The Rise of the *In-Work* Safety Net: Implications for Income Inequality and Family Health and Well-being

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The Welfare State And The Fight Against Inequality

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Columbia University

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Overview

- The U.S. social safety net for lower income families has shifted to one based on *in-work* assistance (welfare reform, EITC expansion)
- Here I provide a brief summary of how these changes affect families:
  1. Motivating context: falling wages and incomes
  2. Policy Setting: The rise of the *in-work* safety net
  3. Research: What are the impacts of the EITC?
  4. Holes in the Safety Net

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1. Motivating Context: Falling Wages and Declines in Labor Force Participation

- Since the mid 1970s, there has been little gain in wages for less skilled workers, especially for men
- Additionally, labor force participation rates are declining for prime age men, and more recently, prime age women
- The implication is stagnant family incomes for the bottom of the distribution

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Wages declines, or lack of gains for less skilled workers

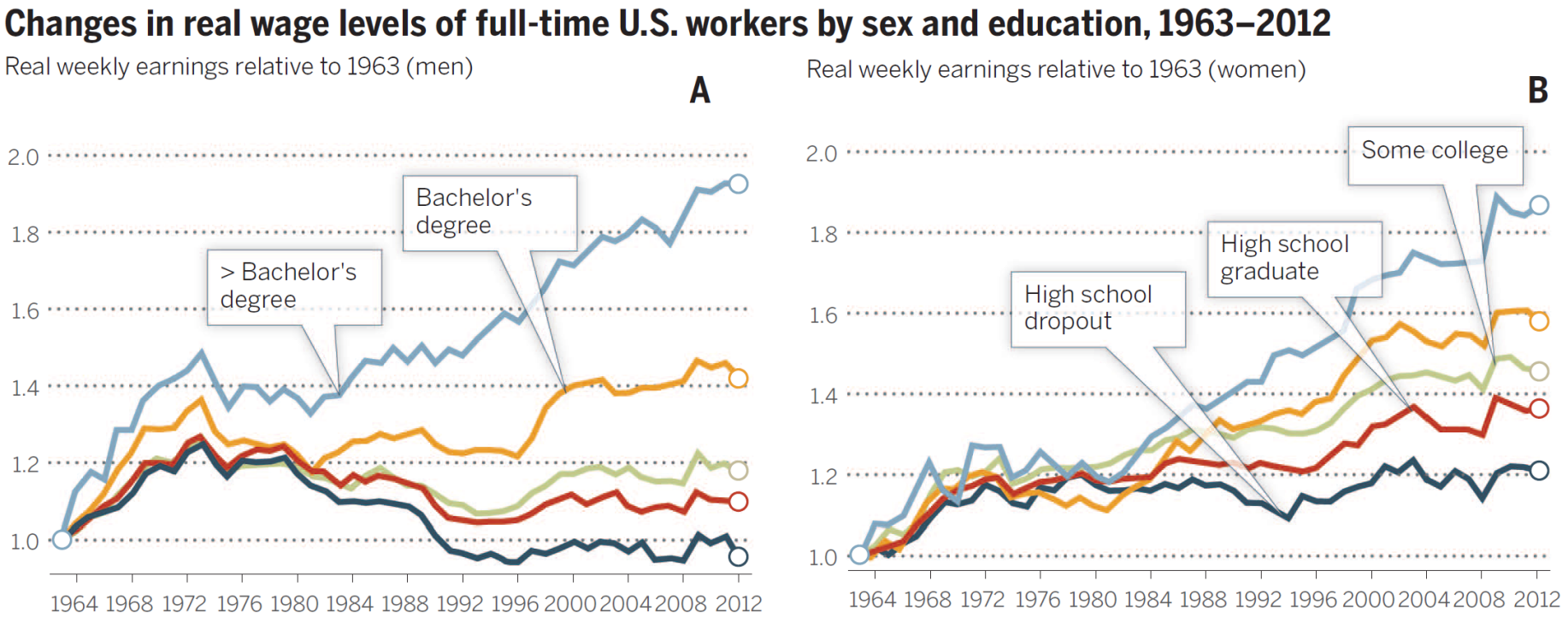


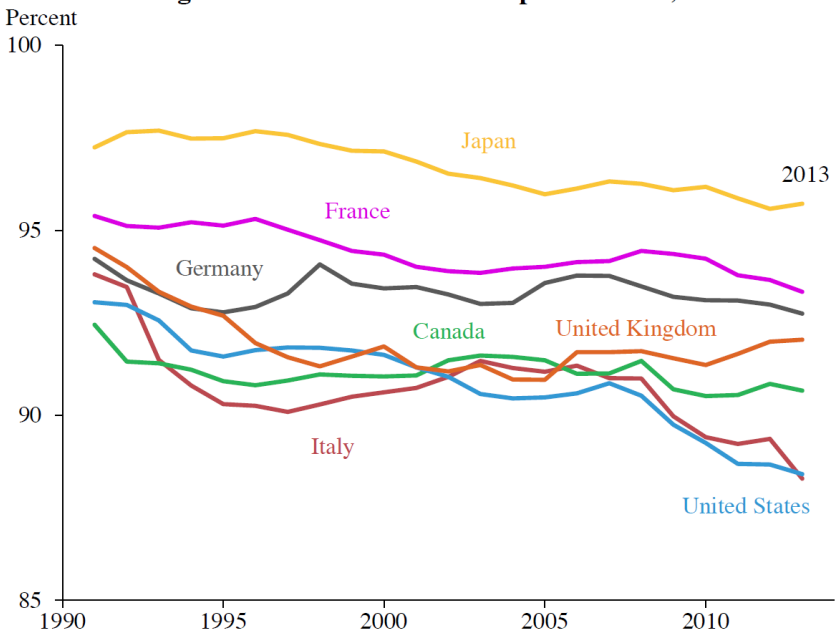
Fig. 6. Change in real wage levels of full-time workers by education, 1963–2012. (**A**) Male workers, (**B**) female workers. Data and sample construction are as in Fig. 3.

David Autor, Science.

Labor force participation rate declines in the U.S.

Figure 1-9

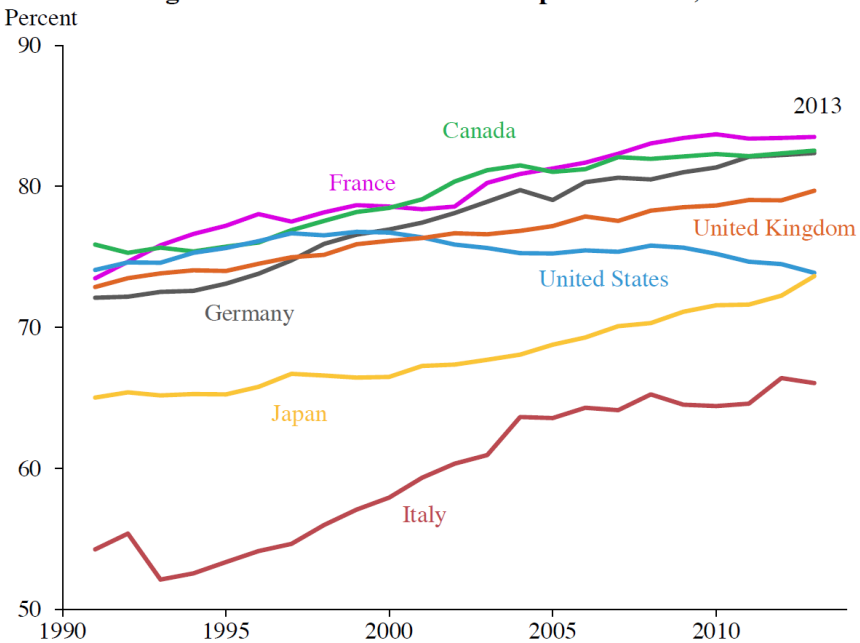
Prime-Age Male Labor Force Participation Rates, 1991–2013



Source: Organisation for Economic Co-operation and Development.

Figure 1-10

Prime-Age Female Labor Force Participation Rates, 1991–2013



Source: Organisation for Economic Co-operation and Development.

Economic Report of the President, 2015.

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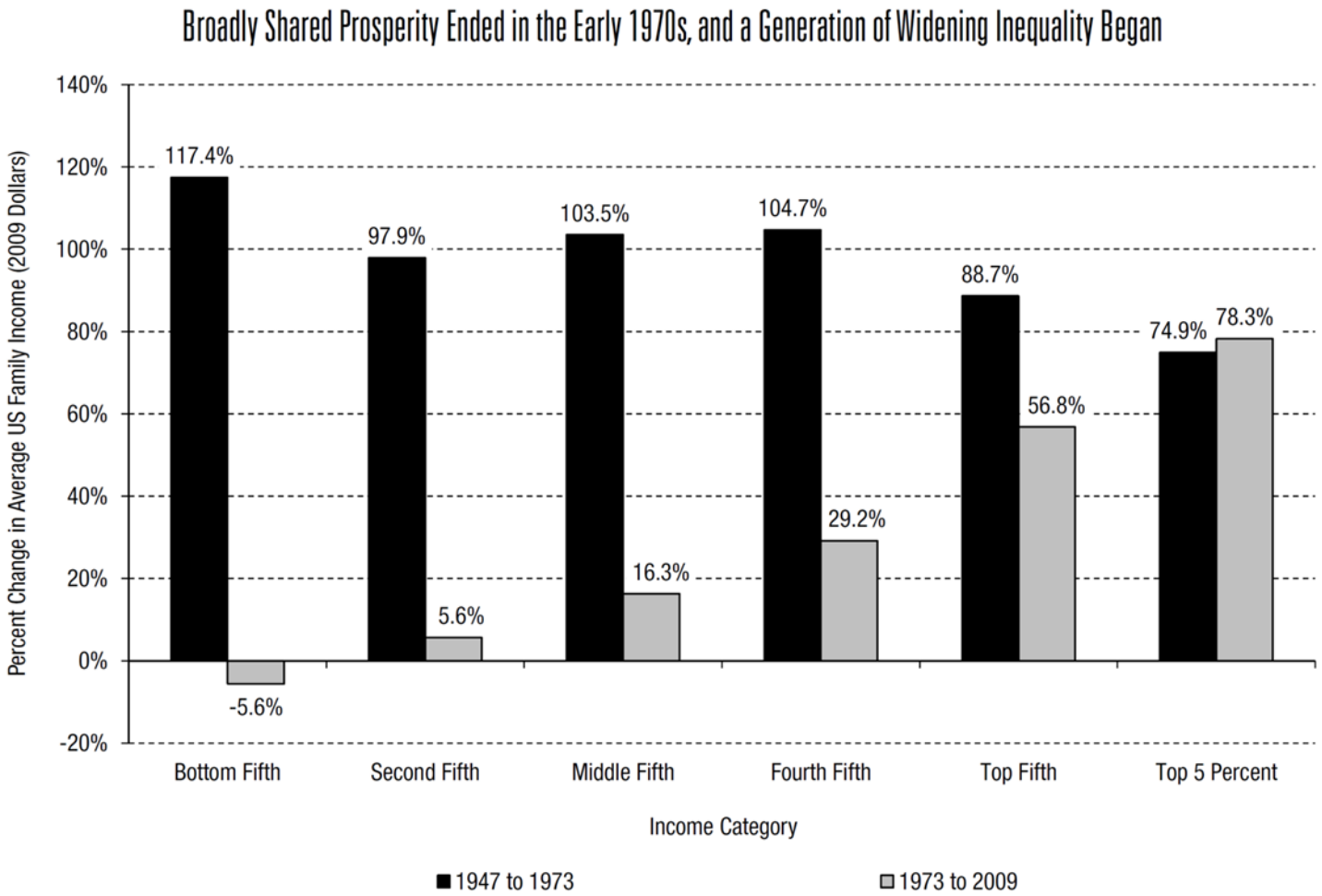
The result: Little gain in family incomes below median



CALIFORNIA BUDGET PROJECT

Source: Economic Policy Institute

- The implication is an increasing need to supplement earnings with social safety net to maintain family income levels.
- The Earned Income Tax Credit (and SNAP) are central here
- More generally, the EITC is the main *post-market* policy that affects the twin concerns of low employment and stagnant income

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2. Policy Setting: Changes in the Social Safety Net

The U.S. has experienced a tremendous change in the social safety net for low income families with children:

- Decline in the *out-of-work* safety net (1996 welfare reform)
- Rise of the *in-work* safety net (the EITC)
  - The EITC is received by 28 million tax filing units, almost 20 percent of all tax filers and 44 percent of filers with children receive the EITC.

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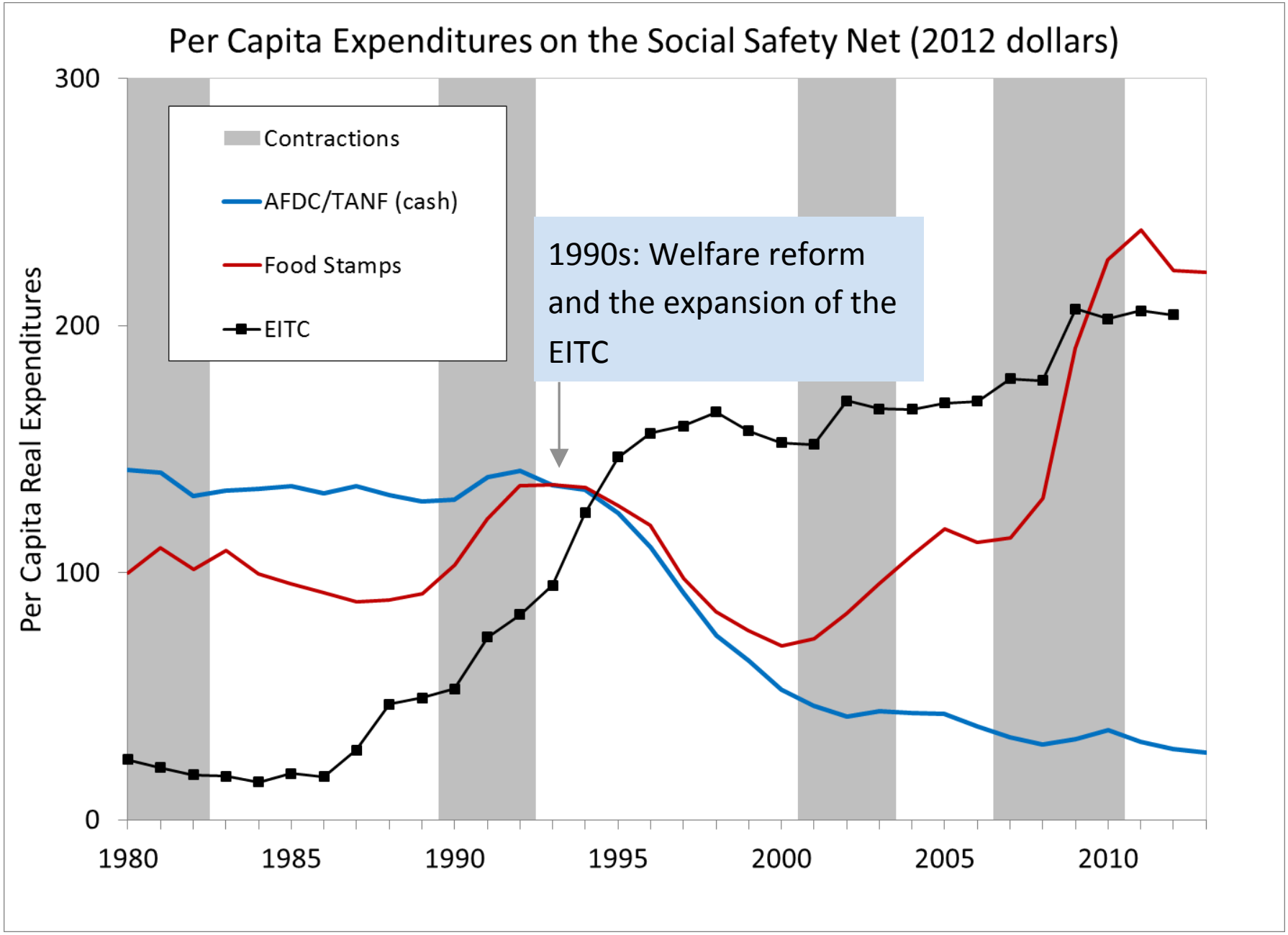
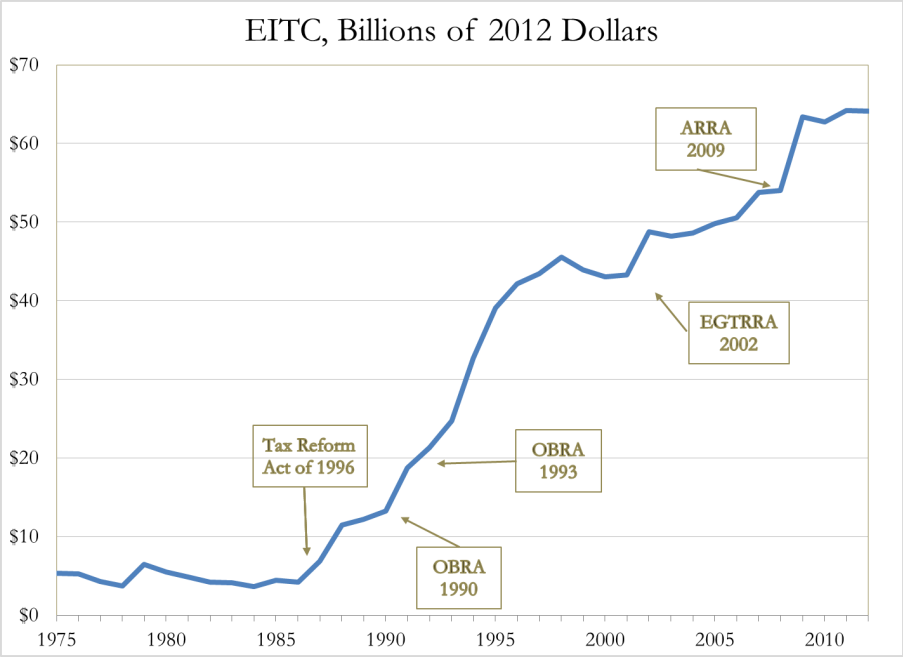
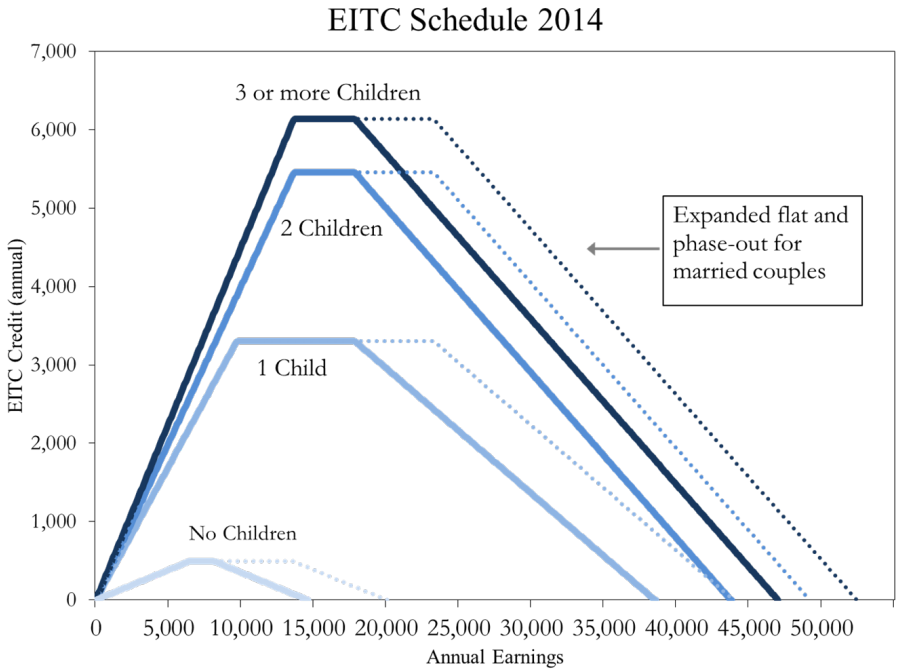


Source: Bitler and Hoynes "The More Things Change, the More They Stay the Same? The Safety Net and Poverty in the Great Recession," forthcoming *Journal of Labor Economics*.

Earned Income Tax Credit

- In-work, tax based assistance
- Refundable tax credit for low income families
- Credit varies by number of children (small credit for childless), earnings (and AGI)





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EITC in the broader (European) policy context

- Over the past decades many other countries have adopted EITC-type in work credit
- However, not all are created alike -- the design of an in-work credit will reflect a country's value on the tradeoffs between universality, work incentives and income supplementation
- More targeted (high withdrawal, high credit) [US, IRL, UK, BEL, NZ]
- Low withdrawal, low credit [CAN, FR, ESP]
- Low withdrawal, higher credit [DEN, SWE, NLD]

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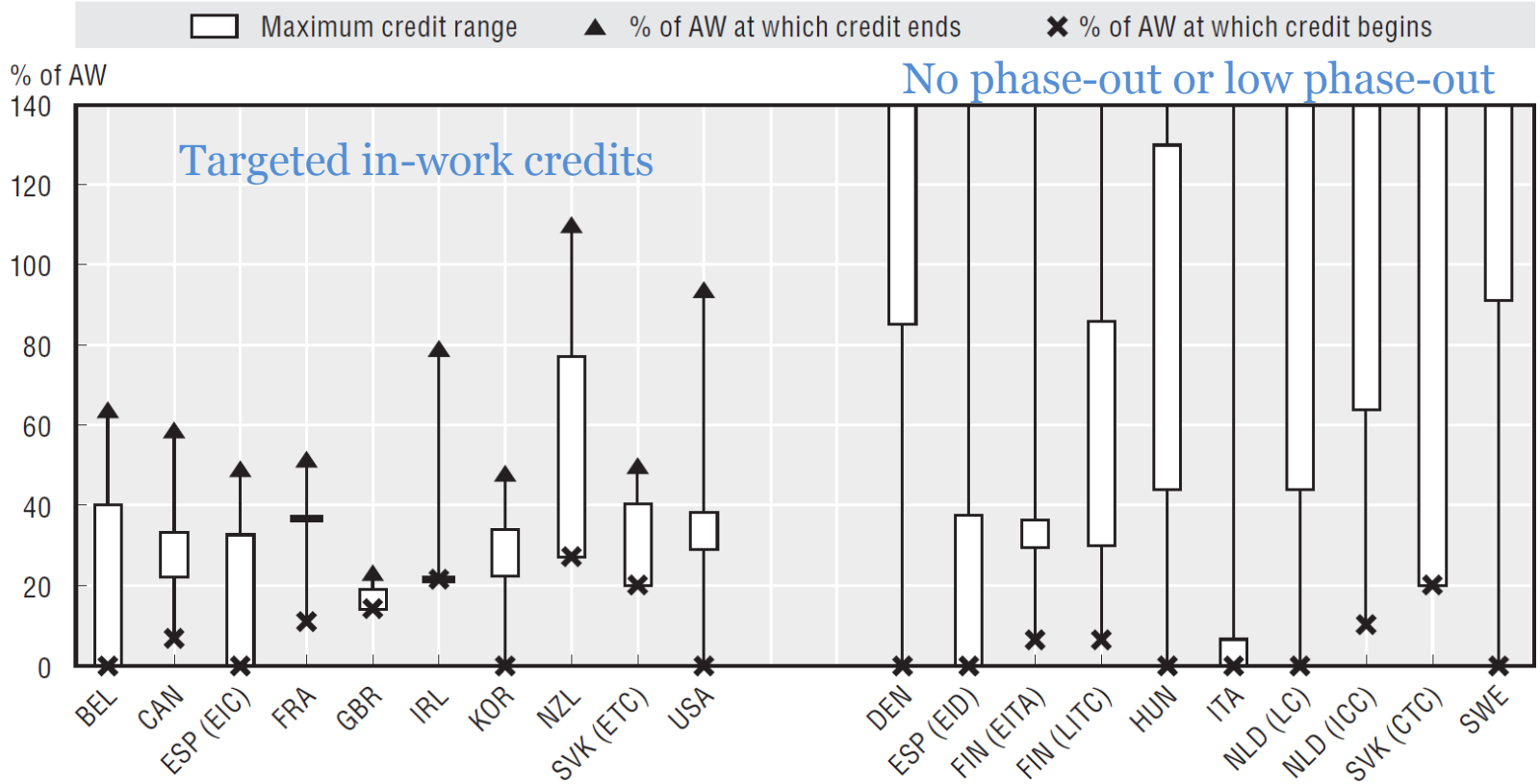
Figure 2.7. **Targeting of in-work credits in OECD countries (for single parent with two children), 2010**[1]



1. EIC: Earned Income Credit; ETC: Employee Tax Credit; EID: Earned Income Deduction; EITA: Earned Income Tax Allowance; LITC: Labour Income Tax Credit; LC: Labour Credit; ICC: Income Dependent Combination Credit; CTC: Child Tax Credit.

Source: OECD (2011), *Taxation and Employment*, OECD Tax Policy Studies, No. 21,

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3. How does the EITC affect family well-being?

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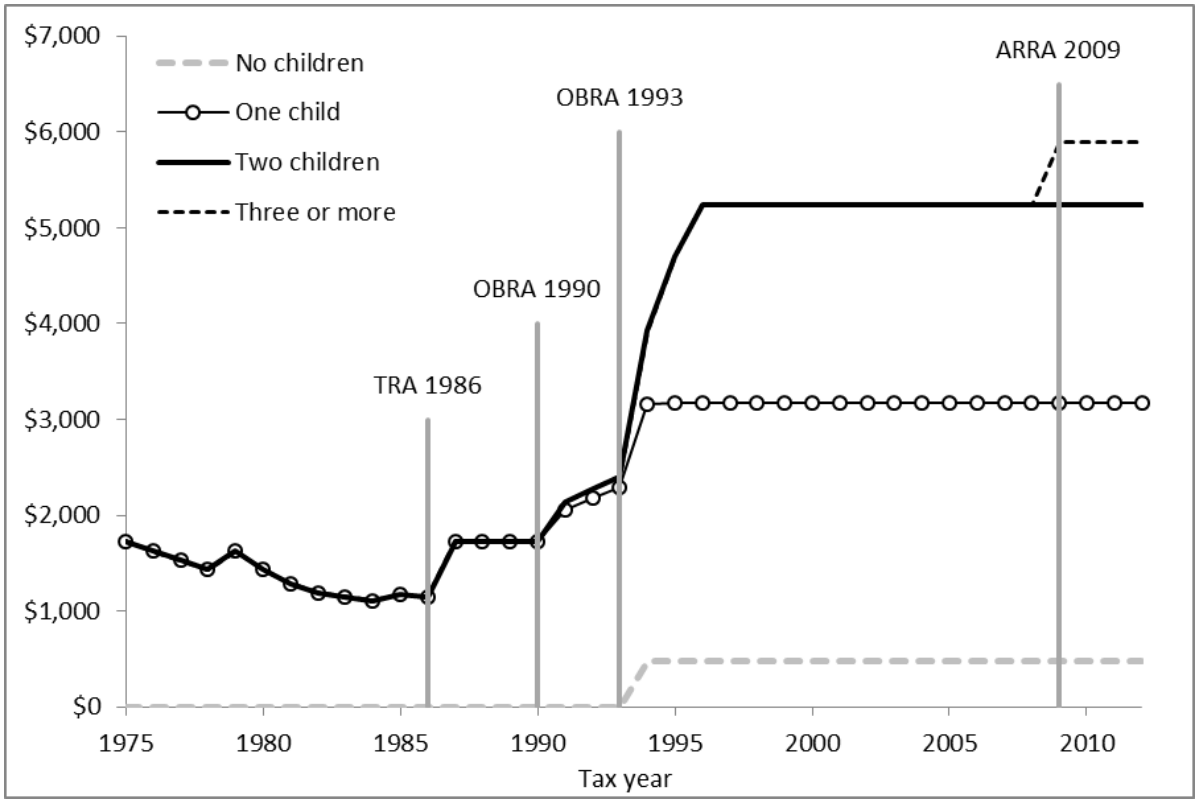
Much of the research takes advantage of the large changes in the generosity of the EITC by family size, particularly as part of the 1993 expansion of the EITC

Maximum EITC by number of children (2012 $)



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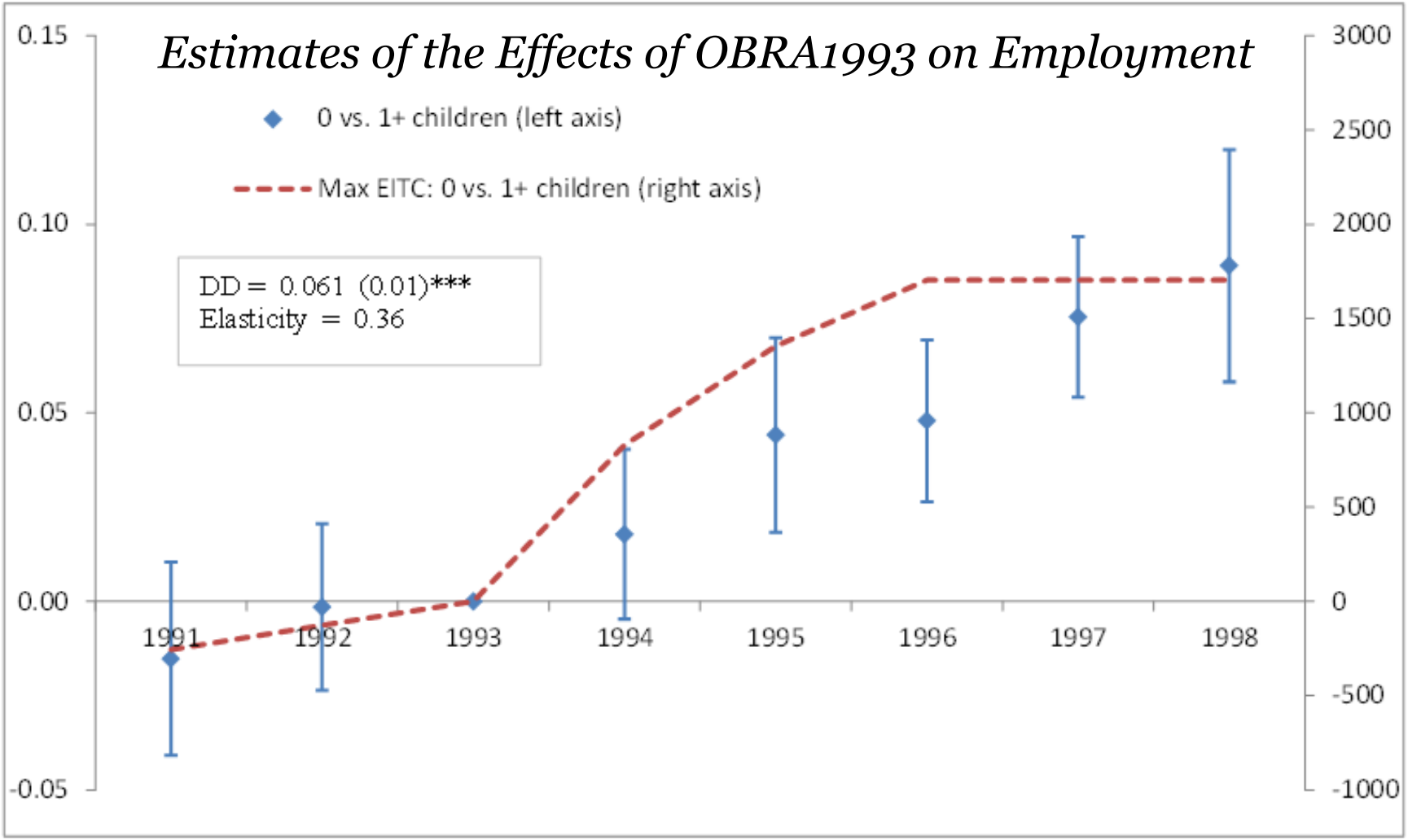
FINDING 1: A more generous EITC leads to substantial increases in employment



Source: Hoynes and Patel (2015). "Effective Policy for Reducing Inequality? The Earned Income Tax Credit and the Distribution of Income"

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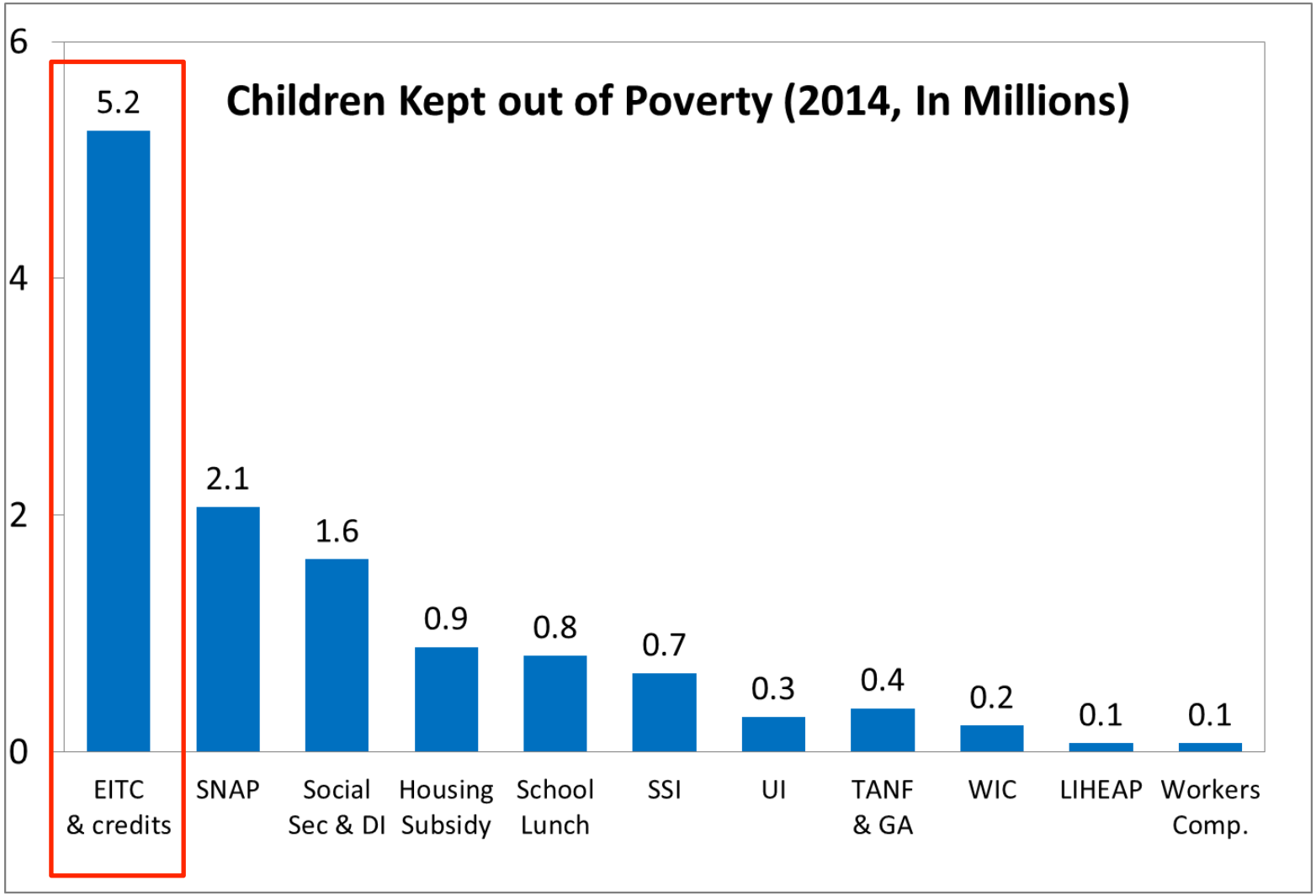
FINDING 2: The EITC is the largest anti-poverty program for children



Source: Calculations based on *Supplemental Poverty Measure, 2014* (Kathleen Short), U.S. Department of Census, Current Population Report P60-254.

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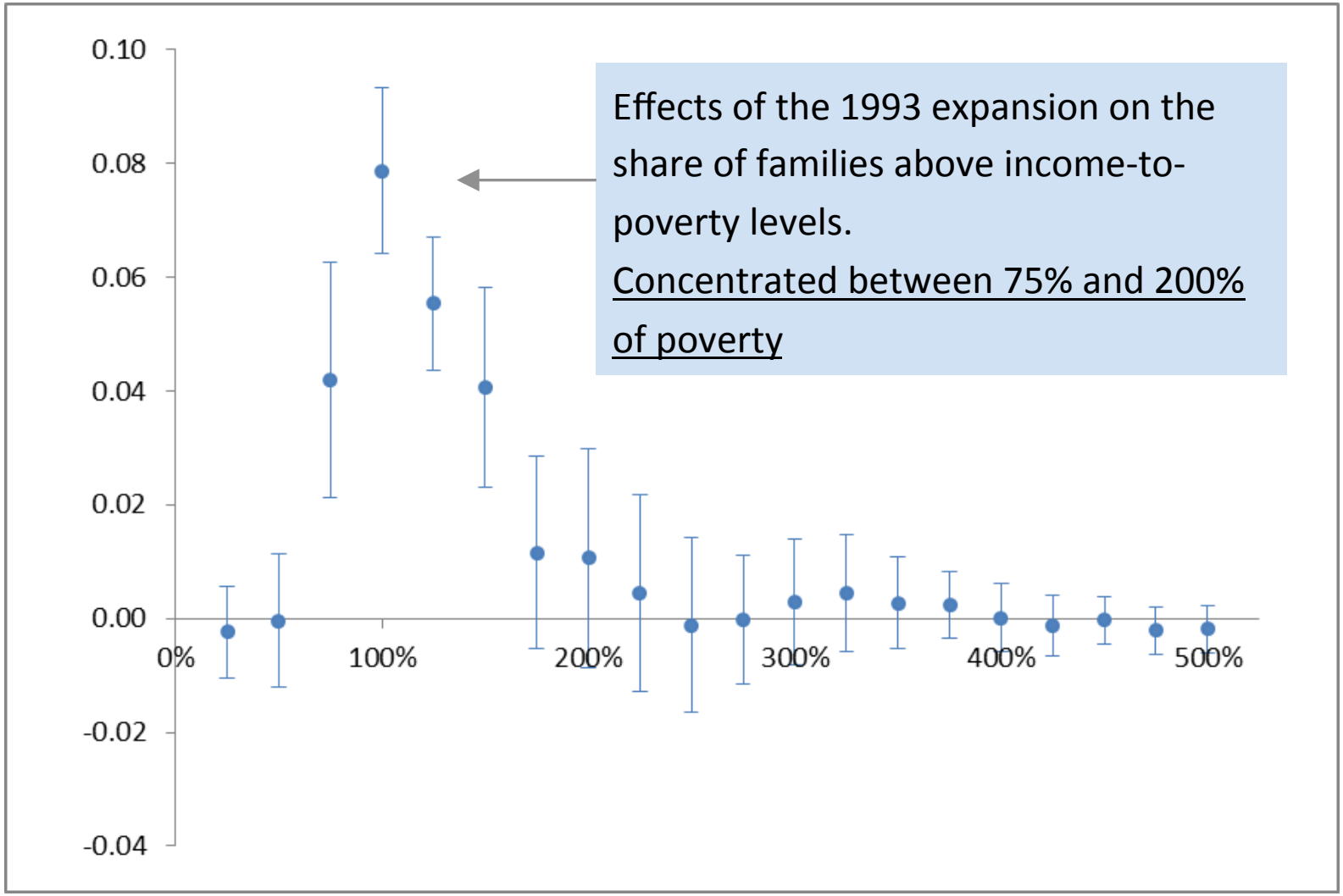
The effects of the EITC on the distribution of income



Source: Hoynes and Patel (2015). "Effective Policy for Reducing Inequality? The Earned Income Tax Credit and the Distribution of Income"

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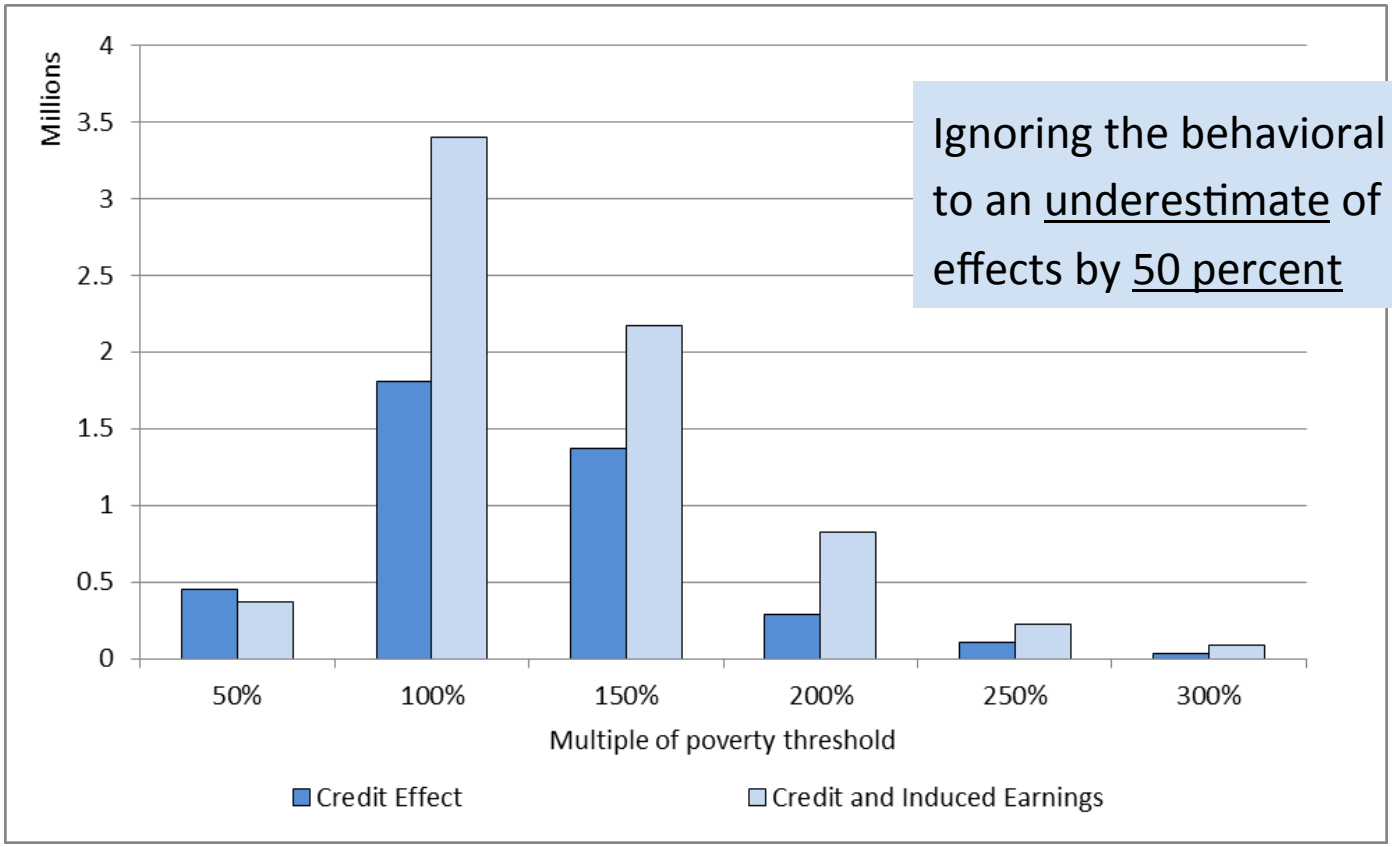
The anti-poverty effects are even higher when you take into account the *credit effect* and *induced earnings* effect



Ignoring the behavioral response leads to an <u>underestimate</u> of the anti-poverty effects by <u>50 percent</u>

Source: Hoynes and Patel (2015). "Effective Policy for Reducing Inequality? The Earned Income Tax Credit and the Distribution of Income"

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FINDING 3: The increased income leads to improvements in family wellbeing

- The EITC leads to an improvement in maternal and infant health (Evans and Garthwaite 2011, Hoynes et al 2015)
- The EITC leads to improvement in educational outcomes (Dahl and Lochner 2011, Michelmore 2013, Manoli and Turner 2014)

4. Holes in the Safety Net

- *In-work safety nets do not work well if in times of no work;* evidence from the Great Recession (Bitler and Hoynes 2015, Bitler, Hoynes and Kuka 2015)
- *The U.S. lacks an adequate safety net for extreme poverty* (SNAP and disability)
- *Limits to in-work subsidies?* Some evidence that part of the benefit of the subsidy is captured by employers (in lower wages). Strengthening the minimum wage can help counter this incidence pathway.

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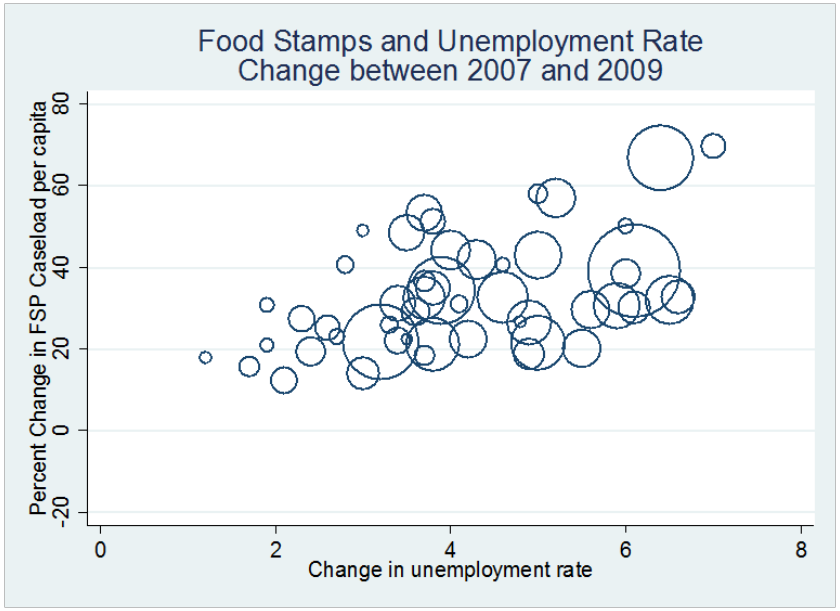
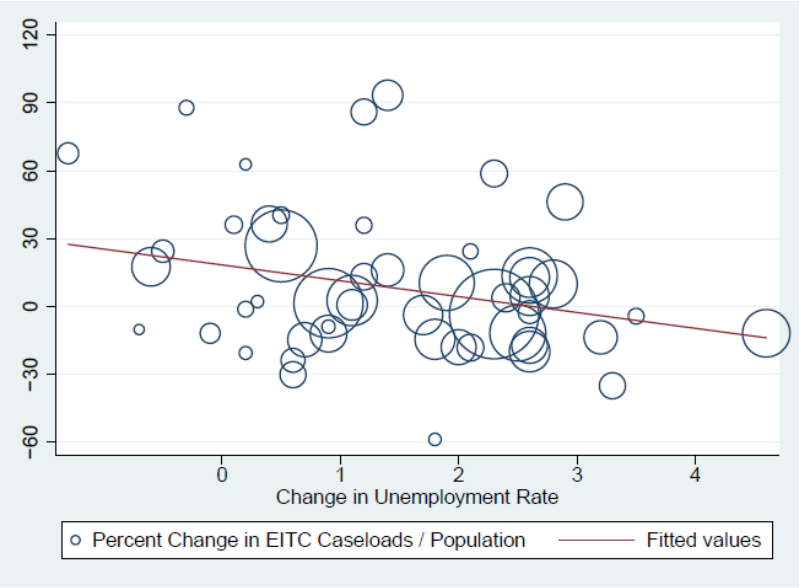
Changes in spending, by state change in UR, in the Great Recession

SNAP (Food Stamps)



EITC (single parents)



- SNAP expanded with need in the Great Recession. For the largest group of EITC recipients (single parents) the program is pro-cyclical

Source: Bitler, Hoynes and Kuka "Do In-Work Tax Credits Serve as a Safety Net?" forthcoming *Journal of Human Resources*, Bitler and Hoynes *Brookings Papers on Economic Activity* 2010.

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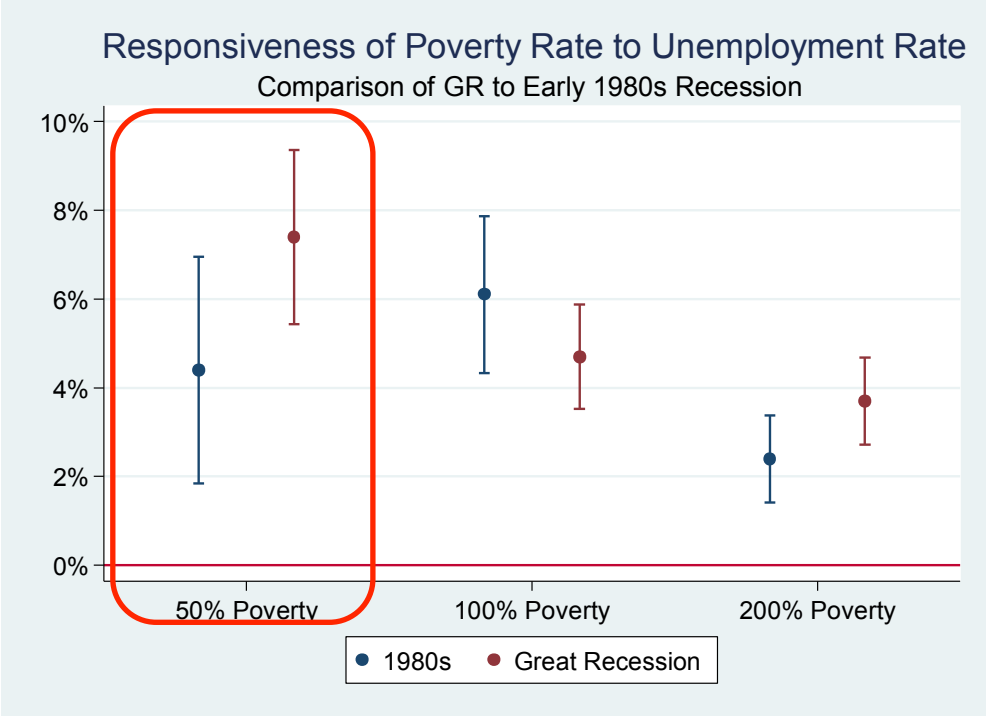

- The share of families falling below 50% poverty (*extreme poverty*) was <u>more affected</u> in the Great Recession that we would have predicted from prior cycles
- Most likely explanation → welfare reform and the loss of the "out of work" safety net

Source: Bitler and Hoynes "The More Things Change, the More They Stay the Same? The Safety Net and Poverty in the Great Recession," forthcoming *Journal of Labor Economics*; Bitler and Hoynes *AER Papers and Proceedings* 2015.

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Summary

- The U.S. social safety net for lower income families is now primary an in-work safety net
- The EITC is the largest anti-poverty program for children in the U.S. and leads to higher employment levels for single parents
- Looking forward we need to think about how to strengthen support when “in-work” isn’t possible

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