

## 2.8 The earned income tax credit (EITC)<sup>1</sup>

The federal "earned income tax credit" (EITC) is a wage subsidy program that began modestly in 1975, but which has increased in recent years to be the largest cash-transfer program available for non-elderly low-income families in the federal income tax system.<sup>2</sup> The credit seeks to encourage labor force participation by "making work pay" for potential low-wage workers.

*Why is this important?* As traditional "welfare" continues to be reformed away from its previous entitlement emphasis and towards providing work incentives, other non-traditional support mechanisms may become relatively more important to the overall economic condition of low-income job seekers. It is important to know how these other mechanisms interrelate with traditional supports to produce the present climate of motivations and rewards within which the workforce system operates, and how they potentially affect ROI.

The EITC program has increased in generosity over time, with the maximum benefit rising from \$400 in 1975 to \$4,204 in 2003, for a family with two children. The size of the benefit varies by the number of children, but the benefits are small for families without children. The program also plays a significant role in reducing poverty and creates significant work incentives for many low-wage workers. Maryland supplements the EITC by 50%, so that a family receiving a federal earned income tax credit of \$4,000 would receive an additional \$2,000 from the state.

The structure of the EITC is straightforward. In 2003, for a family with two children, the first \$10,000 of earnings entitles the family to a refundable tax credit of 40% of earnings, for a maximum credit of \$4,204. The credit remains at \$4,204 until earnings reach \$14,700. The credit is then reduced by 21% of all earnings above \$14,700, until the credit is phased out entirely at earnings of \$34,692. The Maryland credit is then one half of the federal credit. The EITC is also "refundable," meaning that tax filers who owe no income taxes at all are still entitled to receive the credit in the form of a check from the government, and those who do have some federal income tax liability of lesser value than the credit itself, can still receive the difference as a refund. Poor families can also receive the credit spread over the entire year rather than waiting for up to 16 months until the following April when they file their tax return.

The EITC has no direct effect on the number of jobs available in the economy. Instead, it can create employment by filling openings with individuals induced to work by EITC who would have remained out of the labor force in the absence of the EITC. Most studies have shown that the EITC has increased labor force participation by poor single heads of households by several percentage points. It also provides substantial financial support for the working poor, and effectively raises the wage rate for the poor: for example, a low-skill worker who can earn \$8.00 per hour without the EITC, will earn \$12.80 per hour in Maryland. The EITC thus not only provides an incentive to work, it also helps alleviate poverty. In addition to increasing labor force participation among the poor, the EITC helps provide income to poor children, and the program is extremely popular across the political spectrum.<sup>3 4</sup>

<sup>1</sup> This section contributed by Dr. Burt Barnow, of the Johns Hopkins University Institute for Policy Studies.

<sup>2</sup> "The Earned Income Tax Credit and the Labor Supply of Married Couples", Eissa, Nada, and Hilary Williamson Hoynes, 1998, unpublished manuscript, Berkeley, Calif.: University of California.

<sup>3</sup> "New Research Findings on the Effect of the Earned Income Tax Credit," Greenstein, Robert, and Isaac Shapiro, 1998, Washington, D.C.: Center on Budget and Policy Priorities.

<sup>4</sup> In addition to its labor supply impacts, Greenstein and Shapiro note that "the EITC lifts substantially more children

The research literature on the EITC<sup>5</sup> indicates that its only negative attributes are that it may encourage slightly less work by poor two-parent families, by some married couples, and by some single parents. In addition, the refundable nature of the credit creates potential for fraud in application for EITC benefits.<sup>6</sup> Finally, it is important to recognize that, unlike public service jobs, EITC cannot create new jobs, since it does not create or directly impact tax liability for employers. Thus, it is not an appropriate tool to use if the underlying problem is too little aggregate demand.

### ***What have we learned from this section and what recommendations do its findings support?***

The EITC is an important policy for the board to be aware of for several reasons.

1. The presence of the federal and state EITC means that jobs pay better than may be apparent. A job that pays \$6.00 per hour is actually worth \$9.60 for the worker. Although the workforce system strives to place customers in high-paying jobs, a lack of skills or lack of opportunities may make low-paying jobs inevitable in some cases, and for these the EITC means that these jobs will provide the worker more than just the low wage offered by the employer.
2. The EITC improves the cost effectiveness of training investments for the most disadvantaged workers who are placed. With an effective wage subsidy of up to 60%, the EITC means that the dollars of real gain by the trainee (i.e. direct wage + EITC) per \$1 invested in training is increased for all qualifying workers and, because of the way the EITC is structured, that cost effectiveness for trainees is increased most for the most disadvantaged workers.
3. The effect of EITC can be, for some clients, the *opposite* on the ROI from the point of view of the *taxpayer funding the training services*. Trainees who did not earn before training also could not receive EITC then, but if training later helped them obtain a low wage job at an income level qualifying for EITC, then the public account could also be paying out more dollars in EITC while it takes in more dollars in trainee income tax, as a result of training. In practice, the estimated total value of EITC received by the 216 trainees in the training sample study was \$152,800 in aggregate in the year prior to training, but \$85,500 in the year after training. Meanwhile, the aggregate income tax paid by that group rose from \$35,500 in the year before training to \$111,100 in the year after. Hence, the perverse effect on the taxpayer ROI, while possible for individual cases, does not seem significant across larger cohorts of the type in this study.

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out of poverty than any other government program or category of programs.”

<sup>5</sup> See for example: Dickert, Stacy, Scott Houser, and John Karl Scholz (1995) "The Earned Income Tax Credit and Transfer Programs: A Study of Labor Market and Program Participation", *Tax Policy and the Economy* v9; Eissa, Nada, and Jeffrey B. Liebman (1996) "Labor Supply Response to the Earned Income Tax Credit," *Quarterly Journal of Economics*, CXI (2); Meyer, Bruce D., and Dan T. Rosenbaum (1998) "Welfare, the Earned Income Tax Credit, and the Labor Supply of Single Mothers," Unpublished manuscript, Evanston, Ill.: Northwestern University; Hotz, V. Joseph and John Karl Scholz (2001) "The Earned Income Tax Credit," Cambridge, MA: National Bureau of Economic Research, Working Paper #8078.

<sup>6</sup> Greenstein and Shapiro (1998) acknowledge that the error rates associated with EITC are a concern, but they conclude that recent legislative and administrative actions have led to reductions in the error rate and should lead to further reductions.

## 2.9 The “Skills-based Training for Employment Promotion” (STEP) program<sup>7</sup>

A key workforce development strategy, Baltimore's Skills-based Training for Employment Promotion (STEP) initiative, addresses the needs of both employers and workers. The program, managed by the Mayor's Office of Employment Development for the Baltimore Workforce Investment Board, is funded by three grants received from the Governor's Workforce Investment Board (GWIB).

STEP assists businesses in training proven low-wage employees (all of them working parents) for difficult-to-fill, higher-wage, higher-skill positions. Specifically, the program supports Baltimore area hospitals in transitioning individuals (who may be working for them as housekeepers, security staff or dietary aides) into allied health positions for which there are often worker shortages (e.g., surgical technicians, pharmacy technicians, medical coders and nursing extender occupations). The program benefits workers by promoting skill and career development and wage progression.

Participating employers provide 50% of the cost of training and allow workers to receive training during part of their paid workday. The STEP program training partner, Baltimore City Community College, conducts the training. As a part of STEP, the hospitals agree to promote participants to new positions within six months of completing training and to provide health benefits upon promotion.

Entering its third year, STEP has grown from four to six participating hospitals and has graduated 92 individuals. The program has been highly successful, with 98% of graduates working in the positions they trained for, and with graduates achieving an average annual salary increase of \$6,000. Prior to STEP, many participants had to work two or more jobs to support their families. The average cost of training per person is \$4,166, including costs related to administration and services. For those who have been promoted, Maryland should see approximately \$27,000 in additional revenue from state taxes in the first year following program completion.

In addition to its benefits for workers and businesses, the program is noteworthy for its focus on wage progression and career development as a means to strengthen families and communities, and for bringing together competing hospitals to develop agreed-upon curricula and standards. For its achievements, STEP (the full statewide initiative) was selected as one of ten finalists (out of 270 entrants) in the national 2003 Career Advancement Strategy Competition. This competition was conducted by Jobs for the Future, with support from the U.S. Department of Labor, to accelerate the development and expansion of approaches that advance lower-skilled individuals into better paying jobs while at the same time meeting the needs of employers.

## 2.10 Youth

To be successful, a local workforce system must anticipate the future workforce needs of business, and must support the preparation of future workers and facilitate their connection to employment opportunities. To achieve this, the Baltimore Workforce Investment Board Youth Council:

- oversees the expenditure of Workforce Investment Act (WIA) youth funding;
- assists the BWIB in developing and recommending local youth employment and training policy and practice;
- establishes linkages with other organizations serving youth;

<sup>7</sup> Sections 2.9 and 2.10 contributed by Diana Spencer of the Baltimore Mayor's Office of Employment Development.

- evaluates issues that impact youth success in the labor market, and
- works to increase awareness of youth development issues.

The Youth Council works to promote the following outcomes to activities:

- that youth will be academically successful;
- that they will obtain employment, that they will have post-placement job retention;
- that youth will achieve progressive increases in earned income;
- that youth will be prepared to live independently and become economically self-sufficient.

The Council comprises a diverse cross-section of Baltimore's community leaders, youth service providers, public and private businesses, educators, nonprofit organizations, organized labor, youth and parents. Because of its size and diversity, this Council is able to coordinate a system of public and private services, and to encourage communication, cross-referrals, resource sharing, and reduced duplication of services. The Council has also established fruitful partnerships with many organizations involved in career development for youth. This list includes, but is not limited to, Black Professional Men, Civic Works, Job Corps, People Encouraging People, Park Heights Community Health Center, Sylvan Career Starters, Johns Hopkins Hospital, and Baltimore City Community College. The BWIB Youth Council's involvement and influence extends to citywide youth development initiatives such as Baltimore Rising (the Mayor's initiative that uses faith-motivated mentors and intensive monitoring to reduce youth violence), Operation Safe Kids (a multi-agency public health intervention for youth at risk of being perpetrators or victims of violent crime), and the development of a citywide guide to youth programs and services (produced for the first time in summer 2003).

With guidance from the Youth Council, the Mayor's Office of Employment Development (MOED) targets federal workforce funds (both from the WIA and the Youth Opportunities Grant) and other public and private dollars toward career development activities for youth. These activities are provided through a comprehensive service-delivery system for youth from ages 14 to 21. This system is designed to promote high school (or GED) completion, career exploration, skills training and personal development.

Recognizing the importance of youth issues, the full Baltimore Workforce Investment Board (BWIB) has identified building linkages with Baltimore City public schools as one of its three key priorities and has established a task force to address this issue. Through this task force, the BWIB promotes the school-to-career transition for youth by building linkages with the Baltimore City Public School System's neighborhood high school reform efforts. The school-to-career transition is facilitated by support for the creation of school/business partnerships, internships and work opportunities for students and faculty. BWIB members are also looking to support industry advisory councils, sponsor a new innovation high school (focused on college and career exploration and readiness), and promote school system emphasis on retention, computer literacy, job preparedness, and alignment with industry needs.

### **Youth Centers**

The foundation of Baltimore's workforce development system for youth is a network of seven comprehensive, neighborhood-based youth centers offering educational, career, recreational, health, and personal growth/mentoring activities. Five of these centers are funded by a federal Youth Opportunity grant for youth living in Baltimore's Empowerment Zone communities (economically and socially-disadvantaged neighborhoods federally designated for special support). The other two centers are funded through the federal Workforce Investment Act.

Since Baltimore first received a Youth Opportunity grant (in February 2000), more than 3,500

Empowerment Zone residents, ages 14 to 21, have become YO! Members. Of those members:

- 335 have earned high school diplomas;
- 107 have earned GEDs;
- 199 are enrolled in college;
- 527 have earned career credentials; and
- 1,270 have been placed in employment, college or skills training.

The two centers with WIA funding, Malcolm X Youth Center and South Baltimore Career Center, extend the model of Youth Opportunity centers into northwest and south Baltimore. While the two centers both offer an array of career and youth development services, the South Baltimore Career Center specializes in offering training and connecting youth to employer-funded internships and entry-level jobs in food services/hospitality, data entry, office management, retail skills, customer service and telemarketing.

### **Summer work experiences**

Administered by MOED, YouthWorks is Mayor O'Malley's summer jobs program for Baltimore residents aged 14 to 21. YouthWorks offers its participants the opportunity to gain public and private sector work experience and learn more about careers. In 2003, almost \$5 million was raised and employment opportunities were identified or created for 5,500 Baltimore youth. YouthWorks also benefits employers by offering them access to an enthusiastic labor pool and a chance to help shape Baltimore's future workforce. Annual surveys and large numbers of repeat employers reveal high rates of employer satisfaction.

### **Dropout prevention**

The BWIB's youth development system aims to prevent students from dropping out of school through the FUTURES program, operated by MOED in partnership with the Baltimore City Public School System and the Youth Opportunity initiative. FUTURES supports students in attending school regularly and graduating from high school ready to pursue careers and/or further education/training. Located in five public schools, FUTURES targets students who have been deemed "at-risk" of dropping out. The program supports young people continuously from the summer before they begin ninth grade until one year after graduation. FUTURES services include academic classes, computer assisted instruction, counseling and advocacy, work readiness and career exploration activities, and cultural enrichment experiences. Each FUTURES student is assigned to a program advocate who can provide individualized attention and guidance. Through FUTURES Works, supported by corporate partner PepsiCo, students participate in career fairs, workshops, company tours and job readiness training.

From January through October 2003, nearly 430 students participated in FUTURES. Since 1986, FUTURES students have achieved a dropout rate about half that of other students at their schools. More than 75% of FUTURES students become employed or go to college right after graduation. In FY 2003, FUTURES served 1,299 individuals, and since its inception, the program has served more than 4,000 young people.

### **Reconnecting with out-of-school youth**

For youth who have left school without earning high school diplomas, the WIA-funded Baltimore City Career Academy (managed by MOED) serves as an alternative learning center, offering out-of-school youth aged 16 to 21 opportunities to earn GEDs, high school diplomas, college experiences and work skills. Programs (operated in collaboration with Civic Works and

Woodstock Job Corps), offer both academic instruction and occupational skills training. One of the Career Academy's newest programs, Diploma Plus, allows youth the opportunity to earn a Maryland State High School Diploma, rather than a GED, along with some college credits and internship experiences. More than 80% of the young adults enrolled at the Career Academy complete with a GED or a job or attend college.

**Other WIA supported youth activities**

WIA funds, coordinated by the BWIB Youth Council, also support the Delta Youth Education/Employment Program (which assists out of school youth in accessing academic and career-specific services) and the Youth Empowerment Program (based at Baltimore City Community College and offering training in information technology, health care and hospitality-related careers).