a second analysis, where I drew a similarly-sized sample, selecting the lowest-income census tracts in the country until I had a sample equal in size to the proxy RC/EZ/ECs sample, roughly 2.8 million households. This second analysis was motivated by the concern that perhaps the RC/EZ/EC designation reflected not just need, but political connections or some other factor.

A. Cost effectiveness of the targeted wage subsidy for disadvantaged workers

I begin with a brief comparison among the characteristics of the four samples that appear in the top panel of Table 5. For further comparison, I have included similar statistics for the entire United States.

²⁸The department of Housing and Urban Development writes: “HUD re-energized this Initiative in December 2001 by designating 40 urban and rural RCs and 8 new urban EZs. These new designees are able to use a remarkable \$11 Billion tax-incentive package to open new businesses, provide thousands of new jobs, rehab and build new housing, and change lives in urban and rural areas throughout the nation” (see more at <http://www.hud.gov/offices/cpd/economicdevelopment/programs/rc/index.cfm>, which also identifies the specific Census Tracts that make up the RCs, EZs, and ECs.

There are two striking differences between the RC/EZ/EC census tracts and the U.S. population (the SIPP proxy sample is roughly comparable to the RC/EZ/EC tracts). First is the racial composition: 12.2 percent of U.S. households are black, compared to 54.9 percent of households in the RC/EZ/EC tracts. Second is the income: households in the RC/EZ/EC tracts are much poorer than typical households in the United States, with median household income of just over half U.S. median income.

Households in the RC/EZ/EC census tracts have somewhat higher incomes than would be the case if these census tracts were selected solely on the basis of income. Median and average household incomes in the selected low-income census tracts (and their comparable SIPP proxies) are considerably lower than the median and average incomes in the RC/EZ/EC census tracts. This is not because the poorest census tracts have more households over the age of 65—the age composition of the poorest and RC/EZ/EC census tracts is similar.

I estimate the cost of adopting the wage subsidy policy using both the RC/EZ/EC and the selected census tracts with the lowest median incomes. The cost of the proposal and the fraction of total expenditures that close the poverty gap (both given in Table 5) is similar when the target population is defined as those living in the tracts with the lowest median income. I think, given the process used to identify RC/EZ/EC tracts and the other federal resources targeted to these areas, it makes sense to focus the wage subsidies on individuals in those tracts. Nevertheless, other targeting approaches could be used, such as focusing the wage subsidies on residents in the nation's poorest census tracts.

Table 5, bottom panel, presents the results of these analyses. Absent any employment response, the RC/EZ/EC wage subsidy would be received by 1.1 million workers at a cost \$2.2

billion. Forty-three percent of these workers are male and 48 percent are black. Their educational attainment is low, and their average hourly wage is \$7.30, meaning they would receive a subsidy of roughly \$1.35 an hour, or an effective wage increase of 18.5 percent. The annual average subsidy would be \$1,943, an 12.8 percent increase in the average annual income of the household, and 30.4 percent of total expenditure directly closes the poverty gap when measured on a tax filer basis (and 27 percent on a household basis).

B. Administrative considerations with the targeted wage subsidy for disadvantaged workers

The expanded childless EITC builds on an existing administrative mechanism. My wage subsidy proposal requires a new administrative structure.²⁹ It is essential for the policy to deliver benefits directly to employees, both to reduce any stigma that might be associated with the proposal, and to ensure that the subsidy improves directly the financial status of subsidized households.³⁰ But requiring a new bureaucracy (or expanding an existing bureaucracy) is the single biggest drawback of the proposed credit.

The administrative mechanism is likely feasible. State unemployment insurance offices, for example, could be given the additional responsibility of administering the wage subsidies.³¹ Eligible workers would submit pay stubs on a quarterly basis. After matching pay claims to state UI records, the administrative office would then send the subsidy payments to households each

²⁹The new approach was taken on a small scale in the Canadian Self-Sufficiency Project (SSP) that was implemented in British Columbia and New Brunswick. It is not clear that the lessons from the SSP are immediately transferable to my wage subsidy proposal, since the SSP focused on welfare recipients (mostly women) with children, while my wage subsidy is more broadly targeted.

³⁰For example, firms that testify in support of extensions to the WOTC and WtW credit generally talk about the need for the subsidy to offset the training costs associated with hiring low-skilled workers. There is no evidence that the subsidies increase wages.

³¹ Arrangements would nevertheless need to be made to get information on the earnings of employees of multi-state firms whose earnings records might appear in the UI system of the state where the employee is payrolled rather than

quarter.³²

The ability to match to UI records suggests that credit noncompliance is likely to be low. The major administrative pitfall is that UI reports do not include hours of work, so there is no third-party audit trail that would allow administrators to verify hours claims. An incentive would exist, for example, for an employer of a \$10-an-hour worker who works 40 hours a week to instead report that the worker was employed 60 hours (at \$6.67 an hour), thereby allowing the worker to receive a subsidy of \$1.67 an hour. Provisions would need to be put in place for occasional audits of employer payroll records and sanctions would need to be imposed on employers who misstated hours in payroll reports.

As mentioned previously, takeup of employer-based credits has been very low. The reasons for this are not fully clear (Hamersma, 2003). One possibility is that employers find the application process too cumbersome, but there is an industry of consultants and intermediaries who will help with paperwork (in return for a share of the credits). Another possibility is that employers are unaware of the available credits. Neither explanation, however, likely applies to wage subsidies paid directly to employees. It is clear that take-up of this subsidy will be less than 100 percent, but given the money involved, it is likely to be higher than delivering the credit through employers.

C. Behavioral incentives of the targeted wage subsidy for disadvantaged workers

I briefly examine the effects of the targeted wage subsidy for disadvantaged workers on employment, marriage, and crime.

the state where the employee is employed.

Employment

The targeted wage subsidy can substantially increase the return to work, and hence employment, in the RC/EZ/EC target areas, where fewer than half of the adults between ages 18 and 64 are employed. In these tracts, 1.2 million individuals aged 18 to 64 are out of the labor market. Suppose their hourly wage is \$6.50 (the average of those in the labor market is \$7.29). The subsidy would increase the return to work by 27 percent. An appropriate labor supply elasticity for this segment of the labor market is unclear. The conventional wisdom is that labor supply elasticities for men are very low, but somewhat higher for women. The smallest implied elasticity from the Hotz and Scholz (2003) EITC survey, 0.69, applies primarily to women. Suppose the elasticity is 0.4. This would imply that employment would increase by 110,869 (or 5 percent of the total population eligible for the credit, which is 2,232,514 working-age adults).

As noted above, I expect the hours responses to the targeted wage subsidy to be negligible.

Marriage

There is no direct marriage penalty, since eligibility for the subsidy depends only on individual and not household income and is unaffected by an individual's marital decision. I suggest that the ultimate effect of the wage subsidy will be positive, since marriage is positively associated with men's incomes.³³

Crime

I briefly reviewed the literature on wages and crime in the section on expanding the

³²Unemployment data in Wisconsin are updated quarterly, generally with a 3-month lag, so the proposed administrative mechanism is clearly feasible.

³³This is widely known and can be seen in the simple tabulations given in Table 1, where marriage rates increase with educational attainment.

childless EITC. Similar calculations suggest the new policy could reduce crime. Assuming the targeted wage subsidy could increase the after-tax wage by 27 percent, crime rates would be reduced by 8.4 to 27 percent using the range of wage elasticities found in the literature—a substantial decrease. I do not, of course, have any estimates of the number of crimes committed in areas designated as RC/EZ/EC census tracts. Suppose the rate of crime is twice the nationwide average rate (of 0.24 per household). This would imply that roughly 1.2 million crimes are committed by RC/EZ/EC residents. A reduction of 8.4 to 27 percent is a reduction of 100,800 to 324,000 crimes. At an average valuation of \$532 per crime, the monetary value of the crime reduction is \$53 to \$172 million or, at most, 8.9 percent of the total cost of the proposal.

The proposal would have a beneficial effect by reducing crime, but it would by no means be self-financing, unless the monetary value of the crimes is far higher than the \$532 estimate used for back-of-the-envelope calculations.

Other considerations

The wage subsidy proposal is tightly targeted, should increase employment, deliver substantial resources to low-skilled workers, and reduce crime. But the proposal raises two concerns. The first has already been discussed in considerable detail. It would require a new administrative apparatus. In addition, employer reports of hours would have to be audited occasionally, to ensure that workers and employers do not attempt to game the system. I think these administrative hurdles can be overcome.

The second concern, described in Bartik (2001), has to do with choices that firms hiring low-skilled labor may adopt in setting wages. Put loosely, some believe firms make choices to pay low wages and accept higher worker turnover and lower worker productivity, or pay higher

wages and hope to make up the extra costs with lower worker turnover and higher worker morale and effort. With the targeted wage subsidy program, some employers could feel an additional incentive to take the “low wage” route, since higher wages would result in their workers not being eligible for the wage subsidy.

My view is that the wages employers pay is dictated by the job skills of the workers they hire and that the empirical evidence in support of “efficiency wage” or “dual labor market” models is not very strong. Moreover, many of the companies operating in RC/EZ/EC census tracts will also operate in other locations, making it less likely that the presence of the targeted wage subsidy will cause them to alter their hiring and pay packages.

IV. Conclusions

This paper introduces two proposals that would substantially strengthen low-wage labor markets for workers without children. The expanded EITC for childless taxpayers would deliver different benefits depending on whether the childless taxpayer was single or married (or, in one version, if the claimants were under 30 or over 30), would cost \$5.1 billion to \$6.5 billion annually. It would provide a substantial amount of money to low-income, working taxpayers and the communities they live in. It would be easily administered, and would likely have positive effects on employment and crime. The latter benefits would reduce, to a certain extent, the social costs of the proposal. The idea is designed to minimize harmful incentive effects on marriage. Of the ideas discussed in the paper, it would be the easiest policy to adopt and implement.

The primary concern with adopting an expanded childless EITC, particularly one available to taxpayers aged 18 to 24, which is necessary if one expects the policy to increase formal sector employment and reduce crime, is that the policy spends too much money subsidizing well-

educated children from affluent families who are taking time off between school or are working jobs that combine leisure and employment before embarking on careers.

The most novel proposal addresses this concern by directing wage subsidies to employees who reside in federally designated Renewal Communities, Empowerment Zones, or Enterprise Communities. A policy that subsidized 50 percent of the difference between market wages and \$10 an hour would cost roughly \$2 billion annually. I expect this policy would also have a substantial effect on employment, crime reduction, and possibly marriage. It would contribute to the revitalization of these distressed communities. The main drawback to the proposal is that my version would require a new administrative apparatus. Developing the administrative mechanism is important to ensure that the payments largely go to poor working families.

Given my primary concerns, there exist a variety of other policies that would also seem to address them. For example, if the fundamental problem is skills deficits for certain men, one might think aggressive employment and training opportunities for low-skilled groups would be an equally or more effective program. But the evidence on the effectiveness of job training for adults, largely drawn from years of evaluation of the Job Training Partnership Act, is dismal. Although the employment effects of tax credits (or wage subsidies) are modest, the expenditures also have the benefit of augmenting the incomes of recipients.

One might consider certain mandates on behavior, but mandates must be part of a reciprocal relationship. Put differently, mandates work best in an environment where support is provided to help people do the right thing. Failure to adhere to the mandate would then trigger loss of support. With the current array of programs and support, however, there is nothing (or very little) for disadvantaged childless workers to draw upon. When there is nothing to lose, a mandate is

unlikely to be effective, and it may even be inappropriately punitive. I am not against mandates in the abstract (though they have a dubious record in past welfare reform history), but I am skeptical of employer-based mandates, because I do not want to impose any additional constraints on businesses' hiring of low-skilled workers. I question the likely benefits of mandates on individuals, absent a substantial increase in the resources available to low-skilled men. Hence my focus on labor market subsidies, which have some track record of success and are straightforward to implement.

But, even if my two preferred proposals are adopted, the problems they address are massive and employment and/or wage subsidies will not fully solve them. The problems facing low-skilled men are well known. Schools in many communities are dreadful. Crime and gangs are endemic in some neighborhoods. Drugs and the drug culture create formidable problems for communities. Many children are being raised in single-parent households, where the available resources and parenting skills create barriers to success. Employment tax credits will not overcome all these obstacles.

Of course, solving these problems with a single policy is clearly too much to ask. Rather, progress will only arrive by a series of sensible, well-designed policies. Employment credits can be one of the appropriate tools. The expansion of the childless EITC or adoption of the targeted wage subsidy proposals discussed here would be a step in the right direction.

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Table 1: Labor Market Statistics by Gender, Ages 18-40 (excluding full-time students), 1990 and 2003 SIPP (in 2003\$)

Males					2003			
Education Level	1990				Percentage of Total	Employment Rates	Average Hourly Wage	Marriage Rates
	Percentage of Total	Employment Rates	Average Hourly Wage	Marriage Rates				
Less than HS Diploma	16.20	76.4%	\$10.83	47.4%	14.68	73.5%	\$11.78	44.8%
Black /1	24.47	60.4%	\$9.91	27.7%	16.99	50.9%	\$10.11	24.4%
High School Graduate	36.26	89.1%	\$13.72	51.1%	33.29	84.5%	\$13.46	47.0%
Black /1	44.04	78.7%	\$10.82	36.0%	41.56	70.1%	\$11.97	34.1%
Some College	12.31	91.9%	\$14.77	56.2%	17.87	88.6%	\$16.27	48.8%
College Graduate	24.78	95.2%	\$19.24	60.4%	27.79	92.7%	\$22.82	56.3%
Post College Education	10.45	96.8%	\$25.36	70.1%	6.38	96.4%	\$32.54	72.4%
Total /2		89.7%	\$16.07	55.4%		86.6%	\$17.84	51.2%

Females					2003			
Education Level	1990				Percentage of Total	Employment Rates	Average Hourly Wage	Marriage Rates
	Percentage of Total	Employment Rates	Average Hourly Wage	Marriage Rates				
Less than HS Diploma	14.51	43.9%	\$7.98	54.0%	12.50	45.3%	\$8.93	52.7%
Black /1	22.16	34.8%	\$7.78	21.5%	16.00	45.3%	\$7.77	23.3%
High School Graduate	36.41	70.5%	\$10.46	62.0%	27.97	68.1%	\$10.69	53.8%
Black /1	40.83	65.0%	\$9.78	36.3%	34.94	68.1%	\$9.92	32.9%
Some College	13.70	77.6%	\$11.88	59.7%	19.24	77.0%	\$12.56	54.9%
College Graduate	26.09	80.0%	\$15.56	65.6%	33.46	78.4%	\$17.69	67.1%
Post College Education	9.28	86.6%	\$20.55	68.3%	6.83	83.9%	\$26.92	72.8%
Total /2		71.6%	\$12.97	62.1%		71.5%	\$14.72	59.6%

Source and Notes: Authors' calculations from the 1990 and 2001 Survey of Income and Program Participation (SIPP).

/1. The "percentage of total" entry for blacks gives the fraction of black men with less than high school and exactly a high school education.

There are 4,677,561 black men in 1990 and 4,690,958 in 2003. There are 5,646,657 black women in 1990 and 5,274,013 in 2003.

/2. There are 40,659,852 men in 1990 and 38,504,788 in 2003; there are 41,487,380 women in 1990 and 38,178,240 in 2003.

Table 2: Earned Income Tax Credit Parameters, 2004

Year	Phase-in Rate (percent)		Phase-in Range (\$)	Maximum Credit (\$)	Phase-out Rate (percent)	Phase-out Income Range (\$)
2004	34.0	1/	0-7,660	2,604	15.98	14,040 – 30,338
	40.0	2/	0-10,750	4,300	21.06	14,040 – 34,458
	7.65	3/	0-5,100	390	7.65	6,390 – 11,490

Source: Publication 596, Internal Revenue Service

Notes:

1/ Taxpayers with one qualifying child.

2/ Taxpayers with more than one qualifying child

3/ Childless taxpayers

Table 3: Policies Expanding the Existing Childless EITC, SIPP Data, 2003

	Current EITC for Childless Taxpayers	Option 1 /1	Option 2 /2
Potential Eligible Returns	5,869,745	9,483,551	9,483,551
Unmarried males	44.2%	37.3%	37.3%
Black	21.3%	21.4%	21.4%
Less than HS diploma	24.7%	33.1%	33.1%
High School graduate	43.0%	47.2%	47.2%
Average hourly wage (before credits)	\$8.62	\$8.16	\$8.16
Average annual income of tax filing unit	\$6,418	\$7,234	\$7,234
Cost of policy	\$1,213,000,000	\$5,136,000,000	\$6,486,000,000
Average credit	\$206.65	\$541.57	\$683.92
Recipients in phasein	32.9%	39.2%	39.2%
Recipients in the phaseout	55.0%	49.4%	49.4%
On a tax filer basis			
Poverty gap of recipients	\$19,130,000,000	\$30,390,000,000	\$30,390,000,000
Percentage of recipients with below poverty incomes	76.9%	75.6%	75.6%
Percentage of total expenditure that closes the poverty gap	90.7%	78.1%	79.9%
On a family basis			
Poverty gap of recipients	\$12,470,000,000	\$18,470,000,000	\$18,470,000,000
Percentage of recipients with below poverty incomes	47.2%	41.4%	41.4%
Percentage of total expenditure that closes the poverty gap	53.6%	40.3%	40.2%

Notes: /1 Option 1 is available to childless taxpayers between the ages 18 and 64 who are not full time students.

The phasein rate is 15.3 percent from \$1 to \$5,000 for single taxpayers. The phaseout is 19.125% from \$6,000 to \$10,000.

The phasein and phaseout income thresholds are double those for single taxpayers for married taxpayers. See the text for details.

/2 Option 2 is available to childless taxpayers between the ages 18 and 64 who are not full time students.

For any childless tax-filing unit with a member under 30, the phasein rate is 25 percent from \$1 to \$5,000 for single taxpayers. The phaseout is 31.25% from \$6,000 to \$10,000. The income thresholds double for married taxpayers.

For childless tax-filing units older than 30, the policy is the same as option 1. See the text for details.

Table 4: Marriage Penalties in the Tax Code and Under the Expanded Childless EITC Proposals, SIPP Data

People who got married in the SIPP panel					Currently married people				
Under current law					Under current law				
Income (\$k)	% w/ bonus	conditional bonus	% with penalty	conditional penalty	Income (\$k)	% w/ bonus	conditional bonus	% with penalty	conditional penalty
0-10	32.3%	289	2.6%	204	0-10	13.0%	224	4.1%	142
10-20	77.6%	414	22.4%	799	10-20	37.0%	323	54.8%	610
20-30	54.0%	385	46.0%	1074	20-30	31.6%	320	61.2%	1122
30-40	36.2%	641	63.8%	1322	30-40	27.7%	437	69.5%	2743
40-50	30.2%	1201	69.8%	1068	40-50	15.3%	1058	83.7%	2223
Option 1 (see notes to Table 3)					Option 1 (see notes to Table 3)				
Income (\$k)	% w/ bonus	conditional bonus	% with penalty	conditional penalty	Income (\$k)	% w/ bonus	conditional bonus	% with penalty	conditional penalty
0-10	32.7%	676	2.1%	237	0-10	13.0%	370	4.1%	142
10-20	78.9%	907	21.1%	970	10-20	42.1%	555	51.7%	621
20-30	53.4%	385	46.6%	1212	20-30	31.6%	320	61.2%	1141
30-40	34.8%	658	65.2%	1366	30-40	27.7%	437	69.5%	2770
40-50	28.6%	1228	71.4%	1057	40-50	15.3%	1058	83.7%	2223
Option 2 (see notes to Table 3)					Option 2 (see notes to Table 3)				
Income (\$k)	% w/ bonus	conditional bonus	% with penalty	conditional penalty	Income (\$k)	% w/ bonus	conditional bonus	% with penalty	conditional penalty
0-10	32.7%	815	2.1%	237	0-10	13.0%	370	4.1%	142
10-20	79.4%	1069	20.6%	1077	10-20	42.1%	627	51.7%	621
20-30	53.2%	385	46.8%	1276	20-30	31.6%	320	61.2%	1141
30-40	34.4%	663	65.6%	1388	30-40	27.7%	437	69.5%	2779
40-50	27.6%	1267	72.4%	1047	40-50	15.3%	1058	83.7%	2223

Source: Data from the 2001 SIPP Panel, author's calculations described in the text. See the notes to Table 3 for description of the proposals.

Table 5: Costs of the Wage Subsidy Targeted to RCs, EZ, and ECs, 2000 Census and 2003 SIPP Data (see text for details)

	Analysis 1			Analysis 2	
	EZ/EC/RZ	SIPP Proxy	All	Lowest-Income	SIPP Proxy
	Census Tracts	Sample	United States	Census Tracts	Sample
Households	2,811,880	2,803,512	140,000,000	2,801,194	2,841,607
Average Household Size	2.86	2.23	2.19	2.96	2.16
Black	54.9%	52.5%	12.2%	49.7%	49.8%
Median Household Income	\$22,307	\$20,584	\$42,012	\$17,283	\$17,730
Average Household Income	\$30,049	\$29,891	\$53,443	\$22,796	\$25,064
Total Employees	2,675,485	2,520,693	170,100,000	2,475,738	2,434,361
Age 66 and Over	11.9%	7.5%	11.6%	11.7%	12.2%
Age 17 and Less	31.6%	32.7%	26.4%	28.0%	29.9%
	Wage subsidy for individuals in EZ/EC/RCs			Wage subsidy for low-income tracts	
Eligible for Wage Subsidy		1,140,778			1,116,135
Males		42.9%			42.1%
Black		48.4%			57.5%
Less than HS diploma		31.3%			29.6%
High School graduate		34.3%			37.1%
Average hourly wage (before credits)		\$7.30			\$7.45
Average annual income of tax filing unit		\$15,236			\$16,089
Cost of wage subsidy		\$2,216,000,000			\$2,092,000,000
Average annual subsidy		\$1,943			\$1,874
On a tax filer basis					
Poverty gap of recipients		\$2,954,000,000			\$3,094,000,000
Recipients with below-poverty incomes		46.0%			41.5%
% total expenditure closing poverty gap		30.4%			35.8%
On a household basis					
Poverty gap of recipients		\$2,328,000,000			\$1,848,000,000
Recipients with below-poverty incomes		33.6%			30.4%
% total expenditure closing poverty gap		27.0%			26.3%
Adults not in the formal labor market		1,122,719			1,126,705

**Figure 1: Average Weekly Earnings, 1982 Dollars, 1964-2004,
Data from the Economic Report of the President**

