

DISCUSSION PAPER 2007-14

DECEMBER 2007

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Employment-Based Tax Credits for Low-Skilled Workers

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Employment-Based Tax Credits for Low-Skilled Workers

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THE BROOKINGS INSTITUTION

DECEMBER 2007

Abstract

Families in low-income communities face three interrelated problems: unemployment rates are high, incarceration rates of low-skilled men are high, and a large fraction of children in low-income communities are being raised in single-parent households. To address these interrelated problems, I propose a two-part policy designed to increase the return to work. The first part of my proposal is an expanded earned income tax credit that would apply to low-income, childless taxpayers. The second part of my proposal is a targeted wage subsidy for low-wage workers who live in certain economically depressed areas, whereby the federal government would pay subsidies of 50 percent of the *difference* between the worker's market wage and a target wage of \$11.30 per hour. The premise for adopting these policies is straightforward: increasing the return to work for childless low-skilled workers will lower unemployment rates and achieve the dual social benefits of reducing incarceration rates and increasing marriage rates, thus reducing the number of children being raised in single-parent households. The proposal would redistribute \$10.4 billion to poor, working individuals. Based on empirical estimates from the literature, I expect employment to increase by 850,000 jobs and crime to fall by over one million incidents. Conservative estimates of the social cost of crime indicate that the social benefit from reduced crime could cover 8 percent or more of the cost of the proposal. Many estimates of the cost of crime would claim much larger cost saving. The proposal would also increase marriage and improve the environments in which poor children are raised.

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1. The Challenges Faced by Low-Skilled Workers

Families in low-income communities face three interrelated problems: unemployment rates are high, incarceration rates of low-skilled men are high, and a large fraction of children in low-income communities are being raised in single-parent households. I claim no particular originality in suggesting that these three issues are intertwined. Richard Freeman (1996) writes, “How to improve the job market for less skilled young American men, and reverse the huge decline in their earnings and employment opportunities, is *the problem* [emphasis in original] of our times, with implications both for crime and many other social ills” (41). The premise of the two-part proposal in this paper is straightforward: increasing the return to work for childless low-skilled workers will lower unemployment rates and achieve the dual social benefits of reducing incarceration rates and increasing marriage rates, thus reducing the number of children being raised in single-parent households.

Journalistic accounts give a stark perspective on the problem. Katherine Boo (2001, 2003) and Jason DeParle (2004) note the striking divergence of employment rates between low-skilled (non-college-educated) black women and men in the late 1990s. Among black women, employment rates are higher than the rates of white or Latino women. Among black men, employment rates are 30 percentage points below the rates of white or Latino men. Boo and DeParle describe the extraordinary pressure that these employment rates place on children and families. Males, with only a handful of exceptions in these articles, are involved with drugs, violent crime, and failing to provide income, parenting, bonding, and discipline to the children they father. The children that Boo and DeParle discuss yearn for father figures; readers cannot help but wonder how different life might be for the mothers featured in the pieces, if they had the resources, emotional help, and coparenting that an adult partner could provide.

There are many places to find statistics that help give perspectives to the problems addressed here. For much of what is presented below, I draw on data from the Survey of Income and Program Participation (SIPP). The SIPP is an ongoing nationally representative survey conducted by the U.S. Census Bureau that is uniquely capable of capturing intra-year variation in economic and demographic characteristics. Much of the data below come from the 2001 wave of the SIPP, which provides monthly information on respondents from 2001 into 2004. I frequently focus on 2003, which was the last available calendar year of SIPP data at the time this project was being conducted.

Table 1 presents some background about the low-skilled labor market, using level of education as an approximate measure of skill, and focusing on those between the ages of 18 and 40 who are not full-time students. The four panels of the table show the labor market situation for men and women in 1990 and 2003. In 2003, 14.7 percent of men between the ages 18 to 40 did not have a high school diploma. Of this group, 73.5 percent held jobs, with an average hourly wage of \$13.10 (in 2007 dollars). Another 33.3 percent of the men in this age bracket completed their education with a high school diploma. The share of this group with employment was 84.5 percent. Of those employed, their average wage was \$15.04 per hour. As Table 1 shows, these employment rates and hourly wages are considerably lower than those of men and women with higher levels of education.

The longer-run trends are disturbing. Comparing 1990 and 2003 in Table 1, the share of low-skilled workers with a high school education or less who held jobs fell 3 to 4 percentage points. The employment rates for low-skilled black men during this time, however, fell by 9 percentage points for both high school dropouts and high school graduates. Longer-run trends show even greater labor market

deterioration for low-skilled workers (Juhn 1992). Between 1967 and 1987, for example, participation in the labor market in a given week fell 14.4 percentage points for high school dropouts and 7.5 points for high school graduates, compared with only 2.9 points for college graduates. For black high school dropouts, weekly labor market participation fell 20.2 percentage points. The reductions in labor force attachment are even larger for younger men, who by definition have less prior labor market experience. Wages for this group have stagnated as well. Table 1 shows that inflation-adjusted hourly wages for men with less than a high school diploma rose only 7.5 percent from 1990 to 2003; inflation-adjusted wages for men with a high school diploma did even worse than that, actually declining 2.6 percent from 1990 to 2003.

As rates of employment for low-skilled workers have been falling, incarceration rates for men have been rising. In 2001, 4.9 percent of all adult males had spent time in a state or federal prison, compared to 2.3 percent in 1974. In 2001, 16.6 percent of black men had spent time in a prison. Statistics are even more extreme for black men who have low levels of education. Among non-college-educated black men who were born between 1965 and 1969, about 30 percent had been incarcerated by 1999; among those in this cohort without high school diplomas, the proportion is almost 60 percent (U.S. Department of Justice 2003; Pettit and Western 2004).

Marriage rates are also relatively low—and falling—for low-skilled men. As Table 1 shows, 47.4 percent of men aged 18–40 without a high school diploma were married in 1990, declining to 44.8 percent by 2003. Similarly, 51.1 percent of men in this age bracket with a high school diploma were married in 1990, falling to 47.0 percent by 2003. This pattern is not surprising: ethnographic work often suggests that poor women cite “having a good job” as being among the most important characteristics of a man they would consider marrying (for example, Edin and Lein 1997). The fraction of children living in households with two married parents has declined substantially. In 1970, 85 percent of children lived

with two married parents. By 2006, the corresponding figure was only 67 percent (Child Trends Data Bank 2007).

Children growing up in single-parent households have worse outcomes than children growing up in two-parent households. They are substantially more likely to drop out of high school, father or bear a child before age 20, be unemployed, and commit crimes. There are many theories why this is so, all of which presumably have some elements of truth. A second adult in the home can provide a second income, a second set of hands, emotional bonding with the children, discipline, and a network of connections.

To address the interrelated problems of unemployment, incarceration, and single-parent households, I propose a two-part policy designed to increase the return to work. The first part of my proposal is an expanded earned income tax credit (EITC) that would apply to low-income, childless taxpayers. The current EITC is a provision of the tax code (explained in greater detail below) that subsidizes the earnings of low-income workers, but that currently focuses on couples and singles living with their children. The second part of my proposal is a targeted wage subsidy for low-wage workers who live in certain economically depressed areas, whereby the federal government would pay subsidies of 50 percent of the *difference* between the worker’s market wage and a target wage of \$11.30 per hour. Thus, a worker in one of these geographic areas who takes a job that pays \$8 per hour would end up being paid \$9.65 per hour under this program. I propose restricting the scope of the targeted wage subsidy for two reasons. First, while similar proposals have been made for more than 40 years, they have not been implemented. Hence, by focusing on economically disadvantaged areas, I limit the cost and create a setting where the full effects of the policy can be evaluated. Second, concentrated disadvantages exacerbate crime, housing problems, and lack of access to retail establishments and employment. The proposal targets resources to geographic areas of greatest need.

Both parts of my proposal would raise the after-tax return to work for individuals in the targeted group, and thus increase incentives to work and subsequently reduce incentives to commit crimes. With greater labor market earnings, it also seems likely that marriage prospects will improve, leading to fewer children being raised in single-parent households. The two parts of my proposal could be implemented together or separately. The tax reform proposal of Ways and Means Committee Chairman Charles Rangel (H.R. 3970), for example, includes an expansion of the EITC for childless taxpayers that is similar to—though not as far-reaching as—what I propose here.

I estimate the combined cost of both parts of my proposal at \$10.4 billion. The average subsidy is \$770 for the expanded EITC and \$2,696 for the targeted wage subsidy. These payments would go to poor and near-poor individuals who work in the formal, paid labor market. I predict that, based on plausible estimates from the social science literature, these proposed programs would increase incomes, increase the number of employed low-skilled individuals by 850,000, reduce the rate of crime by over one million incidents, and have beneficial effects on marriage and child well-being.

My policy proposals would apply to both men and women. But the barriers to participation in the formal labor market for many low-skilled men are particularly large. A low-wage male worker who is the unmarried father of children, but who is not living with the mother and children, faces a situation where wages earned (in a formal job), beginning at a fairly low level, will be subject to both state and federal income taxes. Marginal tax rates (from state and local individual income taxes and payroll taxes)

range from 25 to 41 percent for childless low-income individuals who have annual incomes of \$10,000 to \$25,000. In contrast, the tax code contains certain provisions that benefit families with children, such as credits that offset taxes and exemptions of a certain amount of income, so that low-income families with children are effectively exempted from paying federal income tax on earnings.

Low-skilled men who have fathered a child outside of marriage also face child support obligations. (About 88 percent of noncustodial parents are fathers, so I sometimes use gender-specific language like “men” when referring to all noncustodial parents.) In Wisconsin, for example, child support obligations are 17 percent of a father’s income for the first child, 25 percent for the second, 29 percent for three children, and 34 percent for five or more children. If men fail to pay their child support obligations, they accumulate child support debt (commonly called *arrearages*), and their wages can be garnished. Child support experts Maria Cancian and Daniel Meyer at the University of Wisconsin–Madison suggest that no more than 30 percent of those in the child support–compliance system are fully compliant. The combination of payroll taxes, state and federal income taxes, and substantial child support obligations can make the economic return to participation in the formal labor market very low for many low-skilled men.

Thus, my proposal can be viewed as an attempt to provide low-skilled men with stronger incentives to enter and remain in the formal labor force. In the rest of this paper, I describe how these programs would operate, both in a practical administrative sense and in how they would alter incentives for low-skilled workers.

2. Expand the EITC Available to Childless Taxpayers

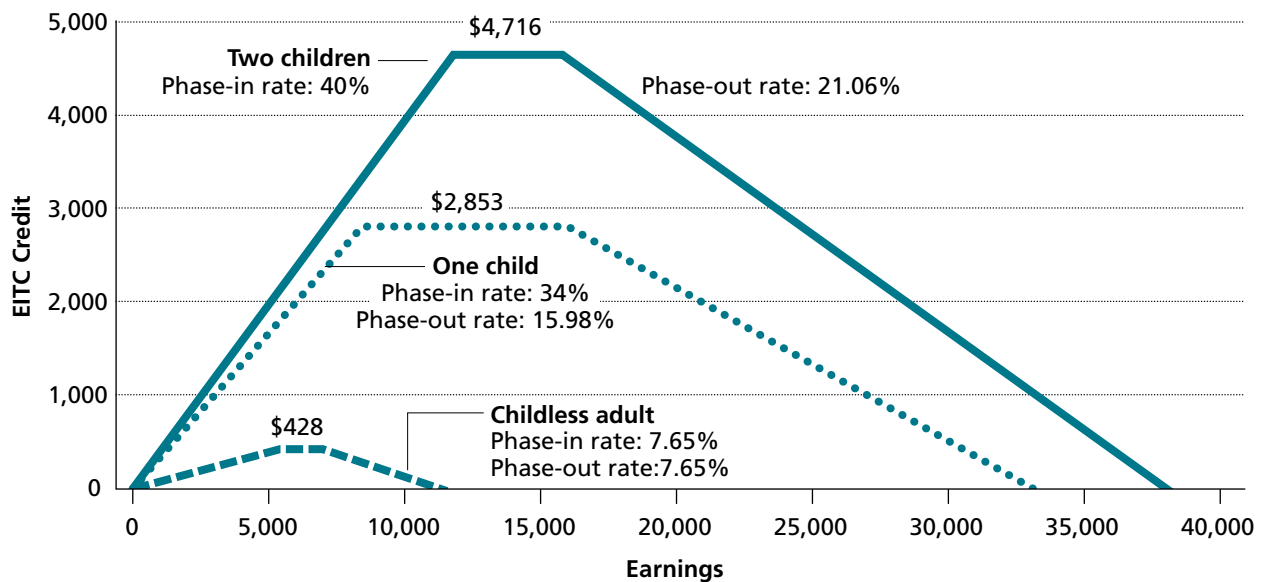
The first part of my proposal to raise the wages of low-skilled workers is modeled along the lines of the current EITC that is part of the federal income tax. My proposal is to expand the EITC available to childless taxpayers. It is similar to proposals by Greenstein (2000); Edelman, Holzer, and Offner (2006); Furman (2006); Berlin (2007); and Gitterman, Gorham, and Dorrance (2007). I will begin by explaining how the EITC works at present.

How the EITC Currently Works

In fiscal 2005, the EITC cost about \$45 billion (dollar amounts are in 2007 dollars), or about 1.7 percent of federal spending. It is the largest cash or near-cash antipoverty program in the U.S. budget. Figure 1 offers some detail on how the EITC works in 2007. It is useful to think of the EITC as consisting of three distinct ranges: the subsidy range,

the flat range, and the phase-out range. Consider a hypothetical household with two or more children: As the earnings of this family rose from zero to \$11,790, the EITC would make a payment to them equal to 40 percent of their earnings, up to a maximum credit of \$4,716. Taxpayers with earnings between \$11,790 and \$15,390 would continue to receive the maximum credit of \$4,716. The credit would then be phased out as earnings rose from \$15,390 to \$37,703 at a rate where each additional dollar earned reduced the EITC payment by 21.06 percent. The EITC is *refundable*, meaning that if the amount of the credit is greater than the taxes owed, the U.S. Treasury still sends a check to the taxpayer for the difference between the credit and other income tax obligations. Seventeen states and the District of Columbia also have earned income tax credits, though six of the state credits are not refundable.

FIGURE 1
Earned Income Tax Credit, by Family Size, 2007



Source: Tax Policy Center (2007).

Note: For married joint filers the phase-in and phase-out rates are \$2,000 larger than what is shown in the graph.

This same general structure for the EITC—subsidy range, flat range, and phase-out range—applies for families with one child and for families with no children. Families with one child receive an EITC of 34 percent of earnings up to \$8,390 in the subsidy range, at which point they would receive a maximum of \$2,853. The flat range of the EITC for single-child families extends from incomes of \$8,390 up to incomes of \$15,390, and then phases out at a rate of 15.98 percent, so that the phase-out range extends up to an income level of \$32,241.

Childless individuals—that is those individuals that do not have a child living with them for at least six months of the year—are eligible for the EITC as well, but the amount they can receive is quite small. The subsidy rate of the EITC for a childless person is 7.65 percent up to an income of \$5,590, so the maximum amount that can be received is \$428. The credit to childless taxpayers is completely phased out at an income of \$12,590. Moreover, the EITC for childless workers is not available to anyone under the age of 25. Of the total \$45 billion spent on the EITC in fiscal year 2005, only \$1.2 billion went to childless workers.

The EITC is well targeted to low-income families with children. Participation rates appear high, with most estimates suggesting that at least 80 percent of eligible taxpayers actually receive the credit (Scholz 1994; IRS 2002a).

Proposal for Expanding the EITC for Childless Workers

To understand the potential costs and effects of expanding the childless EITC, it is useful to start by examining in more detail what the present program does. The first column of Table 2, which is based on calculations using the calendar year 2003 SIPP data from the 2001 SIPP, shows that about 6.0 million workers were eligible for the childless EITC, of which 43.1 percent were unmarried men and 69.4 percent had a high school diploma or less. If every one of the 6.0 million eligible

taxpayers had actually filed and made the claim, then the childless EITC would have cost \$1.43 billion. However, the childless EITC actually cost \$1.2 billion in 2003 (again, in 2007 dollars). The difference between \$1.43 and \$1.2 billion, along with the fact that some taxpayers not eligible for the credit are receiving it, is consistent with participation among those eligible being well below 100 percent.

The childless EITC is tightly targeted to low-income taxpayers; the average hourly wage of recipients is \$9.70 the average annual income is \$7,358. Seventy-seven percent of the tax filers have incomes below the poverty line. One way to look at any anti-poverty program is to calculate what share of its benefits go toward lifting people who are below the poverty line up to the poverty line, and what share of its benefits go to lifting people who are above the poverty line to a higher level of income. The *poverty gap* is defined as the difference between market income and the poverty line; it identifies the amount of money that is needed to raise everyone up to the official poverty line, thus eliminating poverty. Table 2 shows that the poverty gap for those receiving the childless EITC is \$21.6 billion. (For simplicity, the poverty gap is calculated assuming that people's work behavior is not changed by the presence of the program.) For the childless EITC, 91 percent of the expenditures close the poverty gap, and only 9 percent of the benefits go to the working poor just above the poverty line. In comparison, 83.9 percent of Temporary Assistance to Needy Families (TANF) benefits, 69.1 percent of Supplemental Security Income benefits, 53.9 percent of EITC benefits, and 26.6 percent of workers' compensation benefits close the poverty gap (Scholz and Levine 2001).

However, this estimate of childless EITC targeting can be misleading. One of the ways that low-income families make ends meet is by co-residing with family members (such as when an adult child coresides with his or her parents), other families, or individuals. Consequently, I recalculated the poverty gap by looking at all family members under the same roof. In this case, the poverty gap will

TABLE 2

Policies Expanding the Existing Childless EITC, 2003 (dollar amounts are in 2007 dollars)

	Current EITC for childless taxpayers	Expanded childless EITC ^a
Potential eligible returns	6,001,872	9,483,551
Unmarried males	43.1%	37.3%
Black	21.5%	21.4%
Less than HS diploma	26.2%	33.1%
High school graduate	43.2%	47.2%
Average hourly wage (before credits)	\$9.70	\$9.18
Average annual income of tax filing unit	\$7,358	\$8,142
Cost of policy	\$1,429,170,519	\$7,300,356,976
Average credit	\$238	\$770
Recipients in phase-in	32.1%	39.2%
Recipients in the phase-out	54.8%	49.4%
On a tax filer basis		
Poverty gap of recipients	\$21,581,208,254	\$34,206,708,873
Percentage of recipients with below poverty incomes	77.2%	75.6%
Percentage of total expenditure that closes the poverty gap	90.8%	79.9%
Number of people lifted out of poverty	55,565	508,531
On a family basis		
Poverty gap of recipients	\$14,114,517,203	\$20,787,816,006
Percentage of recipients with below poverty incomes	47.0%	41.4%
Percentage of total expenditure that closes the poverty gap	53.4%	40.3%

Source: Author's calculations from the 2001 Survey of Income and Program Participation (SIPP).

a. The expanded childless EITC is available to childless taxpayers between the ages 18 and 64 who are not full-time students. For childless tax-filing units older than 30, the phase-in rate is 15.3 percent from \$1 to \$5,650 for single taxpayers. The phase-out is 19.125 percent from \$6,780 to \$11,300. The phase-in and phase-out income thresholds are double those for single taxpayers for married taxpayers. For any childless tax-filing unit with a member under 30, the phase-in rate is 25 percent from \$1 to \$5,650 for single taxpayers. The phase-out rate is 31.25 percent from \$6,780 to \$11,300. The income thresholds double for married taxpayers. See the text for details.

be lower because when several incomes within a family are combined, fewer families will fall below the poverty line. When I calculate using data from families living together below the poverty line, the poverty gap falls to \$14.1 billion, 47 percent of those who receive the childless EITC are in families below the poverty line, and 53 percent of benefits of the childless EITC go toward closing the poverty gap. If sharing across families is common, the above “family basis” estimates will better reflect reality. If families do not share resources,

the “tax-filer basis” will provide a better measure of expenditure targeting.

The first part of my two-part proposal would expand the EITC for childless recipients. As shown in Figure 1, childless taxpayers in 2007 were eligible for an EITC if their income was between \$1 and \$12,590 and the taxpayer was between the ages of 25 and 64.¹ Taxpayers must have asset income of less than \$2,900. I would alter four features of the existing childless EITC relating to the subsidy rate,

1. The beginning and ending point for the EITC phaseout range is \$2,000 higher for childless taxpayers filing joint returns in 2007.

the income thresholds, and rules relating to age and marriage.²

First, I would make childless taxpayers filing as singles eligible for a 15.3 percent credit on incomes from \$1 to \$5,650. The credit rate of 15.3 percent is equal to the combined employee and employer share of taxes for Social Security and Medicare, and can be thought of as offsetting those payroll taxes for low-income workers. The maximum credit would increase to \$864. The expanded credit for childless singles would phase out at a 19.125 percent rate on incomes between \$6,780 and \$11,300. The credit for married childless taxpayers would have income thresholds that are twice as large—the 15.3 percent phase-in credit would apply to incomes from \$1 to \$11,300, and the 19.125 percent phase-out rate would apply to incomes between \$13,560 and \$22,600.

Second, I would end the age restriction of the childless EITC, to include low-income, childless taxpayers between the ages of 18 and 24. I recognize that allowing 18- to 24-year-olds to receive the credit will lead to a situation where some young people who can reasonably expect to have high lifetime incomes—say, those taking a year off from college—will receive benefits from the program. But a substantial amount of career development and crime occurs for this age cohort (for studies of early career job mobility for young men, see Topel and Ward 1992; Neal 1999). Having some resources going to workers with high lifetime incomes is a worthwhile trade-off for a program that can reach low-skilled workers at a critical time in their careers. Thus, all low-income childless taxpayers would be eligible in my proposal.

Third, I would keep in place the rule that full-time students are not eligible for the childless EITC. It is difficult administratively for the IRS to

identify full-time students, however. As a practical alternative, I would expand the scope and quality of the information reports that colleges and universities now must provide to the IRS, as part of their efforts to administer the HOPE Scholarship and lifelong learning tax credits. Specifically, I propose that the information reports include a box indicating whether the student attended school full time for more than five months in the given tax (calendar) year. Full-time students would not be eligible for the expanded childless EITC.

Fourth, the proposal would incorporate a substantial early career employment incentive for those who are under 30 years of age, with the intention of drawing young people into the formal labor market at an important time of career development. For taxpayers 30 years old or older, the program would be exactly as described earlier.³ For childless taxpayers under age 30, however, this policy would provide a 25 percent credit on incomes from \$1 to \$5,650. The credit would phase out at a 31.25 percent rate on incomes between \$6,780 and \$11,300. Again, the credit for younger married childless taxpayers would have income thresholds that are twice as large.

The last column of Table 2 compares this policy with the existing EITC for childless workers. Under my proposal, the number of eligible persons expand substantially to 9.5 million with no employment response, of whom 37 percent are unmarried males and 80 percent have a high school diploma or less. The cost of this policy would be \$7.3 billion if all who were eligible participated. The average credit would be \$770, which is considerably larger than the current \$238 average childless EITC. More than half a million people would have their incomes lifted to a level above the poverty line; the number of the current childless EITC is one-tenth that number. Additional effects of the proposal are discussed below.

2. The tax reform proposal of Ways and Means Committee Chairman Charles Rangel (H.R. 3970) would double the current childless EITC from its 2008 credit amount of 7.65 to 15.3 percent on incomes up to \$5,720. It increases the earnings level at which the credit begins to phase out from \$7,160 to \$10,900 (and from \$10,160 to \$13,900 for married couples filing jointly). The thresholds are indexed for inflation after 2008.

3. For married childless couples, both partners would need to be 30 or older to not get the early career employment incentive.

This proposal could be tweaked in a number of ways. I briefly describe two possibilities, both of which would reduce the cost of the proposal, but also reduce its likely effectiveness. The first possibility, dropping the early employment bonus for childless taxpayers under the age 30, would reduce the cost of the proposal by roughly \$1.52 billion, reducing the average credit from \$770 to \$610. Going further, a second possibility could trim the proposal by continuing to exclude all individuals who are aged 18–24. The rationale for this second possibility would be to address the concern that too much of the benefit of the expanded EITC would flow to those between the ages of 18–24 whose incomes are only temporarily low, not those on a path toward low incomes in the long term. This change would reduce the potential cost of the proposal described in Table 2 by \$3.2 billion. The baseline statistics shown in Table 2 do not otherwise change substantially for either of the variants that trim the cost of the proposal, though cutting out those aged 18–24 would reduce somewhat the fraction of total payments that directly close the poverty gap.

Effects on Employment

A considerable body of economic research in the last few decades has established that employment, and the decision about whether to seek work or to step out of the labor force, is responsive to wages (Heckman 1993). The stagnant wages for low-skilled workers (Table 1) help to explain the declining labor-force participation rates of these workers. Analyses of the effects of the current EITC on labor market participation come to a similar conclusion: the current EITC has a statistically significant and large effect on encouraging labor-force participation of single women with children. (For a survey, see Hotz and Scholz 2003; more recent studies include Grogger 2003, and Hotz, Mullin, and Scholz 2005.) However, there is also some evidence that in two-adult households the EITC can create a small negative effect on the employment of secondary workers (Eissa and Hoynes 2004), presumably because when one worker in the household can bring in more income while working the same number

of hours, in some cases the secondary earner in the family might decide to work fewer hours.

The existing estimates of how workers have reacted to the current EITC can be used to project how childless workers not in the paid labor market would react to an expanded EITC. The calculations here are necessarily speculative, since they require estimating what earnings would be for people not in the labor market if they took a job in the formal labor market. Table 2 showed that the families who are already in the labor market and who are eligible for the new childless tax credit have an average wage of \$9.18 an hour and earn \$8,142, implying that they work 887 hours per year. Suppose those not in the labor market could earn the same, should they decide to work. Of course, it is likely that those not currently in the labor force would have lower earnings, on average, than those presently in the labor force, which would result in the EITC having a larger potential effect on their after-tax return to work, but that should not have a major quantitative effect on the calculations given below.

For those out of the labor market, an expanded childless EITC of \$770 on labor-market earnings of \$8,142 implies a 9.5 percent increase in the after-tax return to work. Hotz and Scholz (2003) present a survey of the evidence on how employment reacts to changes and variations in the EITC. However, since the EITC applies largely to women with children, these estimates also apply primarily to women with children. The conventional wisdom is that both childless men and women will react less to a rise in wages than women with children will. Thus, I use the lowest estimate from the Hotz and Scholz survey, which is that a 10 percent increase in the wage as a result of the EITC leads to an increase in employment of 6.9 percent. A 9.5 percent increase in after-tax income would lead to a 6.56 percent increase in employment for those out of the labor market. Absent any employment increase, 9.5 million workers would be eligible for expanded childless EITC. There are another 10.8 million childless individuals and couples fully out of the labor market who would be eligible for the

expanded EITC, if they had earned income in the designated range. If their employment increased by 6.56 percent, roughly 708,000 more workers would be in the paid labor market.

This estimate is likely a conservative one; it is based on the lowest of the estimates of how employment will respond to a rise in take-home income. Nonetheless, the magnitude of this expected response is relatively small in percentage-point terms, or in the context of an overall U.S. economy that had roughly 146 million workers in 2003 (Bureau of Labor Statistics 2007).

However, this policy is not exceptionally costly, either. Given the steady declines in employment rates of low-skilled workers over the past few decades, policies that can augment incomes of this group while increasing employment deserve serious consideration.

It seems unlikely that the expansion of the childless EITC will have a substantial positive or negative effect on the quantity of hours worked by current EITC recipients. This statement might seem surprising: after all, wouldn't workers adjust the hours that they choose to work in response to the incentives of the EITC? However, studies estimating the effects of the EITC on hours of work for those households that are working find only small negative effects. In one such study, Liebman (1997) points out that negative effects on hours for people already in the labor market are small, because the precise relationship between the EITC and hours worked is likely to be poorly understood by most taxpayers. After all, most low-skilled workers do not carry out calculations about how varying the quantity of hours that they work during the calendar year will affect the tax returns they likely will not file until late January to April in the following year. Indeed, the majority of EITC recipients pay a third party to prepare their tax returns. In short, people recognize that the EITC provides a bonus for working, which will encourage some additional people to enter the labor force. Abundant anecdotal evidence indicates that taxpayers have this under-

standing (for example, DeParle 1999). Nevertheless, the EITC does not lead to important changes in the hours that people work, once they have made the decision to work.

Effects on Crime

As described by Freeman (1999), from the mid-1970s to the mid-1990s the number of men in prison or jail in the United States roughly tripled, so that by 1993 one man was incarcerated for every 50 in the workplace. In 1995, 72 percent of those arrested were between the ages of 13 and 34, yet this age group accounts for only 32 percent of the population. Most criminals have limited education and limited labor-market skills. A U.S. Department of Justice (1991) Survey of State Prison Inmates reports that two-thirds had not graduated from high school. Studies examining patterns of crime and incarceration have found solid evidence that stagnant wages for low-skilled workers over the past several decades had an important effect on crime.

For example, Grogger (1998), after examining the relationship between wages and youth crime, suggests that much of the increase in the youth arrest rates between 1970 and 1980 can be attributed to the fall in their inflation-adjusted wages during that time. Furthermore, movements in real wages can explain a substantial component of both the racial differential in criminal participation and the age distribution of crime. He estimates that a 10 percent rise in the wage rate will decrease youth participation in crime by 6 to 9 percent. Gould, Weinberg, and Mustard (2002) find similar evidence, concluding that both wages and unemployment are significantly related to crime for males who have low levels of education, but that wages have played a more important role than unemployment over the last few decades. They estimate that a 10 percent increase in the wages of low-skilled workers reduces property crime by between 3.6 and 10 percent. Machin and Meghir (2004) provide additional evidence consistent with an important effect of wages on crime, using data from England and Wales between 1975 and 1996.

Levitt (2004) argues that unemployment rates have little effect on crime, but he does not focus on wage rates. The existing literature points to wages as being a more important factor than local unemployment rates in understanding changes in crime over time and across demographic groups.

The wages available, particularly for young men, appear to affect crime rates. The expanded childless EITC proposal described in Table 2 would increase the returns to formal labor market participation, and would raise wages, on average, by 9.5 percent. Based on the connections from higher wages to crime found in the economic studies, such an increase would reduce crime rates by between 3.4 and 9.5 percent. Freeman (1996) calculates that there were roughly 33 million crimes committed in 1992, at a cost of \$532 per crime, \$787 in 2007 dollars. Some crimes are surely committed by people with children, who would be unaffected by this policy. Moreover, crime rates have fallen significantly between 1992 and 2003: a rough estimate based on Freeman's calculations and crime reports from the Statistical Abstract of the United States is that there were 27 million crimes in 2003. Suppose, then, that the expanded childless EITC reduced the number of crimes by the bottom of the range of estimates of the reduction in crime due to wage increases, which is 3.4 percent, or by 918,000 crimes.

It is difficult to estimate the economic value of this crime reduction because estimates of the private and social costs of crime are varied, with little consensus over their magnitudes. Based on Freeman's assessment that each crime costs society \$787, the estimated 918,000 crime reduction would save \$722 million, roughly 10 percent of the total cost of the expanded childless EITC. Some other estimates find much higher values of crime reduction. Levitt (2004) writes, "the most commonly used estimates of the cost of crime to victims (for example, Miller, Cohen and Rossman 1993) places the cost of crime at roughly \$500 billion annually in the early 1990s. Given the sharp declines in crime, today's estimates would likely be substantially lower—perhaps \$400 billion in current dol-

lars" (177). Focusing on the cost of crime to victims still understates the social cost of crime, since it presumably does not include the costs of buying locks, security, and altering behavior that nonvictims take to avoid crime. Even so, if there were 27 million crimes with a cost of \$400 billion in 2003, the cost per crime would be \$14,814, \$16,740 in 2007 dollars, more than 20 times higher than the Freeman (1996) estimate. Using this high number, reducing the number of crimes by 3.4 percent, or by 918,000 crimes, would have a monetary value of \$15.4 billion, which is over two times the total cost of the expanded childless EITC.

Unfortunately, estimates like this are extremely speculative, and depend critically on how much crime would fall in response to increased opportunity in the formal labor market. There is also enormous variation in estimated costs across types of crimes. Cohen (2000) for example, reports that the cost per crime for larceny and attempted larceny is \$370. The cost per arson crime resulting in death is \$2.7 million. Thus, estimates of the return to crime reduction depend not only on estimates of the way policy affects the number of crimes, but also on the composition of crime reduction. Although the magnitude of the estimates varies widely, their main thrust is clear: the social benefit of reduced crime could cover a portion, perhaps a substantial portion, of the cost of an expanded childless EITC.

Effects on Marriage

The *marriage penalty* refers to a situation where after-tax and after-transfer resources are lower for a couple after marriage than they were for the same people (with identical earnings) prior to marriage. Marriage penalties are most frequently discussed in the context of the tax system (Feenberg and Rosen 1995; Alm and Whittington 1995; U.S. Congressional Budget Office 1997; Bull, Holtzblatt, Nunns, and Rebelein 1999). At various points in its history, marriage penalties have been a central issue in political discussions surrounding the EITC. The concern occurs for two related reasons. First, the EITC might raise the incomes of those in a marriage who,

TABLE 3

Marriage Penalties in the Tax Code and Under the Expanded Childless EITC Proposal**People who married during the course of the 2001 SIPP survey**

Income (thousands \$)	Under current law			
	Percent with bonus (%)	Conditional bonus (\$)	Percent with penalty (%)	Conditional penalty
0–10	35.5	362	0.8	169
10–20	79.8	524	20.2	428
20–30	55.7	499	44.3	328
30–40	40.7	827	59.3	295
40–50	33.1	1653	66.9	261
Expanded childless EITC (see notes to Table 2)				
0–10	35.8	1024	0.8	169
10–20	81.9	1396	18.1	607
20–30	54.9	500	45.1	563
30–40	38.9	852	61.1	407
40–50	32.5	1642	67.5	271

People already married when the 2001 SIPP survey began

Income (thousands \$)	Under current law			
	Percent with bonus (%)	Conditional bonus (\$)	Percent with penalty (%)	Conditional penalty
0–10	29.0	303	3.0	175
10–20	66.8	433	32.9	317
20–30	51.9	438	47.8	338
30–40	37.0	733	62.9	325
40–50	41.9	1461	58.0	261
Expanded childless EITC (see notes to Table 2)				
0–10	29.4	519	2.6	184
10–20	69.7	943	30.2	281
20–30	50.7	443	49.0	449
30–40	36.5	733	63.4	381
40–50	40.6	1471	59.3	278

Source: Data from the 2001 SIPP Panel, author's calculations described in the text.

if the marriage dissolved, would become custodial parents. By increasing the value of the alternative outside of marriage, the proposal may increase the incentive for married couples to divorce. Second, if someone with a low income, who is receiving an EITC, marries someone whose higher income makes him or her ineligible for the credit, then the combined household income will be too high for the couple to be eligible for the credit. Hence, the EITC may reduce the incentive for single people to

marry. These circumstances could also apply to the expanded EITC for childless taxpayers.

Due to the important role marriage penalties have played in past EITC policy discussions, I calculate marriage penalties associated with the current-law childless EITC and my proposed expanded childless EITC in Table 3. I use all nine waves of the 2001 SIPP (starting in January 2001), assuming that all taxpayers take the EITC when eligible and that

all taxpayers use the standard deduction (so I limit the analysis to taxpayers with incomes of less than \$50,000). The sample is limited to childless taxpayers. I split the sample into two groups. The top half of the table shows penalties and bonuses for single people who marry in later waves of the 2001 SIPP panel (using the income of the original SIPP respondent in 2001, and the income of the spouse in the year they marry). The bottom half of the table shows penalties for couples who were married in the beginning of the 2001 SIPP.

For both groups—those who marry and those who are married at the start of the SIPP panel—I show marriage bonuses and penalties under the current tax law in Table 3. In the SIPP, for single taxpayers who marry, more than half of those with incomes of less than \$30,000 have marriage bonuses, and the size of the bonuses when there is one tends to be larger than the size of the penalties. The same is true for childless couples in the 2001 SIPP who started out married.

Why would married couples facing marriage penalties stay married? For several reasons: People may not be aware of the tax consequences of their marriage. They may value the institution of marriage sufficiently to be unconcerned about the tax penalty. And marriage, or at least living together, provides a considerable economic benefit; living together is less expensive than living apart. As Primus (n.d.) notes, the poverty line for a family of three—in this example, a married couple with one child—was \$14,776 in 2004. If the parents separate, the poverty line for the custodial parent and child is \$12,649; for the noncustodial parent, the poverty line is \$9,827. The combined poverty income for the two separate households is \$22,476, or 52 percent more than the poverty line for the intact couple. The comparable calculation for a married couple with two children is that the economy of scale associated with joint living is 26 percent. Couples are financially better off living together (maintaining one residence) than they are living apart (maintaining separate residences).

Table 3 also shows marriage penalties and bonuses under my expanded childless EITC proposal for childless single people who marry at some point during the period covered by the nine waves of the SIPP and for childless married couples. The proposal has little effect on the fraction of the population receiving marriage penalties or bonuses. Conditional on getting a bonus or penalty, however, the magnitudes increase. Conditional bonuses increase sharply, by \$200 to \$870 for households with incomes under \$20,000 in the newly married and married samples. Conditional penalties increase as well, but by much smaller amounts. Thus, among its many virtues, the proposed expanded childless EITC could be characterized as “pro-marriage.”

Marriage penalties are politically inflammatory. However, careful studies generally find no effect of marriage penalties on family structure. Three studies have examined whether the EITC encourages the existence of female-headed families. Dickert-Conlin and Houser (2002) look at how changes in the EITC have been correlated with the number of families headed by females, and find little effect of the EITC on marriage decisions. Eissa and Hoynes (1999) and Ellwood (2000) also find little or no evidence that EITC marriage penalties or bonuses affect marriage. The likely reason for this outcome is that the potential economic effects of marriage run in all directions, once certain factors are taken into account: the cost savings from living together, the future benefit of the larger EITC for families when they have children, and decisions by one spouse to leave or enter the labor force.

There is some, though limited, empirical evidence that

- improving employment and earnings of men increase marriage rates for women in all education groups (Blau, Kahn, and Waldfogel 2000; Mare and Winship 1991);
- increases in husband’s earnings decrease divorce rates (Hoffman and Duncan 1995); and
- men’s wages and education are correlated with marriage, but education appears to be a more

important factor than earnings for black men (Wong 2003).

The methodologies used in studies of marriage do not generally yield a simple parameter like the elasticity of marriage with respect to men's wages; even if it did, there are few credible estimates that would allow me to quantify the potential benefits of increased marriage on child and family well-being. I am confident that the expanded childless EITC, if adopted, would have a positive effect on marriage and children. The literature, in my view, cannot yet support a defensible effort to quantify and monetize these benefits.

Administrative Considerations

Expanding the childless EITC does not require a new administrative apparatus, since it builds on the EITC, a provision of the tax code that has been in place for more than 30 years. Consequently, the two major administrative concerns have to do with noncompliance and with participation. Would payments go to taxpayers who are not eligible for the credit? Would those taxpayers who are eligible for the expanded EITC file returns and receive the credit?

A large fraction of current EITC payments—particularly for families with children—appears to go to taxpayers who are ineligible for the credit. The IRS's most recent study of EITC noncompliance examines returns filed in 2000 (for tax year 1999) and finds that of the \$31.3 billion claimed in EITC payments, between \$8.5 and \$9.9 billion, or 27.0 to 31.7 percent of the total, exceeded the amount for which taxpayers were eligible (IRS 2002b). Of the errors the IRS was able to classify, roughly one-half arose because of qualifying-child errors, and one-half of those (or 25 percent of the total) arose because the child that was claimed was not the taxpayer's qualifying child. Holtzblatt and McCubbin (2004) provide a good discussion of the results of the EITC compliance study and broader tax compliance issues for low-income households, while Hotz and Scholz (2003) discuss EITC compliance

and offer a more detailed discussion of other EITC related issues.”

The most common problem was that the EITC-qualifying child failed to live for at least six months with the taxpayer claiming the child. Mistakes of this type can run the gamut from innocent taxpayers running afoul of complex IRS rules, to outright fraud. Tax returns do not collect information on the actual location of children during the year. Consequently, the IRS has little ability to scrutinize EITC qualifying-child claims before the EITC is paid. These child-related issues, of course, do not apply to the EITC available for childless taxpayers.

There is no evidence that EITC noncompliance rates for childless taxpayers (before enforcement actions) are lower than error rates for families with children. Holtzblatt and McCubbin (2004) analyze data from the IRS's most recent study of EITC noncompliance and find that the EITC noncompliance rates for childless taxpayers (before enforcement actions) are 39.3 to 44.6 percent. The reason for this high error rate is not clear; Holtzblatt and McCubbin emphasize that the results need to be viewed with caution, because of a small number of childless taxpayers in the study sample. To the extent that the earlier noncompliance estimates for childless claimants are accurate, the IRS has third-party reports of the two key issues affecting childless taxpayer claims—both age and income claims can be verified from Social Security data and employer wage and salary reports. Also, a taxpayer with a child would not find it advantageous to file instead for a childless EITC, even with an expanded credit. Thus, even if an expanded childless EITC is leading to larger claims than are legally justified, the enforcement actions to reduce these erroneous claims are straightforward. Moreover, with a larger credit, the government would have a stronger incentive to use already available information to reduce noncompliance rates.

At the risk of seeming to condone tax noncompliance, it is also worth pointing out that most of those receiving inappropriate EITC payments are

low-income, working poor families with children. The dollars received likely help to enable adults to stay in the labor market and provide for their children. It clearly is important to enforce the law, but EITC noncompliance of around \$9 billion is a small portion of the overall tax gap of \$345 billion (IRS 2007).

There have been no empirical studies of EITC participation among eligible childless taxpayers. The IRS (2002a) examines EITC participation among eligibles in 1996, but focuses only on families with children, presumably because the EITC available to childless taxpayers is only a small part of overall EITC spending. Similarly, Scholz (1994) and Blumenthal, Erard, and Ho (2005) examine tax years prior to the inception of the credit for childless taxpayers.

Given that the maximum childless EITC under current law is only \$428, I would expect the childless taxpayer participation rate to be less than the 80 percent rates found for taxpayers with children. Although there is little empirical evidence on the matter, my best guess is that with a larger available credit that extends further up into the income distribution, participation rates for the expanded EITC for childless taxpayers would resemble the participation rates obtained for the EITC available to taxpayers with children. One boost to program participation is that childless taxpayers can receive the EITC when using the 1040-EZ form, which is the simpler two-page tax form. This filing approach should improve participation relative to an arrangement where the credit can only be claimed on the more complex 1040-A or 1040 forms.

Other Considerations

A natural concern with any employment subsidy for disadvantaged workers is to ask whether the employment responses to the credit are large enough to cause wages for low-skilled labor to fall. Given the relatively modest employment responses to the expanded childless EITC, it seems unlikely that it will have broader effects on market wages.

Another issue has to do with the possibility that employers may capture some of the benefit of an expanded tax credit by paying workers less than they otherwise would receive, and counting on the EITC to make up the difference. There is little evidence in the EITC literature that employers are able to capture part of the benefit of the credit (Rothstein 2005). A key issue here is whether employers of low-wage workers have the market power to set wages at a level lower than the competitive wage. If the employer pays the worker less than the value of the marginal product of the worker's labor, absent collusion, a competitor ought to be willing to bid up wages. Given that barriers to entry in industries that employ low-skilled workers are typically low, and that returns to capital are not unexpectedly high, I think the competitive model is a good characterization of low-wage labor markets. This implies that employers will have a difficult time capturing the benefit of the expanded EITC.

My cost estimate for the expanded EITC for childless taxpayers is \$7.3 billion if all eligible taxpayers receive the credit, but participation in tax incentives is never 100 percent among eligible taxpayers. If the participation rate is 80 percent, which is similar to the EITC participation rate for taxpayers with children, the cost is \$5.8 billion. The targeting of the proposal is not airtight: it would provide benefits to many young people who have low incomes while working in jobs between college and graduate school. But I estimate that it would increase employment for more than 700,000 men and women currently out of the labor market, and reduce crimes by 918,000 incidents, which would save anywhere from \$722 million to more than enough to pay for the policy, and would increase marriage and the number of children raised in households with two adults. The policy would be straightforward to administer and would efficiently target one of the most important social problems facing our country.

3. Target Wage Subsidies to Disadvantaged Workers

The second part of my proposal to raise the wages of low-skilled workers is for a government program to pay subsidies of 50 percent of the *difference* between the worker's market wage and a specified target wage. Thus, for example, if the market wage for a low-skilled worker is \$7 an hour and the targeted wage is \$11.30 per hour, his or her effective, subsidized wage would be \$9.15 an hour.⁴

The United States has a long history of experimentation with targeted wage subsidies to aid disadvantaged workers, but most of these subsidies have been paid to employers for hiring disadvantaged workers from targeted groups. Bartik (2001, particularly chapter 8) provides a detailed discussion of these policies. For example, the Targeted Jobs Tax Credit (TJTC) from 1978 to 1994 provided a tax subsidy for hiring economically disadvantaged workers. The ongoing Work Opportunity Tax Credit (WOTC) was enacted in 1996 to provide tax credits aimed at helping former welfare recipients find jobs. The Welfare-to-Work credit took effect in 1998 and ended in late 2004; its purpose was to provide firms with tax credits for hiring long-term welfare recipients.

The empirical evidence suggests that the efficacy of credits paid to employers to subsidize the hiring of disadvantaged workers is weak. Burtless (1985) shows, using data from a well-designed experiment, that job seekers given vouchers to show to employers that they are eligible for a generous wage subsidy were significantly *less* likely to find employment than were job seekers without vouchers. It appears that the label *disadvantaged worker* is very harmful to low-skilled workers, even when it is accompanied by payments to offset additional hiring costs of such workers. Subsidy take-up also appears to be exceptionally low over the years. Katz (1998) estimates that in the mid- to late-1980s only 9 percent of the

eligible youth hired were claimed by employers to receive the TJTC. Hamersma (2003) shows that take-up of the WOTC and the Welfare-to-Work credit is less than 17 percent for disadvantaged youth and less than 33 percent for welfare recipients—and the actual take-up rates may be much lower than these figures. The credits also appear to have small to negligible beneficial effects on low-wage labor markets. Hamersma (2005), for example, using administrative data from Wisconsin on earnings, finds that the workers who were certified as eligible for the WOTC and the Welfare-to-Work credit were no more likely to be employed than were workers without that certification. Subsidized workers do appear to have slightly higher earnings because of the credits, but she estimates that only one-quarter of the credit is passed on to workers in higher wages, with the rest going to the employer. Indeed, firms that testify in support of extensions to the WOTC and the Welfare-To-Work credit generally discuss the need for the subsidy to offset the training costs associated with hiring low-skilled workers.

A Proposal for Wage Subsidies Sent Directly to Workers

Given the dismal history of employer-based tax credits, my proposal differs from previously enacted employer-based credits. To avoid the stigmatization of workers, and to lessen concerns that employers would receive the bulk of the benefit from the proposed labor market subsidy, a new delivery mechanism would be developed whereby workers would receive subsidy checks directly, after submitting pay stubs to the program administrators. Employers would not know whether a given worker receives a subsidy. Thus, any stigmas about receiving the subsidies would be reduced. Also, employers would be less able to capture a portion of the subsidy benefit when payments go directly to workers. If employ-

4. The target I actually examine in the proposal is \$10 an hour in 2003, which is equal to \$11.30 an hour in 2007.

ers had a mixture of subsidized and unsubsidized workers—and were not aware who received the subsidy—they would have a hard time paying the workers different amounts. Consequently, much, if not all, of the earnings subsidies paid to workers would accrue to the worker.

Wage subsidies similar to what I am proposing here have a long history in academic writing on poverty. Muth (1966) writes, “under the wage-subsidy variant . . . the government would agree to pay an employer a certain fraction, say one-half, of the difference between the wage the employer pays a worker and some minimum level, say \$2 per hour, provided his wage is less than this minimum” (68–69). Subsequent analyses of similar programs include Barth (1974), Betson and Bishop (1982), Browning (1973), Haveman (1973), Kesselman (1969), Lerman (1982), MaCurdy and McIntyre (2004), and Zechhauser and Schuck (1970). Nobel Laureate Edmund Phelps proposed a universal wage subsidy in *Rewarding Work* (1997). He estimated that the subsidy would cost more than \$125 billion annually. There is a reason that scholars and policy analysts have written for more than 40 years about wage subsidies as one piece of a comprehensive, market-based antipoverty agenda. The arguments for the policy—its extremely effective targeting and its relatively benign labor market incentives—are compelling, but the cost of a universal program like Phelps’s is overwhelming.

My proposal would restrain costs by targeting the policy to individuals living in federally designated Renewal Communities, Empowerment Zones, or Enterprise Communities (RCs/EZs/ECs). I do this for two reasons: First, given the intellectual attractiveness of the idea, the efficacy of wage subsidies should be explored in a rigorous manner—an experiment or pilot program should have limited scope to minimize the fiscal consequences if the policy does not meet expectations. Second, poverty, particularly crime and lack of employment of young males in the formal labor market, has a significant spatial or place-based dimension. Given that mechanisms are already in place for a set of place-based policy

initiatives, it makes sense to target these distressed communities for a pilot program on the efficacy of wage subsidies.

In the words of the U.S. Department of Housing and Urban Development (n.d., Introduction),

the RC/EZ/EC Initiative brings communities together through public and private partnerships to attract the investment necessary for sustainable economic and community development. It provides tax incentives, grants, loans, and technical assistance, to spur private investment in communities that have experienced severe economic decline. The program provides performance-oriented, flexible Federal grant funding so communities can design local solutions that empower residents to participate in the revitalization of their neighborhoods.

The urban EZs have used their Federal seed money to create partnerships that have leveraged more than \$12 billion in public and private investment. Strategies resulting from these partnerships have generated jobs; provided business assistance and services; trained and educated youth and families; improved access to childcare, healthcare and transportation; and increased residents’ safety and involvement in their neighborhoods.

There are roughly 100 urban RC/EZ/EC communities in 40 states and the District of Columbia. They tend to include high-poverty areas in many of the nation’s largest cities. (Poverty rates in some rural communities are also high, but the problem there tends to be the lack of an economic base. Consequently, wage subsidies are not likely to be an effective policy intervention.) The benefits of being designated as an RC/EZ/EC community include

- an RC employment credit (both the worker and business must be in the zone, and restrictions apply),

TABLE 4

Costs of the Wage Subsidy Targeted to RCs, EZ, and ECs, 2000 Census and 2003 SIPP Data
(dollar amounts are in 2007 dollars)

	Analysis 1			Analysis 2	
	EZ/EC/RC Census Tracts	SIPP Proxy Sample	All United States	Lowest-Income Census Tracts	SIPP Proxy Sample
Households	2,811,880	2,494,143	140,000,000	2,801,194	2,596,823
Average Household Size	2.86	2.27	2.19	2.96	2.10
Black	54.9%	58.1%	12.2%	49.7%	56.4%
Median Household Income	\$25,107	\$21,093	\$47,286	\$19,453	\$19,149
Average Household Income	\$33,821	\$28,783	\$60,152	\$25,658	\$24,718
Total Employees	2,675,485	2,226,317	170,100,000	2,475,738	2,063,853
Age 66 and Over	11.9%	7.2%	11.6%	11.7%	13.8%
Age 17 and Less	31.6%	34.3%	26.4%	28.0%	30.1%
	Wage subsidy for individuals in EZ/EC/RCs			Wage subsidy for low-income tracts	
Eligible for Wage Subsidy	1,149,973			1,028,097	
Males	41.8%			39.3%	
Black	59.5%			61.6%	
Less than high school diploma	22.8%			30.8%	
High school graduate	37.3%			41.1%	
Average hourly wage (before credits)	\$8.00			\$8.12	
Average annual income of tax filing unit	\$17,424			\$17,119	
Cost of wage subsidy	\$3,100,883,016			\$2,248,168,539	
Average annual subsidy	\$2,696			\$2,187	
On a tax filer basis					
Poverty gap of recipients	\$3,927,254,228			\$2,835,894,136	
Recipients with below-poverty incomes	48.9%			47.8%	
% total expenditure closing poverty gap	45.6%			35.0%	
On a household basis					
Poverty gap of recipients	\$3,260,362,838			\$2,178,797,459	
Recipients with below-poverty incomes	35.8%			30.0%	
% total expenditure closing poverty gap	37.2%			25.9%	
Adults not in the formal labor market	991,776			964,810	

Source: Author's calculations from the 2001 Survey of Income and Program Participation (SIPP) and the 2000 Census.
Note: See text for details.

- use of accelerated cost recovery for revitalization of commercial buildings in a renewal community,
- larger deductions for the cost of eligible equipment purchases for businesses in RCs and EZs,
- partial income exclusion for capital gains earned in RC and EZ businesses, and
- the ability to issue qualified zone academy bonds, which allow governments in RCs and EZs to issue subsidized bonds to finance public school programs.

For further description of these economically disadvantaged areas, including the specific census tracts that make up the RCs/EZs/ECs, see U.S. Department of Housing and Urban Development (2007).

To examine the potential impact of a wage subsidy targeted to these urban areas, I began by looking at data from the U.S. Census Bureau. The Census Bureau divides the country into census tracts, each of which typically includes 1,500 to 8,000 people. Thus, I first compiled the 2,601 census tracts that make up the targeted areas. Unfortunately, the areas are designated in terms of 1990 census tracts, so it was first necessary to convert them to tracts from the 2000 Census. I then compiled the year 2000 characteristics of these tracts. The first column of Table 4 describes some characteristics of these areas based on the data from the 2000 Census. These areas include approximately 8 million people, living in 2.8 million households. More than half of this population is black, and the median household income is \$25,107. Comparable figures for the U.S. economy as a whole appear in the third column of Table 4. Clearly, the population of these zones is disproportionately black and poor compared to the U.S. national averages.

An obvious question is the extent to which these RCs/EZs/ECs were chosen based on the extent of their economic disadvantage, and the extent to which they were chosen based on other, perhaps

political, factors. To examine this question, I selected the lowest-income census tracts in the country until I had a sample equal in population size to the RC/EZ/EC zones, roughly 2.8 million households. The broad characteristics of this group are shown in the fourth column of Table 4. It turns out that those census tracts designated as RC/EZ/EC households have somewhat higher incomes than would be the case if these census tracts were selected solely on the basis of income. This is not because the poorest census tracts have more households over the age of 65; in fact, the age compositions of the poorest and the RC/EZ/EC census tracts are similar.

However, the data from the U.S. Census do not provide sufficient detail for estimating how much a wage subsidy program would cost. The census lacks sufficient detail on hourly wages and individual characteristics needed to assess tax liabilities. The Census Bureau's SIPP data contain this more-detailed information, but those data do not provide detailed geographic information, so I cannot use them to identify census tracts or RCs/EZs/ECs. Given this complication, I draw a random sample from the national SIPP data that comes fairly close to matching important characteristics of the population that I am trying to estimate. Briefly, I randomly select observations from SIPP to roughly replicate the age, income, and race and ethnicity distribution of households found in the RC/EZ/EC zones and the nation's poorest census tracts. As an example, a high-income, elderly white household is less likely to be included in the random replicate samples than is a low-income, middle-aged black household, though there is a positive probability that both are included.

I drew two such samples from the SIPP data, one designed to match the census data for the census tracts that make up the RCs/EZs/ECs and another designed to match the group of lowest-income census tracts. I then estimated the cost of adopting the wage subsidy policy with these data. The two estimates can be viewed as checking on each other. One unexpected insight from these two samples is that the sample chosen to mirror the lowest-income cen-

sus tracts actually has a smaller poverty gap (which is, as explained earlier, the amount that would be needed to raise everyone in the area up to the poverty line) than the sample chosen to mirror the RC/EZ/EC areas. This implies that, although median and average incomes are higher in the census tracts that compose the RC/EZ/EC areas than they are in the lowest-income census tracts, the RC/EZ/EC areas must also have a larger share of people who are quite far below the poverty line—thus making their poverty gap unexpectedly high.

The bottom panel of Table 4 presents the results of these analyses. The aggregate cost of the wage subsidy would be approximately \$3.1 billion. Roughly 1.1 million workers would receive subsidies if there were no positive effects on employment. Forty two percent of these workers are male and 60 percent are black. Their educational attainment is low, and their average hourly wage is around \$8.00 an hour, meaning they would receive a subsidy of roughly \$1.65 an hour (recall \$10 an hour in 2003 is a target wage of \$11.30 in 2007), or an effective wage increase of 20.6 percent. The average annual subsidy would be \$2,7000, an increase of 15.5 percent in the average annual income of the household. Depending on whether one measures poverty status based on households or on tax filers, about one third to nearly one-half of the wage subsidy would go towards closing the poverty gap.

This comparison between the census tracts that make up the RC/EZ/EC areas and the lowest-income census tracts also suggests the possibility that this plan could just be targeted by income. Given the process used to identify RC/EZ/EC tracts and the other federal resources targeted to these areas, it makes sense to focus the wage subsidies on individuals in those tracts, but other targeting approaches could be considered as well.

Effects on Employment

The targeted wage subsidy can substantially increase the return to work, and hence employment, in the geographically targeted areas, where fewer

than half of the working-age adults are employed. In these tracts, nearly one million individuals aged 18 to 64 are out of the labor market. Suppose the hourly wage of those out of the labor market would be \$6.50 if they took jobs; for comparison, the average of those in the labor market is around \$8.00. In this case, the subsidy would increase the return to work by \$2.40 an hour, or 37 percent. It is hard to estimate just how much this increase in wages would lead employment to rise. As discussed earlier, the survey by Hotz and Scholz (2003) of evidence on how employment responds to changes in the EITC finds that the smallest estimate is that a 10 percent rise in wages leads to a rise of 6.9 percent of employment. Because these estimates apply largely to women with children, that low number was used for the likely response to an expanded childless EITC because childless men and women might react less than women with children. But even this low elasticity would probably be an overestimate of the impact from the proposed wage subsidies because the target population is concentrated in especially economically depressed areas where responsiveness to work incentives is likely to be lower than for the population on average. Suppose then that for every 10 percent rise in wages, employment among those in the targeted group rises by 4 percent. This would imply that employment would increase by 146,783 (or 6.9 percent of the total population eligible for the subsidy, which is 2,141,749 working-age adults.)

A wage-subsidy approach was studied in a Canadian randomized social experiment—the Canadian Self-Sufficiency Project (SSP)—implemented in the provinces of British Columbia and New Brunswick. It is not clear that the lessons from the SSP are immediately transferable to my wage subsidy proposal, since the SSP focused on welfare recipients (mostly women) with children, while the wage subsidy proposed here is more broadly targeted. Nonetheless, the results of the Canadian project found that, after one year, those receiving the earnings subsidy were twice as likely as control-group members to be working full time. The effect persisted for the three years that treatment group members could receive

the subsidy. They had substantially higher earnings and incomes (including transfer payments) over the follow-up period. By the end of the long-term evaluation, the treatment-control differences were small, though treatment group members had greater work experience and, as noted, greater overall household resources. The SSP results suggest that wage subsidies can improve the employment prospects of disadvantaged workers.

As discussed above, while the targeted wage subsidy should encourage people to find employment, I do not expect it to have much effect on the hours worked by those who are already employed.

Effects on Crime

In the earlier discussion of expanding the childless EITC, I briefly reviewed some of the studies suggesting that higher wages will reduce crime. Similar calculations suggest that wage subsidies could reduce crime, too. Assuming that the targeted wage subsidy could increase the after-tax wage by 37 percent (as discussed in the previous section), crime rates would be reduced by 13.3 to 37 percent using the range of wage elasticities found in the literature—a substantial decrease.

Estimates of the number of crimes committed are not broken down according to census tracts. Crime rates are higher in low-income communities, however, and so I suppose that the rate of crime in the RCs/EZs/ECs is twice the nationwide average rate of 0.24 per household. This would imply that roughly 1.2 million crimes are committed by residents of these low-income areas. A reduction of 13.3 to 37 percent is a reduction of 159,600 to 442,960 crimes. At an average valuation of \$787 per crime, the monetary value of the crime reduction is \$126 million to \$349 million, or 4 to 11 percent of the total cost of the proposal. Of course, if the reduction in crime carries a larger social value, as many estimates in the literature suggest, the proposal will have a lower net cost. Some estimates suggest that the proposal would more than pay for itself taking into account only the effect on crime.

Effects on Marriage

The targeted wage subsidy here does not create any marriage penalty, since eligibility for the subsidy depends only on individual and not household income, and is unaffected by an individual's marital status. I suggest that the ultimate effect of the wage subsidy will be positive, since marriage is positively associated with men's incomes. This is widely known and can be seen in the simple tabulations given in Table 1, where marriage rates increase with educational attainment. As with the discussion of the expanded childless EITC, I do not think there is sufficient information to calculate a monetary value for the likely small, but beneficial, effect of the policy on marriage and child well-being.

Administrative Considerations

The expanded childless EITC builds on an existing administrative mechanism. However, this wage subsidy proposal requires a new administrative structure to deliver benefits directly to employees. This requirement for a new bureaucracy (or the expansion of an existing bureaucracy) is the single biggest drawback of the proposed credit.

The administrative mechanism appears to be feasible. State unemployment insurance offices, for example, regularly receive data from employers on total amounts paid. In Wisconsin, for example, unemployment data are updated quarterly, generally with a three-month lag. These data could be used as the basis for administering the wage subsidies. As emphasized earlier, eligibility for the wage subsidy is based on where the employee (not the employer) is located.

Under a wage-subsidy program, eligible workers would submit their pay stubs on a quarterly basis. After matching pay claims to state unemployment insurance records each quarter, the administrative office would send the subsidy payments to households.

The government's ability to confirm the receipt of earnings suggests that credit noncompliance is likely to be low. Perhaps the major administrative pitfall is that the reports filed by employers with the state unemployment office often do not include hours of work. Kling (2006) notes, however, that Washington, Oregon, and Minnesota already collect information on hours worked as part of their state unemployment insurance systems. It should be straightforward to extend this requirement to other states. Of course, it would be possible for an employer of a \$11.30-an-hour worker who works 40 hours a week to report that the worker was employed 60 hours (at \$7.53 an hour), thereby allowing the worker to receive a subsidy of \$1.88 an hour. Provisions would need to be put in place for occasional audits of employer payroll records, and sanctions would need to be imposed on employers who misstated hours in payroll reports.

As mentioned previously, take-up of employer-based wage credits has been very low. The reasons for this are not fully clear (Hamersma 2003). One possibility is that employers find the application process too cumbersome, although an industry of consultants and intermediaries stand ready to help with paperwork, in return for a share of the credits. Another possibility is that many employers are unaware of the available credits. Neither explanation, however, likely applies to substantial wage subsidies paid directly to employees within a targeted geographic area. A combination of local publicity and word-of-mouth should ensure a reasonable rate of participation—certainly higher than delivering the wage subsidy through employers.

Other Considerations

The wage subsidy proposal is tightly targeted, should increase employment, deliver substantial resources to low-skilled workers, and reduce

crime. In addition to the administrative concerns already discussed, the other main concern is that it may cause firms to alter their hiring patterns. Bartik (2001) describes a situation in which some firms hire low-skilled labor, and accept that they must face higher worker turnover and lower worker productivity, while other firms pay higher wages and hope to make up the extra costs by reducing worker turnover and by hiring workers who have greater productivity because they have higher morale. With the targeted wage subsidy program, some employers could feel an additional incentive to take the “low-wage” route, since higher wages would result in their workers not being eligible for the wage subsidy.

My view is that the wages that employers pay are dictated by the job skills of the workers they hire and that the empirical evidence in favor of the “dual labor market” models is not very strong. Moreover, many of the employers operating in or near the RCs/EZs/ECs will also operate in other locations and hire workers from other locations, making it less likely that the presence of the targeted wage subsidy will cause them to alter their hiring and pay packages.

Over more than four decades, there has been substantial, sustained intellectual interest in wage subsidies as an antipoverty tool. If the targeted wage subsidy program described here proves to be as effective as I (and many others) anticipate, the policy could be expanded, perhaps gradually, to other areas, or to workers with specific, identifiable, and—ideally—difficult-to-alter characteristics.

4. Conclusions

Antipoverty expenditures historically have been modest in the United States, both as an absolute share of the federal budget and in relation to comparable expenditures in other developed countries. This makes it imperative that antipoverty proposals have desirable behavioral incentives and be cost effective and administrable.

The two policies described here are cost-effective in the sense that scarce federal resources are targeted to needy populations, but this raises a tension. We would like to minimize costs by directing subsidies either to those most in need or to those who will respond most positively to the incentive. But targeting may discourage people from moving out of a targeted group, or encourage others to adopt the behaviors or characteristics needed to receive subsidies. One way that benefits can be tightly targeted is by imposing high implicit (or explicit) tax rates, so that benefits are quickly clawed back as incomes increase over particular ranges. High marginal tax rates, however, may discourage people from working additional hours or seeking a higher-paying job.

Potential negative effects of high cumulative tax rates would have to be monitored closely with these two policy proposals, but I do not expect that this will be an important flaw with the proposed policies. There is considerable evidence from a large EITC literature that existing EITC clawback rates do not negatively affect hours of work. There is less direct evidence on the wage subsidy proposal, but it seems unlikely that it would negatively affect hours of work.

It is difficult to come up with precise, quantitative measures of the degree to which different policy proposals can be implemented and administered. The expanded EITC for childless workers will be straightforward to administer. The targeted wage subsidy proposal will require a new administra-

tive apparatus, perhaps through unemployment insurance offices, to send earnings supplements to workers.

The policies discussed in the paper are designed to increase the after-tax return to work and, in doing so, to increase employment. The expanded EITC for childless taxpayers would provide a substantial amount of money to low-income, working taxpayers and the communities in which they live. It would be easily administered, and would likely have positive effects on employment, crime, and family formation. A 50 percent wage subsidy of the difference between market wages and \$11.30 an hour would cost roughly \$3.1 billion annually if targeted to workers who reside in federally designated RCs/EZs/ECs. This policy would have a substantial effect on employment, crime reduction, and possibly marriage. It would contribute to the revitalization of these distressed communities.

The two parts of my proposal combined would cost \$10.4 billion. Based on empirical estimates from the literature, I expect employment to increase by nearly 850,000 jobs and crime to fall by over one million incidents. Conservative estimates of the social cost of crime indicate that the social benefit from reduced crime could cover 8 percent or more of the cost of the proposal. Many estimates of the cost of crime would claim much larger cost saving. The proposal would also increase marriage and improve the environments in which poor children are raised. These collateral benefits are striking for a policy that redistributes a substantial amount to poor, working individuals.

I nevertheless do not wish to oversell my proposal. The problems facing low-skilled workers and the communities they live in are massive. Schools in many communities are dreadful. Crime and gangs are endemic in some neighborhoods. Drugs and the drug culture create formidable problems for com-

munities. Many children are being raised in single-parent households, where the available resources and parenting skills create barriers to children's success. Employment tax credits and wage subsidies will not eliminate these problems.

Requiring that any set of policies costing \$10 billion solve all of these issues is clearly too much to ask. Rather, progress against these social ills will be gradual, arriving only with a series of sensible, well-designed policies. The social science evidence sug-

gests that expanding the childless EITC and adopting a targeted wage subsidy would be a meaningful step in the right direction. In addition, the policies are straightforward to implement (although the expanded EITC is clearly easier to implement than the wage subsidy.) The potential impacts of the childless tax credit and wage subsidies on employment, crime, and marriage are modest but real, and the expenditures have the additional benefit of augmenting the incomes of the working poor.

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Acknowledgments

I am grateful for the excellent assistance of Bradley Caruth, Ben Cowan, Hisam Kim, and Binzhen Wu. I also thank Jan Blakeslee, Gary Burtless, Jason DeParle, Robert Gordon, Bob Greenstein, Jeff Kling (particularly for his insights on wage subsidies and their administration), Peter Orszag, and Timothy Taylor and others on The Hamilton Project staff who provided helpful comments and guidance.



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