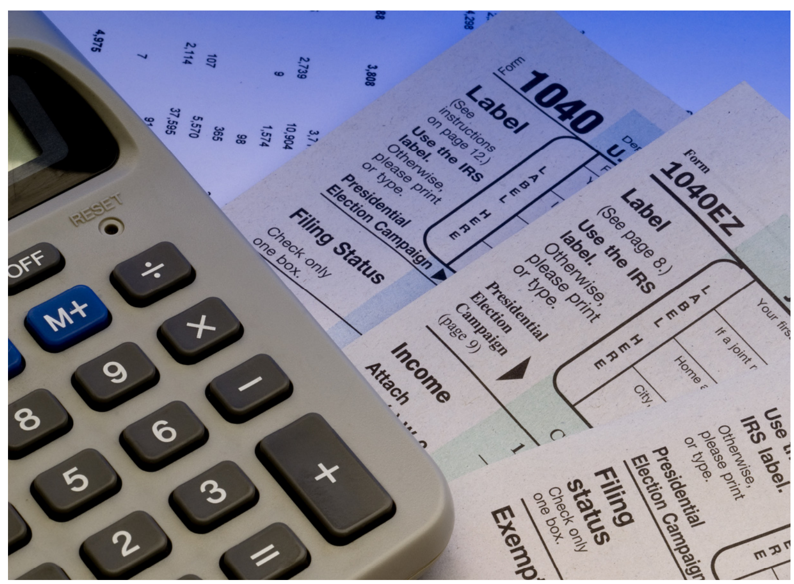
The Earned Income Tax Credit and Illegal Immigration

A Study in Fraud, Abuse, and Liberal Activism

BY EDWIN S. RUBENSTEIN

AN EXCLUSIVE REPORT



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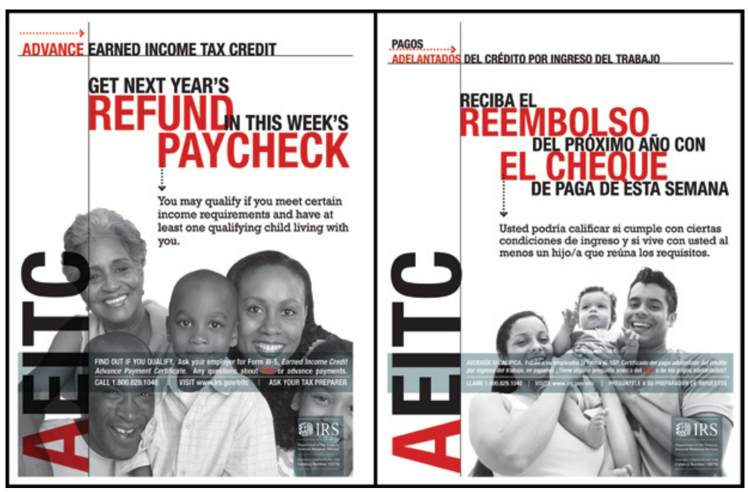
The Social Contract, a quarterly journal of public affairs, was launched in the fall of 1990 by publisher and founding editor John H. Tanton, a retired ophthalmologist and conservationist, to examine vital issues dealing with human population growth, mass immigration, the environment, language, national unity, and culture as well as the necessity of balancing our rights, liberties, and entitlements with responsibilities, duties, and obligations—namely the fundamental requirements of citizenship.

The Internal Revenue Service poster on the cover of this report (in Spanish) appears in English at right.



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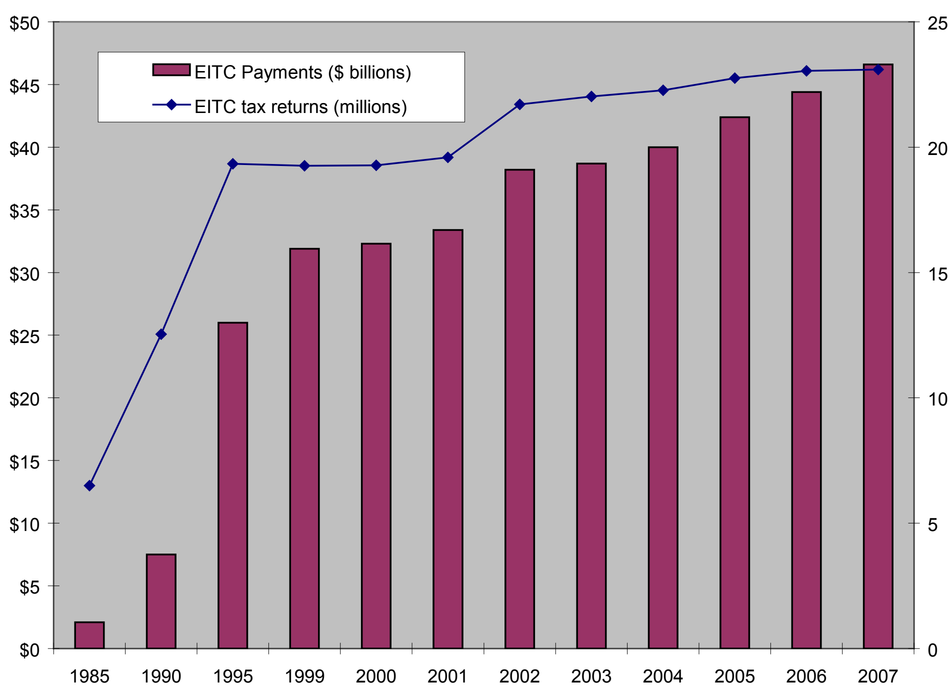
Introduction

Since the Earned Income Tax Credit (EITC) became part of the income tax code in 1975, it has quietly become the largest cash transfer program in the United States. At a cost of more than $44 billion per year, EITC spending dwarfs that of the traditional welfare program—Temporary Assistance for Needy Families (TANF)—and food stamps combined. More than 23 million households currently receive the credit.

Whether measured in dollars or tax returns, the EITC had grown continuously for more than two decades:

From 1985 to 2006, EITC payments grew from $2.1 billion to $44.4 billion, or by an eye-popping 2,014 percent. Total federal income tax revenues rose by 217 percent over that same period. Similarly, the number of returns claiming the EITC rose from 6.4 million to 23.0 million—an increase of 255 percent—over a period when the total number of federal income tax returns increased by 36 percent.

The Rise, and Rise, of the Earned Income Tax Credit, 1985-2007



More than one in four immigrant households received the EITC in 2000—nearly twice the 13.2 percent rate of households headed by native Americans. And because immigrant households are larger (primarily because of higher fertility), their EITC payments are larger than those received by native households.

Bottom line: Immigrants accounted for about 13 percent of the U.S. population in 2008 but receive an estimated 26 percent of EITC benefits—about $12 billion.

Yet politicians from Ronald Reagan to Michael Bloomberg have touted the EITC as the one anti-poverty program that works. Their enthusiasm reflects the perception that the EITC, unlike welfare, helps only the working poor—especially families with children. While welfare benefits are phased out as a recipient's private earnings increase, the EITC credit is *phased in*—increasing work incentives for low-income individuals. The EITC payment is only phased out as income approaches the poverty level.

Bipartisan support for the credit extends beyond the Beltway: As of 2006, some 20 states had their own EITCs. These state plans generally mimic the federal structure on a smaller scale, with individuals receiving a state credit equal to a fixed percentage, generally between 15 and 30 percent—of what they receive from the federal credit. A few

About the Author

Edwin S. Rubenstein, *president of ESR Research, economic consultants, has 25 years of experience as a business researcher, financial analyst, and economics journalist. Mr. Rubenstein joined the Hudson Institute, a public policy think tank headquartered in Indianapolis, and served as director of research from 1997–2002. While at Hudson he wrote proposals and conducted research on a wide array of topics, including workforce development, the impact of AIDS on South Africa's labor force, Boston's "Big Dig," the economic impact of transportation infrastructure, and the future of the private water industry in the United States.*

As a journalist, Mr. Rubenstein was a contributing editor at Forbes *Magazine and economics editor at* National Review, *where his "Right Data" column was featured for more than a decade. His televised appearances include Firing Line, Bill Moyers, McNeil-Lehrer, CNBC, and Debates-Debates. He is the author of two books:* From the Empire State to the Vampire State: New York in a Downward Transition *(with Herbert London) and* The Right Data.

Mr. Rubenstein also served as an adjunct fellow at the Manhattan Institute, where he was principal investigator in the institute's ongoing analysis of New York state's budget and tax structure. He published a newsletter devoted to economic statistics and contributed regularly to The City Journal, *the Manhattan Institute's quarterly publication.*

From 1980 to 1986 he was senior economist at W.R. Grace & Co., where he directed studies of government waste and inefficiency for the Grace Commission.

From 1978 to 1980 he was a municipal bond analyst for Moody's Investors Service, where he was also editor of the Bond Survey, *a weekly review of the municipal bond market. He served as senior quantitative analyst for the Office of the Mayor of New York City from 1973 to 1978. His writings have appeared in the* Wall Street Journal, *the* New York Times, Harvard Business Review, Investor's Business Daily, *and* Newsday. *He is a regular contributor to the* Social Contract *and* VDARE.com.

Mr. Rubenstein has a B.A. in economics from Johns Hopkins University and an M.A. in public finance from Columbia University.

small EITCs have been enacted by local governments—in San Francisco, New York City, and Montgomery County, Maryland.[1]

But enthusiasm for the credit has blinded policy makers to its problems. The EITC program is dominated by fraud. Year after year about one-third of all EITC returns are based on illegal multiple returns, phony Social Security numbers, or claims of non-existent children or spouses. A disproportionate share of illegal alien households receive the benefit.

Washington's love affair with the EITC has allowed the minimum wage to decline in real value. Native workers have suffered as a result. So have labor unions. In effect, the EITC subsidizes employers who hire low-wage immigrants and reject equally qualified natives. No one should be surprised, therefore, that Walmart, the U.S. Chamber of Commerce, and most liberal activist groups are major EITC supporters.

For most poor families, the tax credit check is the largest single sum of money they will receive during the year. Most receive it after filing income taxes. But some need the money immediately, and they can get it—for a price. A niche financial sector thrives by lending EITC recipients immediate cash in return for a hefty chunk of their credit check. The cost to the poor of these so-called Refund Anticipation Loans (RALs) has been estimated at 6 percent of the entire EITC program.

Legislative history

The EITC was the brainchild of Senate Finance Committee Chairman Russell Long. An arch-conservative, Long was detested by liberals who saw him as an obstacle to expanding the welfare state. True to form, he worked to defeat President Nixon's Family Assistance Plan—a negative income tax scheme that would have effectively doubled the size of the welfare rolls.[2]

But the Senator was not averse to giving poor people a helping hand—as long as it was done in a way that encouraged rather than discouraged work. His own welfare reform plan accomplished that by *guaranteeing* a public sector job to any family head needing work. The guaranteed jobs paid less than the minimum wage, so as not to encourage people to abandon more demanding private-sector employment. To help people cope with poorly paying jobs, Long added the EITC as a "work bonus" to help the new workers pay their Social Security taxes.

At its inception in 1975 the net cost of the Senator Long's welfare plan was about $4.3 billion—with $1 billion going for the EITC—big, big money in those days and more than a 60-percent increase over what Washington was then spending on welfare. The credit has been expanded a number of times, most notably by Ronald Reagan in 1986, Bill Clinton in the early 1990s, and George W. Bush in 2001.

Widespread availability of high-interest RALs made poor borrowers easy marks for sub-prime mortgage hucksters. The resulting defaults have pushed the entire economy to the brink of collapse. While the sub-prime story is well known, few are aware of the EITC's role in introducing the poor to the culture of debt.

Has the EITC lived up to its hype? In answering this, consider the following:

- The EITC originated as an anti-poverty program; the number of the returns claiming EITC benefits rose 25 times faster than the poverty population over the past two decades.[3]
- EITC benefits rise sharply with parenthood; poverty rates for families with children have risen faster than those for childless families since the credit was created.
- The EITC is the most illegal-immigrant friendly of poverty programs; illegal immigrants constitute a far larger share of the poverty population now.
- The EITC's payment structure is supposedly pro-family; a larger share of poor children live in single-parent households now than when the credit started.

Implication: The EITC is a textbook case of unintended consequences. (Our economic meltdown may be among them.)

The **good news:** The Obama administration is well aware of these problems. As evidence, this sage advice is excerpted from a memo prepared for the incoming Obama Administration and the new Congress:

> **...The current federal EITC provides large benefits to families with children, mostly single mothers, and minimal benefits to singles, even though declining wages have affected all low-income workers. These disparities create disincentives to work in the formal labor market and for poor men and women to marry, cohabitate, and coparent. Strategies that expand the current EITC would reduce family and child poverty but could perpetuate existing inequities[4]....**

The **bad news:** President Obama's stimulus package increased EITC payments by $600 for poor families with three or more children, while leaving the program's perverse disincentives intact. This will merely exacerbate the credit's bias against work and marriage.[5]

Our take: The more Mr. Obama "changes" things, the more they remain the same. ■

Notes

1. Wikipedia

2. Jodie T. Allen, "Present at the Creation," Chatterbox, Dec. 13, 1999.

3. http://www.census.gov/prod/2008pubs/p60-235.pdf.

4. http://www.mdrc.org/recommendation_8.html

5. CBPP website.

EITC Fraud

Section I

President Obama's stimulus program includes tax cuts for low-income workers. The purpose, of course, is to put money back into taxpayers' hands so they will spend it and boost the economy. But thanks to the EITC, much of the "tax relief" will go to people who have never paid a cent of tax—and may have already defrauded the government of huge sums each year.

How is this possible? The EITC is a "refundable credit,"—meaning that beneficiaries can receive more from the government than they pay in taxes. As a result, many low-income workers who pay no income taxes will file a tax return for one reason: to get an EITC check.

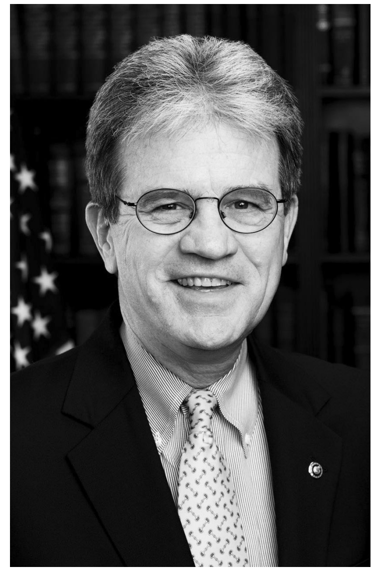
The incentive to cheat is huge: a worker with two children and earned income less than $38,646 could receive an EITC payment of up to $4,824 in 2008. A related tax credit—the Additional Child Tax Credit (ACTC)—pays this person another $1,126 if his or her income was less than $16,000.[1] For most families in this income bracket, the EITC check is the largest single sum of money they will receive in the course of the year.

Technically, EITC is available only to people with valid Social Security numbers (SSNs). In practice, identity theft, counterfeit Social Security cards, and other scams easily nullify such restrictions. EITC outreach groups—most prominently, the Center on Budget and Policy Priorities—offer tips as to how immigrants can receive EITC payments for years in which they did not have a valid SSN. As a result, illegal aliens are estimated to receive the EITC at even greater rates than their legal counterparts. (See the **More Evidence of EITC Fraud** section on page 14.)

The ACTC is available to illegals even if they do not have a valid SSN. All they need is an Income Taxpayer Identification Number (ITIN)—which the IRS is only too happy to provide. (See the **Illegal Aliens and the EITC** section on page 13.)

The General Accounting Office (GAO) verified the vast scale of the fraud, reporting that **"...the IRS estimated [it is] between 27 and 32 percent of EITC dollars claimed."**[2]

EITC scams are common, well-organized, and massive. In 1993, *Dateline*, a network television news program, filmed perpetrators paying housing project residents $400 for their names and SSNs. The con men used this information to file federal income tax returns electronically and receive bank loans using the estimated EITC refund as collateral.[3]



U.S. Sen. Tom Coburn (R-OK)

Most illegal immigrants have fraudulent Social Security cards, according to federal security officials. Their favorite target: young children. Social Security Numbers assigned to infants are stolen from medical paperwork and used to file returns. The fraud can go undetected for years—until the child looks for a job as a teenager.[4]

Media exposure shamed the IRS into conducting its own study. After randomly selecting 1,000 EITC tax returns, the tax collection agency sent criminal investigators to interview the taxpayers. Based on the interrogations, the IRS estimated that $4 billion of the $15 billion in EITC refunds paid in 1993 were made in error—a 27-percent error rate. This revelation led to new control system investments and policy changes, including a slowdown in EITC refunds and a decision to make banks liable for loans made to EITC filers.

More than a decade later, depressingly little changed, as evidenced by this written exchange between Senator Tom Coburn and McCoy Williams, GAO's Director of Financial Management and Assurance:

Senator Coburn:

> **As you know, the improper payments made in the Earned Income Tax Credit make up the second largest portion of government-wide improper payments for fiscal year 2005, estimating $9.6 to $11.4 billion dollars paid improperly.**
>
> **In fiscal year 2004, EITC had an improper payment rate of 25 percent. For fiscal year 2005, it was 28 percent and this is on the low side, because it's just an estimate. This program does not just need help, it needs a complete overhaul, with an improper payment rate that high.**
>
> **I am familiar with the legislative proposals in the President's fiscal year 2007 Budget. OMB believes that if enacted, this proposal would save $232 million in the first year and $5 billion over 10 years. That seems a bit under-ambitious when EITC is making at least $10 billion in improper payments every year.... Mr. Williams, has GAO done any analysis of the President's proposals? If so, what is the GAO's assessment? Has GAO made any recommendations regarding the administration and financial controls in the EITC program?**

McCoy Williams:

> **To date, we have not performed an analysis or an assessment of the President's legislative proposals as they relate to the Earned Income Tax Credit (EITC) program. Regarding any recommendations made, since fiscal year 2001, we have issued three reports that included seven recommendations related to the administration and financial controls in the EITC program[5]....**

The GAO's recommendations were hardly earth-shattering. Among other things, the agency urged the IRS to take steps to better quantify EITC payment error rates; to determine why IRS service centers had been unable to stop questionable EITC refunds; and to collect reliable cost/benefit data so as to better estimate the reduction in fraudulent tax refunds per dollar spent in EITC fraud prevention.

None of the GAO's recommendations have been fully implemented.

Getting a (Fraudulent) EITC Advance

Most EITC recipients receive the benefit after filing their tax returns. A small number—about 3 percent—takes advantage of the Advance Earned Income Tax Credit (AEITC). They receive a portion of the credit throughout the year in their paychecks.

While AEITC usage is low, the rate of fraud is high. A recent analysis of the AEITC program provides details:

> **As many as 80 percent of AEITC recipients did not comply with at least one of the program requirements GAO reviewed, and some were noncompliant with more than one during the 3 years we reviewed.**
>
> **Almost 40 percent (about 200,000 recipients) did not file the required tax return; these individuals received $42 million to $50 million each year.**
>
> **Of the about 60 percent (more than 300,000) AEITC recipients who did file a return, about two-thirds misreported the amount received.[6]**

The GAO's notes that its findings are based on its analysis of the tax returns of those recipients who were "potentially" eligible for the advance. The agency cautions that **"… about 20 percent, or more than 100,000 AEITC recipients, may not have been eligible for the AEITC because they had an invalid Social Security number…."**

This implies that, by analyzing only returns with valid SSNs, the GAO may have underestimated the extent of AEITC fraud.

The problem is large but not insurmountable:

> **IRS could address AEITC noncompliance by sending "soft notices" to recipients, requiring employers to verify employee SSNs before providing the AEITC, or creating a Forms W-5, "EITC Advance Payment Certificate," database.[7]**

The IRS obviously has not seen fit to devote enough resources to AEITC non-compliance. The GAO charitably chalks this up to **"resource constraints."** In fact, it smacks of politics as usual.

Everybody's Doing It?

Fraudulent payments are a long-standing problem that affects every federal program. Advocates for poor people insist that EITC fraud is unfairly singled out by those who would reduce all payments to deserving poor people. But the size and intensity of EITC fraud is demonstrably larger than that in other federal programs. We know this because of new reporting requirements Congress recently imposed on federal agencies.

The Improper Payments Act of 2002 (IPIA) requires agencies to identify programs and activities susceptible to fraudulent payments, estimate the amount of such payments, and report on actions they have undertaken to reduce them. In fiscal 2005, the GAO reviewed 18 such reports, covering 57 programs, with $38.8 billion of improper payments reported.[8] The EITC ranked second among the 57 programs in fraudulent payments. Only Medicare, at $12.1 billion, reported a larger dollar amount. As a percent of total program spending, however, EITC fraud far exceeds that of any other program:

Improper Payments Reported by Federal Agencies, 2005
(10 largest improper payments reported)

Program	Amount ($, millions)	Program (%)
Medicare	12,100	3.6
Earned Income Tax Credit (EITC)	10,500	30.4
Old Age and Survivors Insurance (OASDI)	3,681	0.8
Supplemental Security Incomes (SSI)	2,910	8.2
Food Stamps	1,432	4.4
Student loans (Pell Grants)	617	5.0
Section 8 Housing (tenant based)	551	11.6
Military Pay	432	0.3
Veterans Administration Compensation	323	1.1
Veterans Administration Pension	261	7.7

Sources:
Government Accountability Office, "Challenges Remain in Meeting Requirements of the Improper Payments Information Act," Testimony, March 9, 2006. Appendix II.[9] (Improper payments.); Office of Management and Budget, FY2005 Budget. (Program payments.) Calculations by author.

More than 30 percent of EITC outlays are "improper," according to the Treasury Department's accountability report. This is by far the largest error rate of the major programs reviewed by the GAO. The runner up—the Department of Housing and Urban Developments's (HUD) notoriously corrupt Section 8 housing subsidy—estimated its improper payments at 11.6 percent of outlays, while Medicare's payment fraud is estimated at 3.6 percent.

For the record, the following major programs did not submit Improper Payment reports in FY2005: School lunch programs; State Children's Health Insurance Program (SCHIP); Woman, Infants, and Children (WIC); Medicaid; Child Care and Development Fund; Temporary Assistance for Needy Families (TANF); and Community Development Block Housing Grant.

EITC Fraud in Context

> **The IRS estimates that a single type of illegal scheme—offshore sheltering of income—practiced by 505,000 taxpayers in 2000 resulted in tax losses of $20 billion to $40 billion. This one scheme, used by only a half million high-income**

> **evaders, cost the Treasury two to four times as much as the six million EITC noncompliers[10]...**

Mr. Liebman has a point: The amount of federal tax dollars lost to EITC fraud is trivial alongside the amount lost due to the fraudulent tax manipulations of middle- and upper-income Americans, who do not receive the credit. The latter amount, called the "tax gap," is the difference between what these taxpayers should pay and what they actually pay on a timely basis.

In tax year 2001, the total tax gap ranged from $312 billion to $353 billion, according to the IRS.[11] That is about 30 times the amount lost to EITC fraud that year—an estimated $10 billion.

But wait a minute. There were 130 million federal tax returns filed in 2002, and only 19.6 million of them received the EITC. So on a per-capita basis, the difference between EITC and middle- and upper-income tax fraud is only about one-sixth as large as the aggregate amounts suggest.

Even more telling is the percent of total tax liability each group fraudulently avoids.

In tax year 2001, middle- and upper-income taxpayers paid the federal government $1.767 trillion on time, a figure equal to 83.4 percent to 85.0 percent of their total tax liability. This implies that the noncompliance rate for all federal taxes is from 15 percent to 16.6 percent of the true tax liability. This is about half of the estimated EITC fraud rate of 30 percent.[12]

So if fraud is measured relative to total tax liability, the EITC crowd is about twice as fraudulent as middle- and upper-income taxpayers.

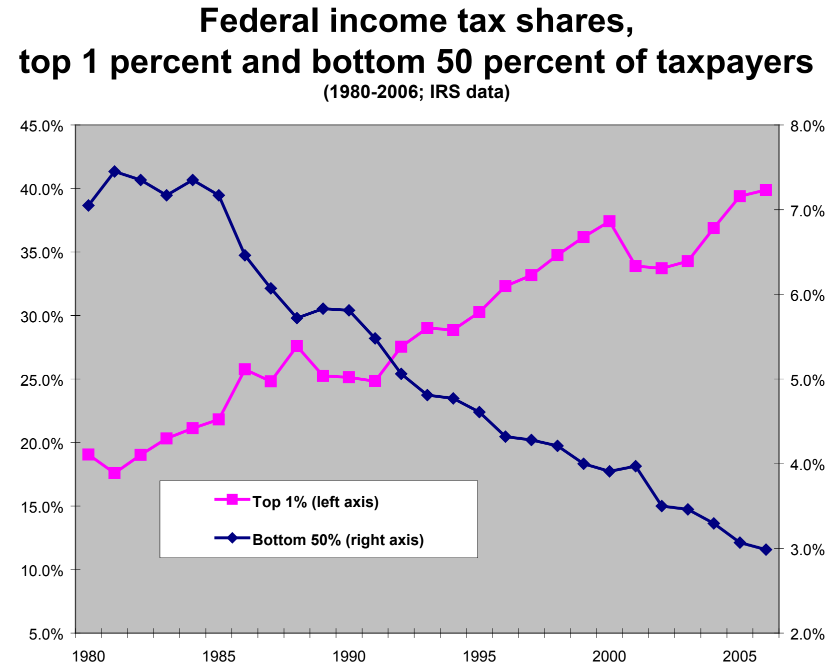
Moreover, late payments and enforcement efforts such as IRS audits and collection activities (payment arrangements, liens, levies, and other legal actions) recover some of the tax gap. For 2001, the IRS expects to eventually collect $55 billion of the tax gap, reducing the noncompliance rate.

By comparison, fraudulent EITC payments are rarely recovered.

It is not that middle- or upper-income taxpayers are more honest than EITC recipients—although that may indeed be the case. Most of us simply cannot avoid paying taxes because of withholding. And most of us cannot "hide" income because employers report our wages and salaries and tips directly to the IRS through the form W-2. Less than 1.5 percent of income subject to withholding is misreported on income tax returns.[13]

Skeptics still believe the tax code is tilted toward the rich and that the EITC should be expanded to ease the burden on low-income workers. The data simply do not support this view:

In 1980, the richest 1 percent of taxpayers paid 19.1 percent of all federal income taxes; by 2006, their tax share had more than doubled to 39.9 percent. Over the same period, the share paid by the bottom half of taxpayers fell sharply—to 3.0 percent in 2006 from 7.1 percent in 1980.[14]



Tax rates have declined for all taxpayers since the 1980s—thanks to the Reagan revolution. But those in the poorest half have been the biggest beneficiaries of the trend. Their average tax rate (taxes as a percent of Adjusted Gross Income) fell from 6.1 percent in 1980 to 3.0 percent in 2006. For the top 1 percent, the decline was more muted: from 15.5 percent to 12.6 percent.

Bottom line: the tax system is far more progressive today than it was in 1980.

Most of the increased progressively reflects changes in tax rates and other policies designed to ease the burden on lower-income taxpayers. Some of it, however, is unintended—the result of high rates of tax fraud among low-income taxpayers. The EITC is responsible for much of this troubling trend.

Illegal Aliens and the EITC

The Internal Revenue Code does not prohibit illegal aliens from receiving the EITC if they meet the prescribed eligibility requirements. Foremost among them is filing a legitimate tax return.

Since 1996, the IRS has encouraged illegal aliens to file tax returns using Income Taxpayer Identification Numbers (ITINs.) At first, illegals were reluctant to apply, fearing the IRS would share the information with the Immigration and Naturalization Service (INS) or its successor agency, the Department of Homeland Security (DHS). But illegals without ITINs found themselves shunned by employers.

Low-wage employers opted against paying illegals “off the books.” To them, the EITC was a valuable wage subsidy paid for by taxpayers. Illegals receiving the EITC were willing to work for less than their counterparts who did not file for the credit.

The decision by the IRS to make ITINs available to illegals was made solely to increase the likelihood that they would pay taxes—not to enforce the immigration laws. In its publications, website, and forms, the IRS makes clear that the ITIN is “for tax purposes only.”[15]

Illegal aliens soon realized they had nothing to fear, and lots to gain, from filing for the EITC. The stampede for ITINs was on:

Since 1996, the IRS has issued more than 14 million ITINs. Annual issuance has exceeded 1 million in seven of the last eight years—a sure sign that the influx of illegal alien workers is larger than commonly believed.

ITIN issuance spiked sharply in 1997, and fell dramatically in the next few years. The volatility stems from changes to EITC eligibility rules. Prior to 1998 taxpayers with ITINs were eligible for the credit. The Clinton welfare reform law, in an effort to curb use by illegal aliens, required valid Social Security numbers. As a result, since 1998 immigrants without SSNs, or whose EITC-qualifying children do not have SSNs, are not eligible for the credit—even if they have ITINs.

Despite this “crackdown,” the total number of tax returns claiming the EITC continued to rise. This could not have happened had illegals been shut out of the EITC program. Instead, they filed tax returns using bogus Social Security numbers (SSN).

Illegal Alien IDs:
Individual Taxpayer Identification Numbers Assigned by the IRS

Year	Volume
1996	60,682
1997	1,363,071
1998	566,745
1999	615,413
2000	818,392
2001	1,088,837
2002	1,493,284
2003	1,229,097
2004	838,070
2005	1,195,397
2006	1,548,802
2007	1,768,902
2008	1,628,354
Total	
1996-2008	14,215,046

Source:
Email to author[17]

The IRS makes it easy. The tax collection agency does little to verity the validity of SSNs, the existence of dependent children, or to ascertain that they have lived with the taxpayer for more than six months of the year as required by law. With relative impunity illegal aliens claim as dependents children still in Mexico. Illegal alien husbands and wives often file separate returns on which both claim the same kids.”

More Evidence of EITC Fraud

Illegal immigrants defrauded the tax credit program long before the IRS effectively encouraged them to do so. This is from a GAO report issued in October 1994:

> **Limited data from manual reviews under the 1994 EITC Compliance Initiative show that a minimum of 160,000 taxpayers, out of about 8.7 million who filed paper returns claiming the EITC, entered 205(c) instead of an SSN for a qualifying child. According to IRS officials, the taxpayers who filed these returns likely are illegal aliens. IRS expects most of these refunds to be denied because taxpayers will not be able to support their claims. For example, IRS expects many claims to be denied because dependents will not meet residency requirements. In addition to the 160,000, an unknown number of illegal aliens would have received the EIC because the amount they claimed was below the Compliance Initiative's dollar threshold.[16]**

This finding is the result of a special "Compliance Initiative" undertaken to measure the extent of the fraud. Such initiatives are few and far between. The vast majority of fraudulent EITC claims go unreported and unpunished.

IRS forms do not require illegal aliens to identify themselves as such; therefore, the agency does not know how many illegal aliens receive EITC. Estimates of EITC usage among illegal aliens have been published by private think tanks, however.

Steven A. Camarota, of the Center for Immigration Studies, examines EITC recipiency rates among Mexican immigrants in a report issued in July 2001. Camarota finds that immigrants in general, and Mexican immigrants in particular, use every major means-tested program at higher rates than natives.

The EITC stands out as the program most likely to be received by illegal alien households:

Immigrant Recipiency Rates of EITC and Other Means-Tested Programs, 2000

Program	Natives (%)	All Immigrants (%)	Illegal aliens from Mexico (%)
SSI	3.9	5.3	0.7
Public Housing	4.2	4.9	1.9
General Assistance (TANF)	2.1	3.2	1.2
Food Stamps	5.3	6.7	8.0
Medicaid	12.1	18.6	22.4
Unemployment Compensation	4.7	5.0	7.2
EITC	13.1	25.5	39.4

Source:
Steven A. Camarota, "Immigration from Mexico: Assessing the Impact on the United States," Center for Immigration Studies, July 2001.[18]

Households headed by illegal Mexican immigrants are more than three times as likely to receive the EITC than households headed by native-born Americans. In no other means-tested program do illegals receive such de facto preferential treatment.

Moreover, immigrants receive larger average benefit payments than natives. For the EITC, average payment amounts in 1999 were as follows:

- natives $1,456
- all immigrants, $1,693
- Mexican immigrants, $1,887

This is because EITC payments, like payments for public assistance and food stamps, typically reflect the number of people in the households. Because immigrant households are larger on average (primarily because of higher fertility), the size of their average payment is also larger.

Mr. Camarota issues a cautionary note to those who yearn for amnesty or would confer guestworker status on all illegal aliens:

> **Use of means-tested programs by illegal immigrants from Mexico points to a fundamental problem that would almost certainly exist with any guestworker program. Even if guestworkers are made technically ineligible for means-tested programs, it seems almost certain that they would make use of them anyway by receiving benefits on behalf of their native-born children. After all, the findings …indicate that despite an outright ban on their use, illegals from Mexico actually use such programs at higher rates than natives in many cases.[19]**

EITC Recipiency by State

State data provide further evidence of a link between the EITC and illegal aliens. States with large illegal alien populations have above-average fractions of federal tax returns claiming the credit.

The positive correlation is evident in the table on page 16:

The table on page 16 ranks the 15 states with the largest illegal alien populations on their illegal alien population shares. At the top is Arizona, where an estimated 9 percent of residents are illegals. California ranks second, with a rate of 8 percent illegal, although it has the largest illegal population——2.84 million. Tied for last place are Massachusetts, New York, and Virginia, each with 3 percent.

EITC was claimed on 17.28 percent of tax returns filed by residents living in these 15 states, versus 16.64 percent of returns from residents living in other states. The average EITC benefit was also significantly larger—$1,733 in the top 15 illegal alien venues versus $1,689 in the rest of the country.

Zeroing in on states with the five highest illegal alien population shares (Arizona, California, Texas, Florida, and Nevada), the recipiency rate differences are even more pronounced. Residents of those states claimed the EITC on 19.10 percent of their tax returns, versus 16.22 percent in the rest of the country.

Residents of the top five illegal alien states also received significantly larger benefits—an average $1,785—or 5.2 percent more than the $1,696 average in the rest of the country. The differential reflects, in part, the relatively large number of children in illegal immigrant households.

Illegal Aliens and EITC Recipiency, by State
(15 States with largest illegal alien populations)

	Illegal aliens as % of total state population	federal returns claiming the EITC (%)	Average EITC payment	Illegal Alien Population (millions.)
Arizona	9%	17.49%	1,776.14	579
California	8%	16.54%	1,745.90	2,840
Texas	7%	23.25%	1,967.75	1,702
Florida	6%	20.08%	1,781.61	1,012
Nevada	6%	15.33%	1,653.64	160
Georgia	5%	22.79%	1,944.01	504
Maryland	5%	13.44%	1,676.38	268
New Jersey	5%	12.14%	1,691.43	429
Colorado	4%	12.85%	1,593.07	170
Illinois	4%	14.94%	1,754.98	480
North Carolina	4%	20.40%	1,829.85	363
Washington	4%	12.63%	1,614.43	277
Massachusetts	3%	10.09%	1,521.31	220
New York	3%	17.42%	1,738.15	552
Virginia	3%	14.58%	1,712.23	259
15 illegal alien states	6%	17.28%	1,733.39	9,815
Rest of Nation	1%	16.64%	1,688,72	1,513
Nation - all states	4%	17.01%	1,701.86	11,328

Note: Alien population estimates are for 2005; EITC data are for the 2003 tax year.

Sources:
Steven A. Camarota, "Immigrants in the United States, 2007," Center for Immigration Studies, November 2007, table 21.[20]

Congressional Research Service, "The Earned Income Tax Credit (EITC): Percentage of Total Tax Returns and Credit Anount by State," November 4, 2005, table 1.[21]

EITC benefits rise dramatically when children enter the picture. There is thus a strong incentive for low-income households—including illegals—to have children (anchor babies) or to misrepresent their status as custodial parents in order to qualify for larger EITC payments.

Is the EITC Under-Utilized?

> **Given the income of the people we are talking about, I would prefer "fraud" of people taking it when they are NOT eligible for it, than people NOT taking it when there [sic] eligible for EITC.[22]**

This blogger is not alone. Many liberals believe the EITC application process is overly complex and difficult for low-income workers to understand—a deliberate ploy to discourage legitimate beneficiaries from applying. A little fraud on the part of individuals who are not eligible for the credit is, well, poetic justice.

The perception that millions of eligible individuals do not file for the credit and end up forgoing millions of dollars for which they are qualified has fueled a well-funded EITC outreach campaign. (See the section on **Liberal Activism**.)

Is the EITC underutilized? Is it a well-kept secret relative to, say, Food Stamps or Medicaid?

Au contraire! When the GAO studied the issue a few years ago, it found that EITC was the *most* accessible of the major entitlement programs. The proportion of eligible people who were enrolled varied as follows:

Estimated Participation Rates of Entitlement Programs

Program (year)	Eligibility unit	Participation rate (%)
EITC (1999)	Households	75
Food Stamps (2002)	Households	48
Medicaid (2000)	Individuals	66-70
SSI (2001)	Individuals and married couple	66-73

Source:
Government Accountability Office, "Means-Tested Programs: Information on Program Access Can Be an Important Management Tool," March 2005, table 4.[23]

The EITC is utilized by 75 percent of households eligible for the benefit. For eligible households with two children, EITC participation rises to an amazing 96 percent.

GAO calls these estimates "conservative" because they exclude households that are estimated to have received EITC benefits in error. Despite the adjustment, the EITC's overall participation rate is about 50 percent higher than that of Food Stamps, and significantly above that of Medicaid.

Why are EITC participation rates so high? Factors include the ease with which potential participants can access the program. For example, local Medicaid, TANF, and Food Stamp Offices typically require face-to-face interviews before individuals can receive benefits. Traditional office hours of 8:00 a.m. to 5:00 p.m. pose a barrier to potential applicants who work and would have to take time off to apply.

By comparison, getting an EITC check is breeze. All persons who file a return are eligible should receive the EITC automatically, because the IRS processes it automatically. Only persons whose employment is not reported to the IRS (i.e., they work off the books) or who do not file an income tax return will not receive the credit.

Perhaps the greatest incentive to participate in the EITC is the size of the benefit: A two-person family could receive up to $4,824 in 2008. For most recipients, it is the largest single check they receive during the year. And unlike Food Stamps or Medicaid, it is cash and therefore available for the most pressing needs. ■

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EITC and Population Growth

Section II

The EITC originated as an income supplement for low-income workers. Somewhere along the line, its purpose seems to have changed. Today it is a program whose benefits are heavily contingent on parenthood.

EITC payments rise sharply as the number of children in the taxpayer's household rises. In 2008, a family with no children received a maximum EITC payment of $438; a family with one child received up to $2,917; two or more children bumps the maxim credit to $4,824.

Children thus trigger a hefty increase in the EITC payment.

That is an irresistible windfall for low-income workers, a big incentive to procreate—or at least claim to. The IRS estimates that roughly half of the incorrect filing claims under the EITC involve fraudulent child custodial claims.[1] Yet, the tax collection agency does little to verify the existence of children claimed on tax returns.

But most children claimed on EITC tax returns are real—and therein lies the problem. The decision to have children may often be influenced, at least in part, by the generous tax credit.

The perverse childbearing incentives are far more acute among immigrant households—as evidenced by their above-average eligibility rates:

Immigrant households with children under age 18 are about 50 percent more likely to be eligible for the EITC than similar households headed by natives. This reflects the lower average income of immigrant households with children.

While it is impossible to determine how many births are directly related to the EITC or similar pro-parenthood programs, circumstantial evidence that

EITC Eligibility Rates (%), 2007

All immigrants	**31.1%**
Immigrant households with children under 18	**47.6%**
All natives	**17.8%**
Native households with children under 18	**32.4%**

Source:
Center for Immigration Studies, "Immigrants in the United States, 2007," November 2007, table 13.

such a linkage exists is easily obtained. Since the introduction of the EITC in the 1970s, for example, births to immigrant mothers have quadrupled:

- 228,486 in 1970 (6.1 percent of all births)
- 339,662 in 1980 (9.4 percent of all births)
- 621,442 in 1990 (14.9 percent of all births)
- 915,800 in 2002 (22.7 percent of all births)

In 1970, immigrant mothers accounted for about 6 percent of U.S. births. By 2002, their share rose to 22.7 percent. Even in 1910—the peak of the Great Wave—only 21.9 percent of births were to foreign-born mothers.[2]

EITC and Immigrant Fertility

Three mega-trends explain the record-shattering rise of immigrant births.

First is simply the increase in the number of immigrants and their share of the overall population. Between 1970 and 2002, the foreign-born population of the U.S. increased from 9.6 million to 32.5 million—an increase of 225 percent. Over the same period, however, the number of children born in the U.S. to immigrant mothers rose even faster:

Births to Immigrant Mothers Rise Faster than Immigrant Population

	Births to Immigrant Mothers		Immigrant Population	
	Number	All Births (%)	Number (millions)	Total Population (%)
1970	228,486	6.1	9.7	4.7
1980	339,662	9.4	14.1	6.2
1990	621,442	14.9	19.8	7.9
2002	915,800	22.7	32.5	11.5
% increase, 1970-2002	300.1		225.1	

Source:
Steven Camarota, "Births to Immigrants in America, 1970 to 2002," Center for Immigration Studies, July 2005, figure 2.[3]

The second mega-trend is the change in the age distribution of the foreign-born and native-born populations. In 1970, the current wave of immigration had just begun; a significant fraction of foreign-born residents were older, pre-WWII arrivals, well past their primary reproductive years. Only 36 percent of female immigrants were 15 to 44 years of age, much less than the 41 percent of natives, according to the 1970 Census. By 1980, the female groups had changed places: 46 percent of immigrant women were in the prime childbearing years versus 45 percent of native women.

Since then, the age distribution has tilted further in favor of young immigrant mothers. Specifically, the share of immigrant females in their childbearing years increased from 53 percent in 1990 to 56 percent in 1992, while for natives it fell from 45 percent to 41 percent.[4]

Third mega-trend—and the one most directly influenced by the EITC—is the average number of children immigrant women will have during their prime reproductive years. This is best measured by what demographers call a Total Fertility Rate (TFR): the expected number of children a woman will have over the course of her lifetime, based on current birth rate trends.

TFR comparisons are particularly useful when large age differences exist among groups. If, say, female immigrants are much younger than female natives, the TFRs of the two groups will not be affected. By contrast, birth rates—calculated as births per 100,000 population—will generally be larger in the group with the younger population.

Put differently, the TFR reflects the desire of women in various groups to have children. The prospect of a generous child benefit such as EITC can certainly affect that decision.

The relevant TFRs in 2002 were as follows:

- Immigrant females: 2.86 children
- Native-born females: 1.65 children[5]

On average, a foreign-born female will give birth to nearly three children during her lifetime versus less than two for a native-born female.

And if history is any guide, the immigrant/native fertility gap will remain intact in future generations. Fertility rates of the U.S.-born descendants of today's immigrants will exceed by a similar margin those of the descendants of today's natives.

Note: A TFR of 2.1 is considered the "replacement" rate—i.e., the value at which a group can exactly replace itself over the course of a generation. If fertility stays below replacement for an extended period of time, the population will eventually shrink. This is the prospect facing non-Hispanic whites in the years following 2030, as seen in the table on page 22.

Even small differences in fertility rates can produce enormous differences in population growth if they persist over a long period of time. They are the demographic equivalent of compound interest rates.

In this way, immigrants influence future population growth by more than their numbers might suggest. Over time, the immigrants die, but their U.S.-born offspring will have children themselves, followed by grandchildren and subsequent generations. A sophisticated population projection methodology is required to measure the impact of future immigrants on future population growth.

The Pew Research Center published the best of these forecasts in 2008.[6] The main projections of the total, foreign-born, and native-born populations for the period to 2050 are noted in the table on page 22.

U.S. Population: Total, Native-born, and Foreign-born, 1960-2050 (population in thousands)

	Total	Native-born	Foreign-born	Foreign-born % of Total
1960	179,980	170,242	9,738	5.4%
1970	204,401	194,788	9,613	4.7%
1980	227,537	213,864	13,673	6.0%
1990	248,623	229,023	19,600	7.9%
2000	281,646	250,478	31,168	11.1%
2005	295,709	260,180	35,529	12.0%
	Projections			
2010	309,653	269,666	39,987	12.9%
2020	340,219	290,694	49,525	14.6%
2030	371,822	312,152	59,670	16.0%
2040	403,648	333,422	70,226	17.4%
2050	438,153	356,854	81,299	18.6%
	Increase, 2005-2050			
Persons	142,444	96,674	45,770	
%	48.2%	37.2%	128.8%	

Source:
Jeffrey Passel and D'Vera Cohen, "U.S. Population Projections: 2005-2050," Pew Hispanic Center, February 11, 2008, table 2.[7]

The total U.S. population is expected to increase by 142.4 million from 2005 to 2050, an increase of 48 percent. The foreign-born population will increase by 45.8 million, more than doubling its 2005 count, while the U.S.-born population will rise by 37 percent over the same 45-year period.

Based on these figures, the foreign born population will account for 32 percent of total population growth between 2005 to 205—45.8 million of the total 142.4 million increase. But the Pew Research population model shows that if there had been no immigration after 2005, the foreign born population would have actually *declined* by approximately 21 million, as the pre-2005 immigrant cohorts die out. Thus, the net contribution of new (post 2005) immigrants to population change over the 2005 to 2050 period is actually 67 million (45.8 million plus 21 million).

While the new immigrants themselves boost population growth by 67 million, their U.S.-born children are projected to add another 47 million and their grandchildren an additional 3 million. Summing it up, immigration will add 117 million (67 million plus 47 million plus 3 million) to U.S. population growth between 2005 and mid-century.

Bottom-line: Full 82 percent of the U.S. population growth to mid-century will be due to immigrants arriving after 2005 and their descendants.

As things stand, immigration is on course to be the key driver of population growth in the coming half century. The Pew Research study assumes that current immigration policy remains unchanged. Future policy changes—tightened border security and rigorous enforcement of current immigration laws, for example—could substantially alter the projected totals.

Restructuring of the EITC to reduce the financial rewards to parenthood could have an equally strong impact on future population change.

EITC and Immigrant Fertility

The pro-childbearing incentives of the EITC could also explain why immigrant fertility rates are higher in the U.S. than home countries:

Is the EITC Responsible?
Immigrant Fertility Rates Higher in U.S. than in Home Country

Country of origin	TFR in Home Country	TFR in U.S.
Mexico	2.40	3.51
Philippines	3.22	2.30
China	1.70	2.26
India	3.07	2.23
Vietnam	2.32	1.70
Korea	1.23	1.57
Cuba	1.61	1.79
El Salvador	2.88	2.97
Canada	1.51	1.86
United Kingdom	1.66	2.84

Note:
Total Fertility Rate (TFR) is the number of children a woman can be expected to have in her reproductive years. Estimates are based on analysis of 2002 American Community Survey data.

Source:
Steven Camarota, "Birth Rates Among Immigrants in America," Center for Immigration Studies, October 2005, table 1.[8]

Immigrant mothers from most countries have more children in the U.S. than in their home country. Throughout the world, a woman's educational level is a key determinant of her fertility, with more educated women generally having fewer children than less educated women. Yet even after controlling for education differences, immigrant fertility is higher here than in the home country.

Clearly, something happens here that does not happen there. The availability of EITC and other pro-child public benefits to low-income, poorly educated immigrants, is surely one factor.

EITC and Illegal Aliens

The EITC may well be the most illegal-immigrant-friendly of all welfare programs. Nearly 40 percent of households headed by illegals from Mexico are eligible for the EITC, versus 26 percent of all immigrant households and 13 percent of households headed by U.S. natives.[9]

If the EITC's pro-parenthood incentives are as powerful as we think, TFRs should be significantly higher for illegals than the other groups. Drum roll, please: fertility rates for illegal alien females is estimated at 3.06 children, compared to 2.61 children for legal immigrants, and 1.65 for natives.[11]

Births to illegal alien mothers—aka "anchor babies"—accounted for a whopping 42 percent of all immigrant births in 2002. That may sound high until you consider that illegals account for at least 25 percent of foreign-born females who are in the prime childbearing years, ages 18 to 39.[11]

The illegal alien baby boom is also linked to the Constitutional misinterpretation of the 14th Amendment, which confers citizenship on anyone born in the U.S.—no matter what the legal status of the parents. Many Mexican mothers-to-be have their babies in U.S.-border hospitals for one reason: to give birth to a U.S. citizen.

EITC Is Anti-Marriage: The Nexus of Race, Ethnicity, and the EITC

Pro-Child, but Anti-Marriage

EITC payments ramp up dramatically when children are born. But married parents often receive a far smaller benefit than single or cohabiting parents with similar incomes. The marriage penalty occurs when the combined earnings of husband and wife push them into the EITC's "phase-out" range—currently from $15,752 to $38,646. Every additional dollar of income within that range reduces EITC payments by 21 cents.

If a childless full-time minimum wage worker marries a minimum-wage worker with two children, they suffer an EITC marriage penalty of nearly $2,000 compared to what they could have if they remained single. If they each have two children, they stand to lose nearly $6,000 in EITC payments upon tying the knot.

In 1979, 73 percent of children lived in married couple households; by 2003, only 62 percent did. Obviously, cultural and demographic factors play roles in this trend. But the fraction of children living with married parents declines most dramatically during economic downturns, or exactly when EITC eligibility is on the rise.[14]

The financial benefits of the EITC could well be obliterated by its deleterious impact on child living arrangements.

Minorities qualify for the EITC at higher rates than whites because their incomes are lower. Their average credit payment is also larger due to the presence of children. The latter difference is especially pronounced for Hispanic households. The Hispanic TFR in 2005 was 2.5 children per woman. This value is higher than for any of the other racial groups; white and Asian TFRs are about 1.8, and the black TFR is about 2.2. The higher rate for Hispanic women is, in large part, due to the relatively high fertility of Hispanic immigrants who have a TFR of about 2.8.[12]

Although fertility rates overall are expected to decrease by 2050, Hispanic, black, and Asian TFRs will remain above the white TFR. The inevitable result: minorities will displace whites as the majority population group. The tipping point is a little more than a generation away, according to Census Bureau projections released in 2008:

The Coming White Minority: Projected Population by Race and Hispanic Origin, 2010-2050

	Total	White, non-Hispanic	Hispanic	Black, non-Hispanic	Asian, non-Hispanic	Other
	Population in thousands:					
2010	310,233	200,853	49,726	37,985	14,083	7,586
2025	357,452	206,662	75,772	43,703	20,591	10,724
2030	373,504	207,217	85,931	45,461	22,991	11,904
2040	405,655	206,065	108,223	48,780	28,064	14,523
2045	422,059	204,772	120,231	50,380	30,704	15,972
2050	439,010	203,347	132,792	51,949	33,418	17,504
	Total (%):					
2010	100.0%	64.7%	16.0%	12.2%	4.5%	2.4%
2025	100.0%	57.8%	21.2%	12.2%	5.8%	3.0%
2030	100.0%	55.5%	23.0%	12.2%	6.2%	3.2%
2040	100.0%	50.8%	26.7%	12.0%	6.9%	3.6%
2045	100.0%	48.5%	28.5%	11.9%	7.3%	3.8%
2050	100.0%	46.3%	30.2%	11.8%	7.6%	4.0%

Source:
Census Bureau, National Population Projections, August 2008.[13]

A decade ago, census demographers estimated that the nation's population, which topped 300 million in 2006, would not surpass 400 million until after mid-century. Now, they are projecting that the population will top 400 million in 2039 and reach 439 million in 2050.

Whites were an 87 percent majority in 1950.In 2008, they accounted for 64 percent of the population. The census calculates that around 2030 the non-Hispanic white population will start to decline. By 2042 non-Hispanic whites will be in the minority—outnumbered by individuals who identify themselves as Hispanic, black, Asian, American Indian, Native Hawaiian, and Pacific Islander.

Four years ago, Census officials projected the white minority would come in 2050.

By 2050, the number of Hispanic people will nearly triple, to 133 million from 47 million in 2008, to account for 30 percent of Americans, compared with 15 percent today.

People who identify themselves as Asian, with their ranks soaring to 39 million from 16 million, will make up nearly 9 percent of the population, up from 5 percent.

The main reason for the accelerating change is significantly higher fertility rates among immigrants. Indeed, the U.S.-born children of Hispanic immigrants are replacing their parents as the fastest-growing segment of the Latino population. The children will likely surpass their parents in earnings and education, but they will not close the gap with white, non-Hispanics.

A mother's culture, education, and earnings potential are probably more important than the prospect of higher EITC payments when she decides to have another child. But the credit surely is a factor for some. Even a tiny change in average fertility rates, when compounded over time, will have enormous consequences.

The role of the EITC in America's demographic transition cannot be denied. ■

Notes

1. "Earned Income Tax Credit: The Compliance Challenge," Century Foundation Issue Brief.

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3. Ibid.

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EITC and Low-Wage Jobs

Section III

At nearly $45 billion a year, EITC spending dwarfs that of Temporary Assistance for Needy Families (TANF)—traditional welfare—and food stamps combined. Twenty-three million taxpayers filed for the credit last year; they received an average payment of $2,014.

Good news for the working poor, you say? That's what liberal activists would have us believe. So would George W. Bush, the Heritage Foundation, the *Wall Street Journal* editorial page, and the disciples of economist Milton Friedman. No doubt many of the program's conservative supporters are motivated by genuine admiration for its virtues; but activists for the poor, finding themselves in such strange company, would do well to ask themselves: Is there a catch?

Maybe there is. Even more ominous than conservative support for the EITC is the sorry record of the program's closest historical parallel: the "Speenhamland system," an obscure law in force in England between 1795 and 1834. Like the EITC, Speenhamland linked welfare to work. Upperclass 18th-century Englishmen were no more eager to subsidize idleness than their 21st-century American equivalents.

And also like the EITC, Speenhamland was an attempt to raise earnings without placing a burden on employers. If wages fell below a certain level, the government made up the difference; as wages rose, the government benefit fell.

Employers soon discovered they could "game" the system by cutting wages below what workers were really worth to them. Before Speenhamland, they would have gotten what they paid for: mediocre, malnourished, resentful workers. Or none at all. But with the country taking up the slack, they had nothing to fear.

The Poor Law Commissioners' Report of 1834, summarizing the failed program, called Speenhamland a "universal system of pauperism."

> **"In the long run, the result was ghastly," wrote economic historian Karl Polanyi in his 1944 classic *The Great Transformation*. "Wages which were subsidized from public funds were bound eventually to be bottomless." The result was that, as Notre Dame University Teresa Ghilorducci puts it, "The government subsidized wages so much they went broke."[1]**

The EITC, like Speenhamland, rewards employers who pay workers substandard wages. To see this perversity at work, imagine that the economy consists of two companies producing widgets. Employer #1 hires moderately skilled workers at $10 an hour, but he produces 10 widgets per worker per hour.

Employer #2 hires only the least skilled workers. In the absence of the EITC subsidy, assume that no worker would take the job for less than $7.50 an hour. But workers on his less sophisticated assembly line produce only 5 widgets per worker per hour—half the productivity of employees of employer #1.

The result will be employer #1 will have to pay $1 in wages for every widget produced ($10 an hour for 10 widgets per hour), while employer #2 will have to pay $1.50 for every widget produced ($7.50 an hour for 5 widgets per hour.)

In this labor market, low-wage employer #2 will be unable to compete with his more productive, higher-wage competitor. Curtains for employer #2.

Now introduce an EITC program that adds, say, 50 cents to every dollar of wages. The credit is available to workers earning $7.50 an hour or less.

The credit enables employer #2 to cut wages by as much as one-third, to only $5 an hour, since his employees would receive an added $2.50 an hour from the government. Workers at employer #2 will stay on the job, and the low wage company will produce widgets at $1 per widget—the same cost as its more productive competitor.

Increase the EITC subsidy rate even more, and employer #2 will be able to drive his more technologically advanced, higher-wage competitor out of business.

Bottom line: Low-wage subsidies like the EITC destroy high-wage jobs.

This is somewhat of a simplification: In the real world, employers do not cut wages a dollar for each dollar of wage subsidy. But employers have learned how to exploit a system that is ripe for exploitation—a system in which the government subsidizes low-wage jobs while taxing moderate wages.

Wal-Mart, for example, launched an aggressive campaign to "educate" its workers about the EITC program a few years ago. **"The momentum behind it is education—ways our employees can save money and live better,"** a company spokesperson said at the time.[2]

Yet the nation's largest employer pays its non-supervisory employees about $18,000 a year, far less than half what General Motors (GM) workers were paid 35 years ago, adjusted for inflation.[3] And Wal-Mart is notorious both for how few of its workers receive health benefits and for the stinginess of those benefits—and for hiring illegal immigrants.

GM, by contrast, does not "educate" its employees on the virtues of the EITC for this reason: It pays them too well to qualify.

Gary Gereffi, professor of sociology at Duke University, deconstructs the vastly different business philosophies of the two companies in a Frontline interview:[4]

Gereffi: **“Wal-Mart is the biggest, most respected company in the United States, but it’s very interesting to compare Wal-Mart with General Motors, which was the best known, largest, most respected company 50 years ago. I think these two models are radically different models. The Wal-Mart model is premised on global efficiency. The General Motors model was premised on having workers that could afford to buy the products that they made.”**

Frontline: **“Are you suggesting here that Wal-Mart is pushing prices so low and pushing wages so low that it may, in fact, eventually bankrupt its own customers because they won’t be making enough money to go shopping?”**

Gereffi: **“Wal-Mart is pushing wages down to a level where the people that work in Wal-Mart stores are going to be forced to buy in Wal-Mart stores, because they can’t make enough money to buy goods elsewhere in the economy.**

“The traditional model of American capitalism from the mid-20th century was that American corporations were respected because they were globally efficient, but they also paid their workers a good wage so that workers could become consumers and part of the middle class of American society. I think we’ve lost that model today....”

Our take: The EITC enables Wal-Mart, McDonald’s, and other low-wage employers to continue their policies of employee exploitation. It does nothing for high-wage, high-productivity companies like GM. As the EITC subsidy increases, so will the fraction of U.S. businesses built on low-wages rather than high-productivity.

EITC from the Employee’s Perspective

Consider a household with two children in 2008. For each dollar earned up to $12,060, the government kicks in an extra 40 cents. Between $12,060 and $15,752, the benefit is the same—$4,824—neither increasing nor increasing with additional earnings. So if this hypothetical two-child household earned the minimum wage in 2008, it would receive an extra $4,824 after filing income taxes.

But once the family’s income exceeds $15,752—hardly enough to support four persons—their EITC payment starts to “phase-out.” For this unfortunate family, this means they lose 21.06 cents of EITC for every additional dollar of income. Add in Social Security and income taxes, and in some states more than 50 percent of any pay hike is lost to higher taxes and lower credits—a higher marginal tax rate than the wealthy pay.

Why earn more if the government takes over half of the increase?

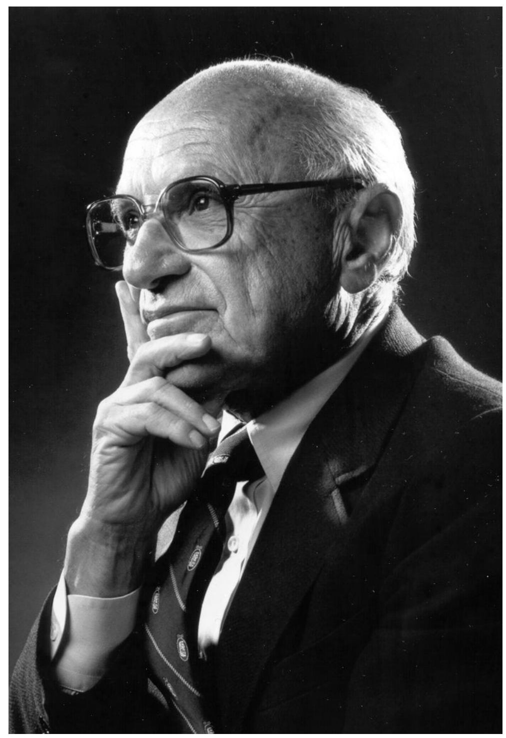
Why invest time, effort, and money to improve your work skills?

If poor families are rational, they will respond to the work disincentives of the EITC by working less. Data back this up. Around 77 percent of EITC recipients have incomes that fall in the flat or phase-out range of the credit. Economists generally agree that most of these folks will work fewer hours, and devote less time and effort to improving their work skills and education, because of the negative EITC incentives.[5]

In the short run, the EITC is effective in moving people out of poverty. But over the long haul, the program enables employers to offer less to workers, who may be satisfied with less because of the program's perverse incentives. As a result, the program originally envisioned as a transfer to low-wage workers has become a transfer to their employers.

EITC v. the Minimum Wage

> *The minimum wage law is most properly described as a law saying that employers must discriminate against people with low skills.*
>
> —Milton Friedman



Nobel Economist Milton Friedman

Here the great conservative economist gives voice to what has become the conventional wisdom among free-market libertarians: Minimum wage laws hurt the poor.

Their argument runs like this: In a free market, wage levels will always reflect a worker's value to the firm—their "marginal productivity." Employers who try to pay workers less than their true worth will only lose them to competitors. They either match the competitive wage or go out of business. Their former employees will find work. But minimum wage laws interfere with this process. Many unskilled, uneducated workers simply do not contribute enough to a firm's bottom line to justify receiving the minimum wage. They are its victims rather than its beneficiaries.

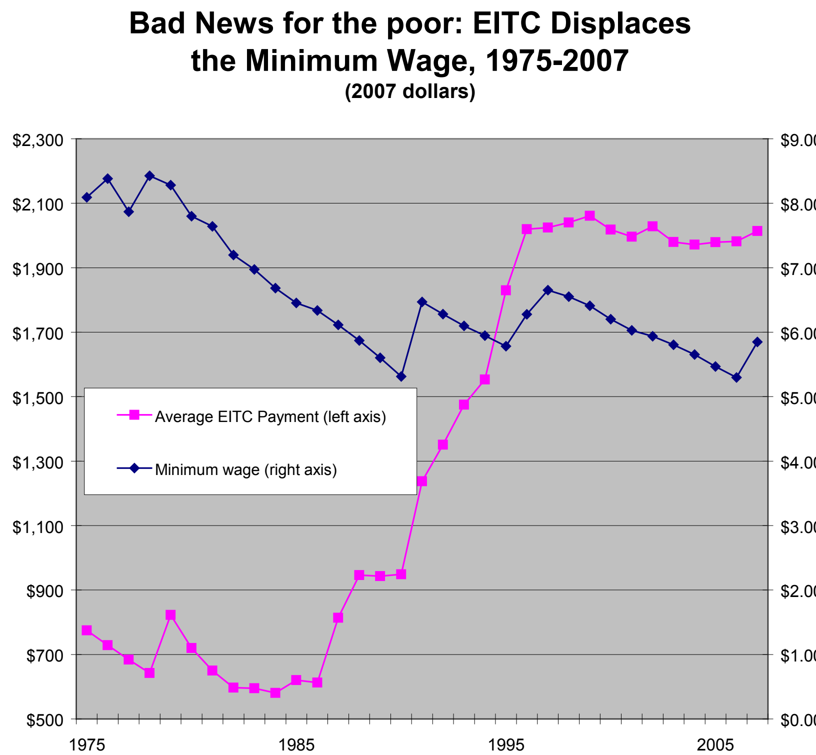
Or, as Friedman cheekily observed: "**It has always been a mystery to me why a youngster is better off unemployed at $4.75 an hour than employed at $4.25.**"

In fact, the conservative critique does not hold up in practice. A number of studies, notably by economists Alan Krueger and David Card in their book *Myth and Measurement*, have found that raising the minimum wage leads to increased employment for the poor because it encourages higher productivity and creates more spending in the poor communities themselves.[6]

More recently, a study of state minimum wage laws finds that "wages are higher and employment is no lower" in states with a higher minimum wage than those without.

The median minimum wage was $1.40 (more than 25 percent) higher than the federal minimum in states that had raised their minimum wage.[7]

Conservative objections to minimum wage laws, and their love for the EITC, have influenced public policy (as evidence see the accompanying chart).



Since 1975, the average EITC benefit, adjusted for inflation, has increased by 176 percent, while the minimum wage has declined by 30 percent. Even with its sharp expansion, however, the EITC fell notably short of offsetting the drop in the minimum wage. Minimum wage families with children saw their real disposable income drop over most of the the nearly 35-year period in which the EITC has been in existence.[8]

Raise the EITC even more, you say? That would merely increase the government subsidy to low-wage employers. It is unconscionable, in this economy, for the federal government to underwrite businesses that exploit poor workers.

The obvious answer is to increase the minimum wage to a level where the EITC subsidy is no longer necessary

But what about the conservative rejoinder—that in a laissez-faire economy where there is no minimum wage, wages will always reflect a worker's productivity?

The marginal product theory holds true in a labor market comprised of many small employers, each competing for the same pool of labor, each too small to influence the market wage. This model may have obtained when Adam Smith first articulated it. It was still relevant in the 19th and early 20th century U.S. But today, with the market for low-wage labor dominated by the likes of Wal-Mart and McDonald's, it breaks down.

Gereffi again:

> **Wal-Mart is also having a negative impact on employment in the retail sector. Wal-Mart is the largest employer in the United States after the federal government. But Wal-Mart is also very well known for being a non-union company and pushing non-union conditions on its workforce.... It pays its workers at a minimum pay scale with very few fringe benefits. Because Wal-**

> **Mart's the largest private employer in the United States, whatever Wal-Mart does in terms of the labor market, all other businesses have to follow. So Wal-Mart is really determining the direction in which the U.S. labor market is moving.[9]**

Wal-Mart, and its enabler, the EITC.

EITC and Immigration

The same business groups that tout the virtues of EITC also support mass immigration. That should come as no surprise: the influx of unskilled, uneducated foreign workers depresses wages for all American workers—foreign and native-born alike. Lower wages mean higher profits, higher share prices, and a net transfer of hundreds of billions of dollars from the pockets of workers to employers.

The EITC and immigration share joint responsibility for one of the most pernicious economic trends of our time: the obscene income gap between rich and poor in the U.S. George Borjas, an economist at Harvard's Kennedy School of Government, estimates that "almost half the decline in the relative wage of high school dropouts may be attributed to immigration." Black Americans in particular are big losers, with immigration reducing the income of the average native black person about $300 per year.[10]

The EITC reinforces the negative impact of immigration by subsidizing low-wage employers and eroding the work incentives of their employees. One must also consider the direct impact EITC has on the number of immigrants entering annually. As the most accessible, generous, and immigrant-friendly of all federal benefits, it undoubtedly ranks high among factors considered by potential entrants.

Mass immigration in the modern (post-World War II) era dates from the Immigration Reform Act of 1965. Prior to that law, only about 250,000 immigrants a year entered the country. By the 1990s the country was admitting more than 800,000 legal immigrants a year, with an additional 300,000 to 500,000 aliens entering and staying in the country illegally.

During the decade of the 1990s, 47 percent of U.S. civilian labor force growth was due to immigration. This represented the largest influx of foreign workers *ever* to enter the U.S. in a given decade—substantially exceeding the number who came here during the Great Wave of 1890 to 1910.[11]

But records are made to be broken, and nowhere more so than in immigration. During the first seven years of the 21st century (2000 to 2007), foreign-born individuals accounted for:

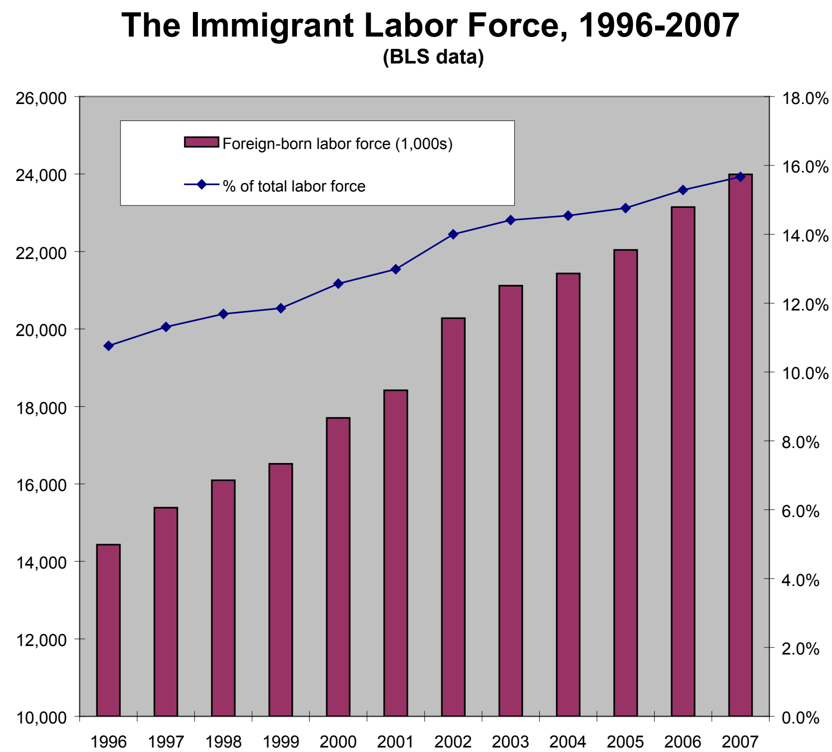
- 38 percent of U.S. population growth
- 51 percent of U.S. labor force growth
- 56 percent of U.S. employment growth

In other words, immigrants displaced Americans.

The 1996 to 2007 period saw unbroken increases in both the number and share of immigrants in the U.S. labor force:

The immigrant labor force (individuals working or looking for work) numbered 14.4 million in 1996; by 2007, it had grown by more than one-half, to 24.0 million.

The foreign-born share of the labor force is also unprecedented—exploding to 15.7 percent in 2007 from 10.8 percent 11 years earlier.



Even more important than quantity is the decreased *quality* of recent immigrants. In 1960, the average immigrant man living in the U.S. earned about 4 percent more than the average native man. By 1998, the average immigrant earned about 23 percent less.

The worsening economic performance of immigrants is due mainly to a decline in relative skills of the more recent cohorts. The newest immigrants arriving in the country in 1960 were better educated than the average native; by 1998, the newest arrivals had nearly two fewer years of schooling. As a result of this growing native/immigrant education gap, the relative wage of successive immigrant waves also fell. Immigrants entering around 1960 earned 13 percent less than natives; by 1998, the newest immigrants earned 34 percent less.[12]

The diminished quality of post-1965 entrants reflects fundamental changes in the criteria for admission. The 1965 law repealed the national origins system, which granted visa mainly to persons living in the U.K., Germany, and other Western European countries. In its place, the law made family ties to persons already living in the key factor in determining whether a visa applicant is admitted to the country.

One notable consequence: the increased Mexicanization of U.S. immigration. This phenomenon's downside is neatly captured by Professor Borjas:

> **...In 1940, 0.5 percent of all male high school dropouts were Mexican immigrants. Even as recently as 1980, only 4.1 percent of male high school dropouts were Mexican immigrants. By 2000, however, 26.2 percent of all male high school dropouts were Mexican born.**

How much does immigration reduce the income of native-born Americans?

Professor Borjas finds that every 10 percent increase in the U.S. labor force due to immigration reduces native wages by about 3.5 percent.[13]

In 2007, foreign-born workers accounted for about 15.4 percent of the U.S. labor force. Thus, if Borjas is right, immigration has reduced the average earnings of native workers by about 5.4 percent (15.4/10.0 X 3.5 percent).

Among native high-school dropouts—roughly the lowest tenth of the labor force—the estimated impact is even larger, reducing their wages by an estimated 7.4 percent.

Immigration, plus the negative incentives of the EITC, poses insurmountable economic obstacles to many uneducated natives.

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The Earned Income Tax Credit and the Culture of Debt

Section IV

The tax refund check is often the largest single sum of money that poor families receive during the year. They may need the money immediately, however. Refund Anticipation Loans (RALs) give them cash quickly—sometimes in the same day or even within an hour of filing their tax returns. But these loans are costly.

RALs are bank loans secured by the taxpayer's expected refund—loans that last about 7 to 14 days until the actual IRS refund repays the loan. This is the first indicator of just how unnecessary most RALs are: Most taxpayers could have their refund in two weeks or less even without the costly loan.[1]

Loan fees for RALs can range from about $30 to over $125 in loan fees. Some tax preparers also charge a separate fee, often called an "application" or "document processing" fee, up to $40.

A Slippery Slope: RAL to Sub-Prime

Sub-prime mortgages are marketed to poor borrowers who, as we now know, have little prospect of paying off the loans. The resulting defaults threaten the entire U.S. economy and the financial system. While the sub-prime story is well known, RALs are not. Yet RALs and sub-prime mortgages have much in common. Both are marketed to poor, unsophisticated borrowers. The borrowing costs of both products are understated—by teaser rates in the case of sub-prime mortgages; by instant cash in the case of RALs. Both are extremely lucrative, mass-market financial products. Regulatory failure is apparent in both markets.

We suspect many sub-prime mortgagees were introduced to the culture of debt by RALs. Did the widespread availability of RALs make poor borrowers easier targets for sub-prime mortgages? Are sub-prime mortgage defaults higher among RAL borrowers than those who did not borrow against their refunds?

A topic for future research, we hope.

The smaller the RAL, the higher the effective interest rate. Annual percentage rates (APRs) for a 10-day loan range from about 40 percent for a loan of $10,000 to 500 percent for a loan of $300. Most EITC loans are less than $500.

If application fees are included in the calculation, the effective APRs on the Earned Income Tax credit (EITC) loans can be over 1,100 percent.[2]

RALs Target EITC Recipients

The biggest market for RALs are workers who claim the EITC. According to IRS data, over 60 percent of all RAL borrowers are EITC recipients, despite the fact at EITC recipients only make up 17 percent of taxpayers. About 30 percent of EITC recipients get a RAL.[3]

Taxpayers who received RALs paid an estimated $960 million in RAL interest and fees in 2005 (the latest year of available data)—essentially borrowing their own money at extremely high interest rates.[4]

Finance costs are only the beginning. Most EITC households hire commercial tax preparers to complete their returns. (In 2005, almost 71 percent did so.) H&R Block reports tax preparation fees for a federal return (including the EITC application) average about $100—roughly equal to the interest on a typical RAL loan. Further, H&R Block and other tax preparers frequently steer customers to companies that charge fees to cash RAL checks, with the preparer getting a kickback on a portion of those fees. (These cozy arrangements frequently are not disclosed to clients.)

Tax preparation fees alone are estimated to drain nearly $2.3 billion in EITC benefits from the pockets of working families.[5]

When you total up the interest payments, tax preparation fees, and check cashing fees, EITC recipients often spend more than 10 percent of their credit just to get the credit.[6]

The mechanics of RALs are stacked against the taxpayer. Commercial tax preparers like H&R Block act as loan brokers, but banks actually issue the refund loans. Before transferring the RAL proceeds to the taxpayer, the banks deduct interest, the tax preparer's fees, loan application fees, and all other charges. As part of the RAL process, the taxpayer must authorize the IRS to send the refund directly through electronic deposit to the bank to repay the loan.

The hapless EITC beneficiary is responsible for paying the loan in full no matter how much of the anticipated refund the IRS actually releases. The IRS can deduct any outstanding federal debts—e.g., back taxes, child support, or student loans—from the EITC payment. If the taxpayer cannot repay the RAL, the lender may send the account to a debt collector.

For large tax preparers, RALs are not just a sideline; they are the main line. The vast majority of H&R Block's clientele consists of people who are filing for EITC refunds prior to April 15.[7] Another large tax preparer—Jackson Hewitt—derives 29.8 percent of total revenues from RALs and related products, according to a 2002 Brookings Institution study. The company's public filings indicate that more than half of its customers purchase RALs or similar products.

EITC-related business is driving the entire tax preparation industry. One telling piece of evidence is the clear relationship between the location of EITC tax filers and the location of Electronic Return Originators (EROs)—tax preparation companies authorized by the IRS to file tax returns electronially, a prerequisite for issuing RALs.

In zip codes where less than 10 percent of all filers receive the credit, there are roughly 10 EROs for every 10,000 filers. This figure increases as the fraction of EITC returns increases: In zip codes where 40 percent of tax filers claim the EITC, there are about 16 tax preparers per 10,000 population.[8]

Recent RAL trends are not all bad, however:

The number of RALs dropped by a dramatic 22.5 percent between 2004 and 2005, the latest year of available data. Prominently mentioned among possible reasons for the decline are more public awareness of the nature of RALs and anti-RAL advocacy.

Refund Anticipation Loans, 2000-2005

Filing Year	No. of RALs (millions)	Change from prior year (%)	RAL loan fees ($, millions)
2000	10.8		$0.810
2001	12.1	12.0%	$0.907
2002	12.7	5.0%	$1.140
2003	12.2	-4.3%	$1.090
2004	12.4	1.9%	$1.240
2005	9.6	-22.5%	$0.960

Source:
National Consumer Law Center, "2007 Refund Anticipation Loan Report," January 2007.[9]

Loan fees also declined. Both industry giant H&R Block and major RAL lender JP Morgan Chase have lowered prices for some of their RALs. H&R Block is marketing debit-card-based accounts that may help its low-income customers become banked and even avoid RALs in the future.[10]

On the other hand, a new line of products—pay stub and holiday RALs—is worse than traditional RALs. These are longer-term loans made during the Christmas season before taxpayers receive their IRS Form W-2s and can prepare and file their returns. They present additional costs and risks to taxpayers and will allow tax preparers to drain tax refunds even after the IRS speeds refund delivery times to a few days.[11]

Who Is To Blame?

With 60 percent of RALs going to EITC recipients, the government has an interest in minimizing the costs of these loans, or eliminating the need for them entirely. To this end, the IRS offers low-income taxpayers free tax preparation services through the Volunteer Income Tax Assistance (VITA) program. Unfortunately, VITA is neither readily available nor well advertised.[12]

Free e-filing, a three-day turnaround time for tax refunds, alerting EITC recipients to free non-IRS tax preparation alternatives—the IRS has tried them all to wean poor taxpayers off RALs, albeit with equally discouraging results. The overwhelming majority of RALs are still procured via professional tax preparation services, at exorbitant costs to low-income taxpayers.

Assigning blame for the (alleged) RAL extortion is not easy:

The IRS blames the tax preparation services for inflating refund amounts in order to market RALs—especially when working with taxpayers eligible for the EITC.[13]

The National Taxpayer Advocate, an IRS watchdog organization, disagrees, claiming that: “**The IRS does not conduct adequate oversight of Electronic Return Originators (EROs) that facilitate RALs.**”[14]

But an undercover GAO investigation by the Government Accountability Office (GAO) found no evidence that tax preparers inflate refund amounts—raising the possibility that the fraud originated with EITC taxpayers, including illegal aliens.[15]

Nevertheless, a coalition of liberal advocacy groups wants to kill the RAL industry:

> **Tax preparers and their bank partners should be prohibited from making loans secured by or expected to be repaid from the EITC. The EITC is the nation’s largest anti-poverty program, and its benefits should go to its intended beneficiaries, not be skimmed off by large banks and multimillion dollar corporations.**[16]

Reality check: Commercial tax preparers flourish because they provide a level of convenience, speed, and expertise that free nonprofit tax services cannot match. Increased competition among the H&R Blocks of the world has significantly reduced preparation fees and RAL interest costs. All U.S. taxpayers, especially those who receive the EITC, would be worse off if commercial tax preparers were prohibited from making loans against future credit payments.

A modest proposal: Require all tax preparers—commercial and nonprofit alike—to screen clients with e-verify. This would ensure that only individuals authorized to work in the U.S. receive the EITC—resulting in a sizable reduction in fraudulent payments.

E-Verify could become EITC-verify. ■

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The Earned Income Tax Credit: A Credit, not a Deduction

A tax credit reduces tax *payments* dollar for dollar. A tax deduction, by contrast, reduces taxable *income* dollar for dollar. A deduction's impact on tax liability depends on the taxpayer's marginal tax rate—the lower the rate, the less the tax reduction.

The lowest federal income tax rate in 2008 was 10 percent. It applied to joint returns with taxable income under $16,050. For taxpayers in this bracket, a $1,000 deduction lowers tax liability by $100 (10 percent of $1,000), while a $1,000 credit lowers tax liability by the full $1,000.

The EITC is a refundable tax credit. Refundable tax credits can reduce the tax liability below zero and result in a net payment to the taxpayer beyond their own payments into the tax system. In this way, refundable credits are a form of negative income tax.

The following example highlights the difference between a refundable credit like the EITC and a tax deduction of equal amount.

Assume a family with two children has taxable income of $16,000. Their federal income tax liability is $1,600 (10 percent of $16,000.)

A $4,000 tax deduction reduces the family's taxable income to $12,000, and cuts their tax liability to $1,200—a reduction of $400.

A $4,000 refundable tax credit reduces the familiy's tax liability by $4,000. This is more than the family's tax bill. So after paying taxes of $1,600, the family receives a check for $4,000. Their net tax payment is therefore negative $2,400.

Bottom line: The $4,000 deduction reduces this family's tax liability from $1,600 to $1,200. The $4,000 refundable credit eliminates the family's tax liablity completely, paying them $2,400 over and above the $1,600 they had paid in taxes.

The Earned Income Tax Credit and Liberal Activism

Section V

Throughout the 2008 campaign, Barack Obama vowed to "change" the way Washington works. Front and center: he would declaw the lobbyists, influence peddlers, and other inside-the-beltway types, who wield inordinate power to influence federal legislation on behalf of the "special interests."

Obama's populism is understandable. Lobbyists have a bad rap. Politicians of both parties routinely vilify them—blaming their own legislative failures on a conspiracy of sleazy insiders. Periodic scandals confirm the stereotypes, e.g., the Jack Abramoffs who wine and dine key congressmen while pulling down millions from casinos, large corporations, and wealthy families.

But Obama's crusade is based on two myths.

Myth #1: Lobbying is anti-democratic because it frustrates "the will of the people." Just the opposite is true: lobbying is democracy in action. Americans are a collection of special interests—and one person's special interest is another person's moral imperative. If people cannot organize to influence government, then democracy is dead.

Myth #2: Lobbying favors the wealthy because only they can afford to organize and pay for access to high-profile politicians. Taxes cuts tilted toward the rich? Anti-poverty programs cut back? Affordable health care beyond the reach of the middle class? Public education starved for funds?

You can blame the rich and powerful.

Reality check: If anything, the rich are the servants of government, not its masters. Exhibit #1: The richest 10 percent of taxpayers pay about 55 percent of federal taxes—and within that, the richest 1 percent pay 28 percent, according to the Congressional Budget Office. Meanwhile, about 60 percent of the federal budget goes to payments to individuals—mostly the poor and middle-class.[1]

The EITC did not become the most expensive federal anti-poverty program without powerful lobbyists.

Many nonprofits promote the EITC on behalf of working poor people. Some even assist taxpayers in filing the tax forms required to receive the credit. But only one is powerful enough to actually shape legislation in Congress. Only one has a seat at the table when the House Ways and Means Committee hammers out income thresholds, eligibility requirements, and fraud controls for the EITC.

The Center on Budget and Policy Priorities (CBPP) is ostensibly a nonprofit think tank. It describes itself as a **" policy organization... working at the federal and state levels on fiscal policy and public programs that affect low- and moderate-income families and individuals."**[2]

In fact, the CBPP is a lobbying juggernaut—one of the most powerful liberal organizations in Washington. Editorials on the EITC and other budget issues do not show up in the *New York Times* or the *Washington Post* without first being run past the Center. Its head has been described as **"one of the top five liberals in America."** Stephen Moore of the *Wall Street Journal's* editorial board recollects being at meetings with Democratic congressmen where they said **"What would Greenstein say?"** about some proposal.

Robert Greenstein (left), founder of the Center on Budget and Policy Priorities, attended a "fiscal responsibility" summit at the White House, February 23, 2009.

Robert Greenstein founded the CBPP in 1981. A former high school history teacher, Greenstein came to Washington in the 1970s to work on food stamps and other low-income issues at the Community Nutrition Institute. He was hired by the U.S. Department of Agriculture during the Carter administration, and he ultimately headed up the Food and Nutrition Service.

Initially, the CBPP had a staff of six and a budget of $50,000. Today, CBPP has a staff of more than 100 and a budget of $18.3 million. More than 80 percent of its revenues are grants from such sources as the Ford Foundation, the Annie E. Casey Foundation, the Rockefeller Foundations, and the Charles Stuart Mott Foundation.[3]

In the strictest legal terms, the CBPP is not a lobbying organization. Its nonprofit status allows it to spend only a small percentage of its time "lobbying." Just two center employees are officially dubbed lobbyists, according to a somewhat dated *National Journal* profile.[4]

Yet the Center is hardly reticent about its lobbying prowess:

> **In 2007, the Center helped to design and promote major improvements in the EITC and the CTC [Child Tax Credit]. One such improvement would greatly expand the EITC for low income workers who are not raising children....**
>
> **Another proposal the Center has promoted would reduce the earnings threshold (now about $12,000) for the refundable CTC, which disqualifies more than 6 million children in low-income working families that earn less than $12,000 a year from receiving the credit....**
>
> **A major tax reform bill that Charles Rangel (D-NY), chairman of the House**

> **Ways and Means Committee, introduced in the fall of 2007 included significant, Center-designed expansions in the CTC and EITC. While Congress did not consider the bill in 2007, prospects for such expansions are improving."[5]**

Question: How does Greenstein's group maintain such clout?

Answer: By promoting itself as a dispassionate, numbers-oriented research organization free of ideological bias.

Robert Greenstein has been described as a genius—and not simply because he received a McArthur Foundation grant for $306,000 in 1996. His genius is in marketing his left-wing Center as a "just the facts" think-tank.

Of course, he has had a little help from his liberal friends. During the Bush II years, the *Washington Post* began referring to the CBPP as **"a fiscally conservative group that advocates for programs that benefit low-income workers...."** That accolade raised eyebrows on both sides of the aisle.

But even GOP stalwarts acknowledge the Center's uniqueness.

Ron Haskins, a former GOP staff member of the House Ways and Means Committee, says the Center projects credibility like no other liberal think-tank. In a *National Journal* interview, he recalled an instance where the Center was planning to release a report critical of the Republican Congress' work in fighting poverty. Greenstein asked Haskins to look over the report. He agreed and was surprised to find that the report came down hard on the GOP's efforts. "**I said to Bob, 'We've had the best success fighting poverty since the 1960s and you're pooh-poohing it.' "** Greenstein agreed not to release the report.[6]

> **"In our view, the issue is not to score political points, it's to do the best possible analysis," Greenstein explained. "We'll pass a paper around before we release it, and often someone will comment that if you want to be as rigorous as possible about it, you'd change this, though it would then lose a lot of its political power. We will invariably modify the paper and have it lose a lot of its power."[7]**

Heritage Foundation welfare expert Robert Rector, who has sparred with him over the years, points out that Greenstein's forte is to win some obscure policy change that, while others nod, raises welfare benefits and gets more people on the rolls. P. J. O'Rourke calls it the "tyranny of boredom": The last one left awake gets to spend all the money.[8]

The trouble is that policy minutiae and boring analysis do not necessarily lead to wisdom. Indeed, they often help hide the forest fire through the trees.

The Center's analysis of the Bush tax cuts is a prime example.

Greenstein claimed the 2001 plan would "cost" the Treasury $2.5 billion over the 10-year period 2001 through 2011. That sum was $1.2 trillion more than the estimate of Congress's Joint Committee on Taxation, and $900 million more than the tax loss estimated by the White House.[9]

No, the Center did not fudge the figures to inflate the loss. It merely ignored the effect tax cuts have on behavior. Tax cuts do not just put money into people's pockets; they change incentives. The statistics that groups like the Center brandish do not take into account how people respond to incentives or how those responses affect outcomes. Thus, a tax cut that stimulates investment and economic activity will often increase the tax base enough to offset much of the reduction in tax rate. That benefit would never make into a Center chart.

To complain, as conservatives often do, that the "static models" of liberals ignore the "dynamic effects" of tax cuts or other policy changes is to understate the philosophical issue. A methodology that ignores the potential for change as incentives change assumes that people are passive and inert. This can lead to exactly the wrong policy prescription.

Case in point: Robert Greenstein's 2005 analysis of the EITC.[10] Here we excerpt several of the static, albeit formally correct, statements about the EITC contained in Greenstein's report. We dub them **"Center truths"** and juxtapose them with our own dynamic, more realistic, **"Higher truths:"**

Center truth: "Recent research also documents another powerful effect of the EITC: reducing poverty. Census data show that in 2003, the EITC lifted 4.4 million people out of poverty, including 2.4 million children."

Higher truth: He is right: Poverty is reduced by the EITC. That is the good news. The bad news is that the EITC increases the likelihood that low-income workers will always need federal support to escape poverty. This insidious result occurs because the EITC induces employers to cut wages and workers to work fewer hours.

Center truth: "Without the EITC, the poverty rate among children would have been nearly one-fourth higher.... Census data show that the EITC lifts more children out of poverty than any other single program or category of programs."

Higher truth: Once again, the statement is formally true: the EITC does lift children out of poverty. At the same time, the credit's generous parenthood subsidy, combined with its marriage penalty, increases incentives for single parents to have children. Taking this dynamic into account, the number of poor households is probably larger *with* the EITC than it would be without it. As with tax cuts, the Center's static model misses the point.

Center truth: ".... Only people who work are eligible for the EITC, and for workers with very low earnings such as those who work less than full time, the size of the credit increases with each additional dollar of earnings, providing an incentive for more work."[11]

Higher truth: This assertion studiously ignores evidence that businesses pay their employees less because of the credit, and that many EITC recipients work fewer hours when they reach the phase-out" range of income, thereby negating the credit's (alleged) positive work incentives.

Center truth: ".... the EITC remains much too complex for low-income working families. Due in significant part to its complexity, the EITC can lead to tax-filing errors, and about 70 percent of filers claiming the EITC resort to paying commercial tax preparers to file their return, a larger percentage than for tax filers generally.... Simplification of the EITC would be highly desirable."[12]

Higher truth: Most of the errors made on EITC tax returns involve understating income or overstating the number of dependent children in the household, according to the IRS. This is not the result of "complexity"; it is outright fraud. How can complexity be a problem when, thanks to Center's outreach efforts, free tax preparation service is available to EITC filers.

Center truth: "The EITC strongly complements the minimum wage. For several years after the EITC expansions of 1990 and 1993, the combination of the EITC, the minimum wage, and food stamps met the goal of ensuring that a family of four with a full-time minimum-wage worker would not have to raise its children in poverty. This goal cannot be met by the minimum wage alone; the minimum wage would have to be set at more than twice its current level to achieve the goal by itself...."

Higher truth: In recent decades, the real (inflation-adjusted) minimum wage has declined while the EITC has expanded. Had the Center devoted even a fraction of its lobbying efforts to the minimum wage, this could have been avoided. By promoting the EITC, the Center has aligned itself with Wal-Mart, McDonalds, and other low-wage, low-benefit corporations.

Our take: The EITC's perverse incentives increase the likelihood that low-income households will remain dependent on federal largesse. While this may be bad for poor people, it represents "job security" for the CBPP and its network of liberal activists.

At the end of the day, the CBPP is its own special interest group.

The EITC Network

All politics is local, even politics relating to the federal EITC. The CBPP has harnessed a large network of community organizations, schools, state and local governments, labor unions, and advocacy groups to its EITC outreach campaign. Members receive a "Tax Credit Outreach Campaign Kit"[13]—updated annually—outlining the CBPP's strategy for promoting the credit and linking eligible workers to free tax filing assistance. Flyers in Hmong, Tagalog, and eighteen other languages—designed to hook immigrants into the EITC culture—are prominent features.[14]

January 30, 2009, was the third annual National EITC Awareness Day. Here is a sampling of the activities that the CBPP suggested its affiliated organizations do on that day:

● Issue news releases to highlight the EITC.

● Check the deadlines for shopper's guides and other free papers to print an advertisement about the EITC and free tax filing assistance sites. Include a checklist of documents that tax filers should bring to the site.

● Provide flyers to schools, libraries, Head Start programs, and after-school programs to distribute to children to take home to their parents.

● Arrange a meeting with the newspaper's editorial board to try to get an editorial printed on January 30 that underscores the importance of the EITC and the availability of free tax help. If the campaign has already been launched locally, provide some information on how many people have already been served and how much in refunds claimed.

● Schedule a radio or TV interview to discuss the importance of the EITC to individuals and to communities. Arrange for a local political leader, business owner, and/or EITC recipient to participate in these interviews. Locally-focused community media, including ethnic radio and TV stations, may be particularly interested.

● Encourage your mayor or other well-known city official to issue a statement or proclamation in support of the EITC and local tax credit outreach efforts.

The public relations blitz extends beyond the federal EITC. Each year, the CBPP issues a report with state-by-state information on the income level at which families begin to owe state income tax. These reports receive widespread media coverage and generate irate editorials—all designed to shame state legislators into easing tax burdens on low-income workers.

> **To maximize the report's impact, we work with a number of partner organizations in individual states to issue materials on the findings regarding their state and to hold conference calls for journalists to highlight that state's particular problems.[15]**

Success, in the Alice in Wonderland world of the EITC zealot, is measured by the number of state EITCs created or expanded:

> **In 2007, our collaborations scored exciting victories in this area. Louisiana and North Carolina became the first states in the South to adopt state EITCs that are "refundable," meaning that families with incomes too low to owe income tax can receive the credit in the form of a refund check to supplement their income. New Mexico also adopted a state EITC, and six other states—Illinois, Iowa, Kansas, Maryland, Nebraska, and New Jersey—expanded their state EITCs.[16]**

This outreach is driven by one key assumption: the EITC is underutilized, a relatively unknown benefit that good liberals should be anxious to publicize. This is simply not the case. As shown in this report, EITC recipiency rates are higher than those of Food Stamps, Medicaid, and Supplemental Security Income (SSI).

Why do liberal activists tout the EITC and ignore other, relatively less-used, poverty programs? Why do they downplay the minimum wage? Are they in league with the

Walmarts and McDonalds of the world? The tax preparation services?

The question deserves an answer. ■

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EITC and Immigration
The Tax That Keeps On Taking

By James R. Edwards, Jr., Ph.D.

The following appended remarks were delivered by Dr. Edwards at the National Press Club, Washington, D.C. on April 14, 2009.

Tomorrow is Tax Day, that perennial date that recurs in infamy. All of us who work for a living, who (unlike a number of Obama appointees) pay our taxes, accept Tax Day with resignation. We look forward to Tax Freedom Day—still several days off—when our earnings for this year stop going to the government and stay with us.

This is the perfect time to examine facets of the tax code with which we may not be familiar, such as the Earned Income Tax Credit (EITC). Ed Rubenstein's latest report exposes a combination that cruelly, needlessly adds to the tax burden that each of us bears. The EITC is an unfair transfer of wealth. Mass immigration today effectively imports poverty. The combination of these two makes the burden on native-born American families much greater.

I'll make three observations. First, refundable tax *credits* are *not* tax *cuts*. Second, immigration makes tax policies like the EITC strike taxpayers' pocketbooks that much harder. And third, the EITC shows that "immigrant family values" aren't the same as traditional American family values.

First, the EITC illustrates how tax cuts and tax credits are not the same thing. Tax cuts refer to lowering the rate at which income is taxed. Cutting tax rates applies to large groups of people who are similarly situated with respect to income. Ronald Reagan did this in 1981 as part of his economic recovery program. Quoting Reagan's autobiography: "Excessive tax *rates* were at the heart of the problem." The Reagan record shows how cutting tax rates boosts prosperity generally and produces more revenue for the government.

By contrast, tax credits and tax deductions reduce the tax liability of a defined group. Refundable tax credits such as the EITC go well beyond reducing a favored group's tax liability. They phase out eligibility as income levels go up. These benefits intentionally treat similarly situated people differently. Someone getting the EITC actually collects a government check—the government *pays them* at tax time. Through schemes like the EITC, the government "spreads the wealth around," to borrow Obama's line to Joe the Plumber.

As Ed Rubenstein's paper shows, the EITC robs some to give to others. This is exactly the kind of so-called "tax relief" Obama talked about during the campaign and in his sales job for his economic stimulus bill. Obama is redistributing wealth via the tax code and misleading the public by calling it tax cuts. Rather, it is welfare by other means.

Thus, tax *rate* cuts benefit taxpayers. They are equitable. And they benefit the economy. But refundable tax credits like the EITC penalize real taxpayers. They are inequitable and redistributionist. And they have much less economic benefit.

Second, taxpayers suffer a one-two punch from the EITC and mass immigration. In many cases, the EITC picks the pockets of native-born Americans and gives the money to the unskilled, low-income foreign-born. The Center for Immigration Studies reports that nearly one-third of immigrant households qualified for the EITC in 2006. Ed found that immigrants collected about $12 billion through EITC last year. That is more than one-fourth of the total EITC payouts. And immigrant participation in the EITC is twice the rate of the native-born.

Legal immigration runs at four times the historical average. We give out 1 million immigrant visas a year, versus an average 250,000 immigrants a year over our nation's first two centuries. The vast majority of today's immigration is by relatives. Also, legal and illegal immigration are connected. The same countries sending most legal immigrants are the same source countries for most illegal aliens.

About James R. Edwards, Jr.

James R. Edwards, Jr., is a Principal at the MITA Group, a Washington-based government affairs, federal sales and acquisition, and business advisory services firm. He consults to corporate, association, and nonprofit clients on issues that include homeland security, health care, immigration, law enforcement, and intellectual property.

Dr. Edwards cofounded Olive, Edwards, & Cooper, a government relations and public affairs firm, where he began his consulting practice in 2001. Dr. Edwards spent five years at the Healthcare Leadership Council (HLC), a respected health care association, where his responsibilities included corporate and advocacy communications and lobbying on health issues under the Judiciary Committee. He was HLC's point man on a health antitrust coalition and a biomedical liability protection coalition.

On Capitol Hill, Dr. Edwards served as U.S. Rep. Ed Bryant's Legislative Director, where he handled the Congressman's Judiciary Committee assignment, including the work of the Crime and Immigration Subcommittees. Previously, Dr. Edwards was Senior Speechwriter at the Republican National Committee, Press Secretary and Legislative Assistant for U.S. Rep. John Duncan, Jr., and began his congressional career on the staff of U.S. Sen. Strom Thurmond, later becoming Sen. Thurmond's Special Assistant on the Senate Judiciary Committee.

Dr. Edwards co-authored The Congressional Politics of Immigration Reform *(Allyn & Bacon, 1999) and has written extensively on policy issues. He was an Adjunct Fellow with the Hudson Institute from 1999-2008 and was selected as a Lincoln Fellow by the Claremont Institute in 1998. Dr. Edwards has advised political campaigns, including as a Co-Chairman of the 2008 Mitt Romney for President Faith and Values Advisory Committee, Ed Bryant's Senate campaign, and several U.S. House campaigns.*

He earned his doctorate at the University of Tennessee, and his bachelor's and master's degrees at the University of Georgia. He has taught in the Claremont McKenna College Washington Semester Program and several other higher education programs.

Chain migration drives up the number of immigrants and drives down the quality of immigrants. Immigration of extended family members means people can come because they are related to an uncle or third cousin who came here several years ago. There is no requirement to be educated, or literate, or skilled, or capable. Therefore, chain migration perpetuates the importation of hundreds of thousands of foreign-born who are net takers, instead of net gains, for America.

Consider the example of high school dropouts. More than half of illegal aliens and a quarter of legal immigrants never complete high school, compared with less than 10 percent of the native-born. Given that immigrant households have more children, guess what? Immigrant participation rates in all kinds of welfare programs and other forms of redistribution of wealth far outpace native participation. This adds up to a tax-and-tax of U.S. citizens and to a spend-and-spend on the foreign-born. Robert Rector at the Heritage Foundation calculated a total net transfer of taxpayer money of nearly $22,500—every single year to every single poorer immigrant household!

We have a requirement on the books that those who sponsor immigrants shoulder financial responsibility for those they bring. It is loophole-ridden, so the new arrivals and their U.S.-born children become lifelong public burdens. We have a public charge doctrine that dates to colonial times. But it has also been gutted by liberals all too eager to show their "compassion" with other people's money. The way to give Americans real tax relief would be to cut legal immigration toward historical levels and adopt skill and educational requirements for all immigrants.

Third, EITC exemplifies how purported "immigrant family values" don't measure up to traditional American family values. Some self-delusional conservatives have convinced themselves that immigrants—Hispanics in particular—are "natural conservatives." This implies that they are ripe for Republican picking. This is simply not true, and the EITC illustrates why.

Ed found high immigrant participation rates in the EITC, the prevalence and ease of EITC fraud, and how illegal aliens readily benefit. We see how the EITC discourages marriage and encourages cohabitation and single parenthood. The Manhattan Institute's Heather Mac Donald has chronicled trends in Hispanic social behavior. Half of all Latino children are now born out of wedlock. The birth rate of unmarried Hispanic females is epidemic—higher than of whites, Asians, or blacks. More than half of the Hispanic children in this country now live in households headed by a single mother in poverty. Only 21 percent of Latino kids live with a pair of married parents. Unmarried Mexican-American parents who start out cohabitating are more likely than whites or blacks to split up.

People living with the consequences of this kind of antisocial conduct—particularly immigrants, who have even less social capital than their native-born counterparts displaying the same kind of behavior—are drawn by pandering politicians and ethnic advocates into the cycle of dependency. Political manipulators employ the EITC and similar goodies to advance their political agendas. Those agendas do not involve personal responsibility, independence, civil society, or ordered liberty. Their agendas rely on the breakdown of the family. The undesirable behavior of the Left's constituencies guarantees dependency. The cycle of dependency involves sexual promiscuity, illegitimacy, gangs and crime, drugs, violence, school dropouts, and reliance on unwholesome civil structures in the subculture and redistributionist programs like the EITC.

In conclusion, the EITC has become yet another means of depriving hard-working Americans of their own resources. These resources could help our less fortunate fellow Americans. But it offers a way of redistributing wealth—through the tax code—to an increasingly foreign-born underclass. This flies in the face of America's immigration ideal, in which capable people come here to do for themselves, not to sign on to the public dole. Here at tax time, we do well to consider this: Is it time to reduce immigration levels and thereby let productive Americans keep more of our own money? ■

About The Social Contract

The English philosopher John Locke, whose thinking helped inspire the American Revolution, said that society should be governed by an understood set of values he termed *the social contract*. Under the social contract, governments have obligations to their citizens, and citizens have responsibilities to society.

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It is this theme of balance between rights and responsibilities that suggested we resurrect the phrase *The Social Contract* as the name for our journal, since so many of the questions we face are ethical and contractarian ones. Who gives, who gets, and how much?

—John H. Tanton

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