

TESTIMONY BEFORE THE SENATE BUDGET AND TAXATION COMMITTEE
ON SENATE BILL 166 – EARNED INCOME CREDIT

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Thank you for the opportunity to speak to you today. My name is Steve Hill. I work at the Maryland Budget and Tax Policy Institute. The Institute is a project of the Maryland Association of Nonprofit Organizations.

My testimony includes a brief discussion of the need for and merits of the refundable earned income credit in Maryland, and several charts which illustrate the disparate growth in our economy.

Recently released Census data show that median household income in Maryland is higher than in any other state in the U.S. After the recession of the early 90s, income growth in Maryland has been faster than virtually every state in the region and well-above the national average.

However, not everyone has been sharing in the prosperity.

During the 1990s, incomes of the poorest 20 percent of Maryland families were largely unchanged—essentially keeping pace with inflation. In other words, while changes in the economy benefitted higher income Marylanders, lower income working families experienced little improvement in their financial well-being.

Usage rates for the Maryland's current refundable earned income credit are a good indicator of the number of poor, working families in Maryland.

For tax year 1999, when Maryland's refundable EIC was 10 percent of the federal credit, and when eligibility phased out at earnings levels below or near the federal poverty guidelines, nearly 132,000 taxpayers received Maryland's refundable EIC. The average amount received was \$176.

Our state of 5 million people, with the highest incomes in the U.S., had more than 130,000 parents who worked, but who remained poor.

The refundable earned income credit is perhaps the most targeted approach to helping these families. Increasing the refundable EIC from the current law 15 percent of the federal credit up to 20 percent of the federal credit, as proposed in SB 166, would provide a more substantial income boost to these families, and extend a modest credit to taxpayers with children whose earnings are slightly higher than the federal poverty level. As shown in one of the attached tables, a 20 percent refundable EIC would provide a maximum of \$800 to a married couple with two or more children and with earnings equivalent to full-time, minimum wage work.

The Benefits of the Earned Income Credit

Expansions of the federal credit in the early 1990s have stimulated research on the effects of the credit. Much of the research is worth noting:

- The Earned Income Credit is the nation's most effective anti-poverty tool for children. More than two and a half million children a year are lifted above the poverty level by the additional income provided by the earned income credit.
- New research from Timothy Smeeding and colleagues at Syracuse University shows that many EIC recipients use their refunds to invest in their futures and/or to meet day-to-day expenses. Earned income credit recipients use their credits to paying off debt, invest in education, obtain decent housing, improve access to transportation – investments that enhance economic security and promote economic opportunity.
- The “make work pay” aspect of the earned income credit encourages more people to work. Several studies have concluded that the EIC has substantially increased labor force participation. For example, one study by Harvard economist Jeffery Liebman concluded that between 1984 and 1996 the EIC was responsible for 60 percent of the increase in labor force participation of single women with children.

In addition to these research outcomes, the earned income credit is central to a strategy to make work pay. It is targeted to families who work, but whose earnings remain low despite work. A taxpayer who works full-time, year round at the minimum wage still has earnings that fall \$3,000 below the federal poverty level for a family of three. Even at earnings of \$7 per hour, earnings remain below poverty for a family of three.

The Earned Income Credit's Impact on Taxes and Income

One rationale for the creation of the state refundable earned income credit in 1998 was to share with Maryland's lowest income, working families the benefits of Maryland's 1997 personal income tax cut. Because poor families did not have personal income tax liability, they did not benefit from Maryland's \$500 million tax cut.

However, research showed that due to the impact of more regressive sales, property, and

other taxes, the poorest 20 percent of Maryland families paid a higher share of their income in state and local taxes than any other income group.

The refundable earned income credit provided tax relief to Maryland's neediest and most heavily taxed families.

As the credit increases, the benefits of the credit become more expansive. Not only does it provide tax relief, but it provides a slight income boost to families. This boost, which comes in the form of a tax refund, can be used by families to invest in their futures and meet essential consumption needs.

The refundable earned income credit works. It rewards work, provides tax relief, and helps the working Marylanders who need it most. It is one of the policy tools used for boosting the incomes of working families.

The attached tables provide both context for the need for a refundable earned income credit, and demonstrate the impact of increasing the credit.

Thank you for the opportunity to testify today, and for your consideration of SB 166.

Note: Additional information about Maryland's Earned Income Credit is published on the Maryland Budget and Tax Policy Web site, www.marylandpolicy.org, or available by calling 301-565-0505.

Also available is our report "How Well Are We Faring?", which provides numerous charts on economic well-being in Maryland and discussion of steps that can be taken to address unmet needs.

Notes to the Tables:

Median Household Income, 1998-1999

Maryland ranked highest among states in median household income, according to the most recent Census Bureau data.

Changes in Real Incomes of Maryland Families, by Fifth of Families, From Late-1970s to the Late-1990s; and Changes in Real Incomes of Maryland Families, by Fifth of Families, From Late-1980s to the Late-1990s

These tables show that not everyone has prospered under the growing economy from recent years. Much of the growth in incomes has been concentrated among the richest 20 percent of Maryland families.

For example, from the late 1970s to the late 1990s, the average income of the richest 20 percent of Maryland families grew by 35 percent, after inflation. This is equivalent to an increase in annual income of \$43,000 per year. On the other hand, the average income of the poorest 20 percent of Maryland families was virtually unchanged over the same time period. The average annual income for this group increased by approximately \$350.

Impact of Refundable EIC Rates on the Tax Liability of Low- and Moderate-Income Families

This table shows how increasing the refundable EIC from 15 percent to 20 percent of the federal credit would increase the amount of the credit received by different family configurations at different income levels. The greatest increase would be experienced by those taxpayers who have earnings approximately equivalent to full-time, year-round work at the minimum wage. Increasing the refundable EIC to 20 percent of the federal credit would also extend the benefit of the EIC to some taxpayers with incomes that are slightly higher than the federal poverty guidelines.

2000 Poverty Guidelines

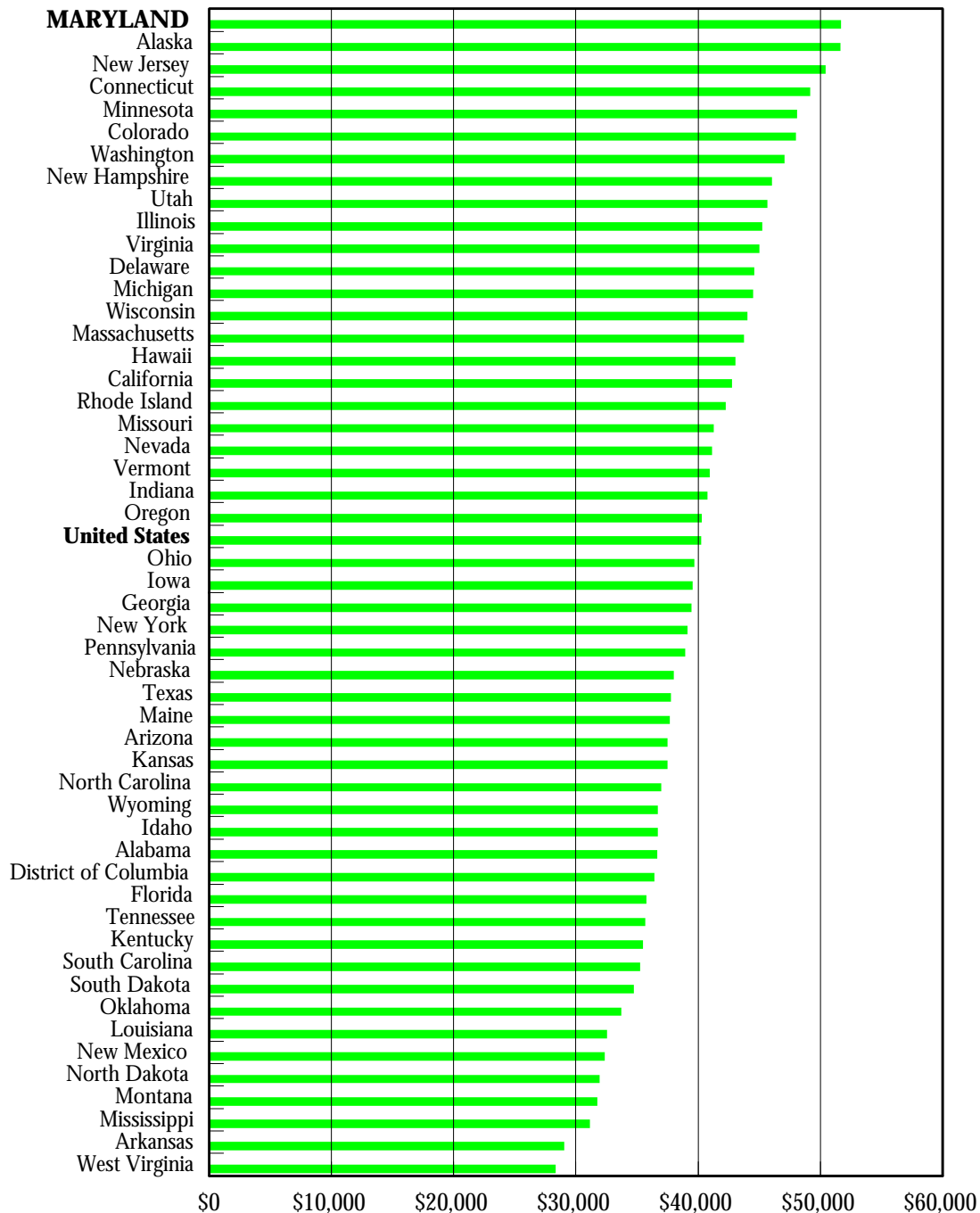
This chart shows the federal poverty guidelines for 2000, as published by the U.S. Department of Health and Human Services. Updated guidelines for 2001 will be published in February or March 2001.

The chart also compares earnings from full-time work at the minimum wage and at \$7 per hour to the poverty guidelines.

Of note, full-time work at the minimum wage provides earnings that remain below the poverty guidelines for any size family with children. Even working full-time at \$7 per hour leaves earnings below poverty for a family of size three. Taxpayers in this income range would benefit most from an increase in the refundable EIC.

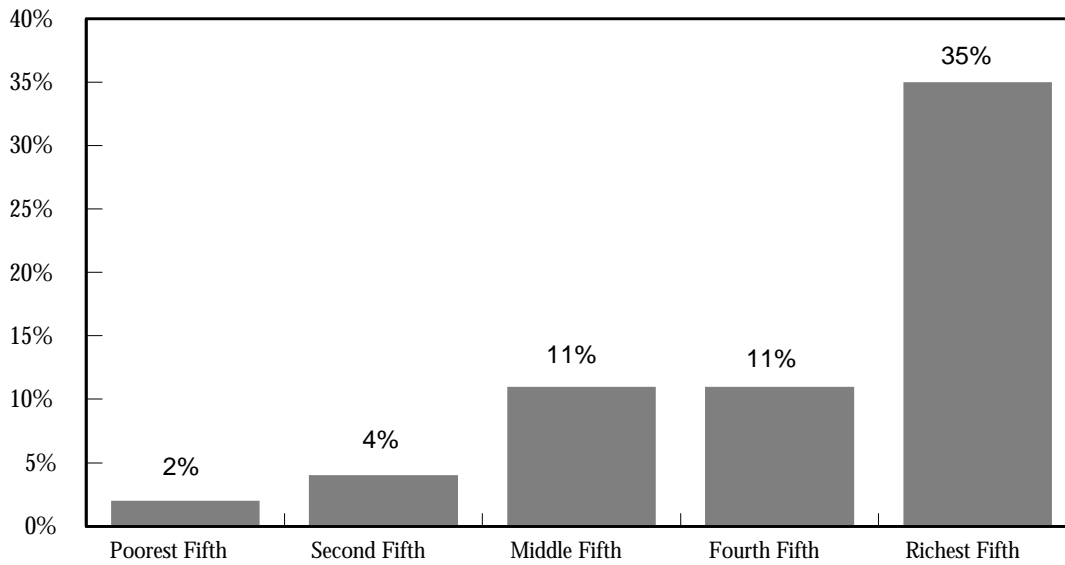
Median Household Income

1998-1999



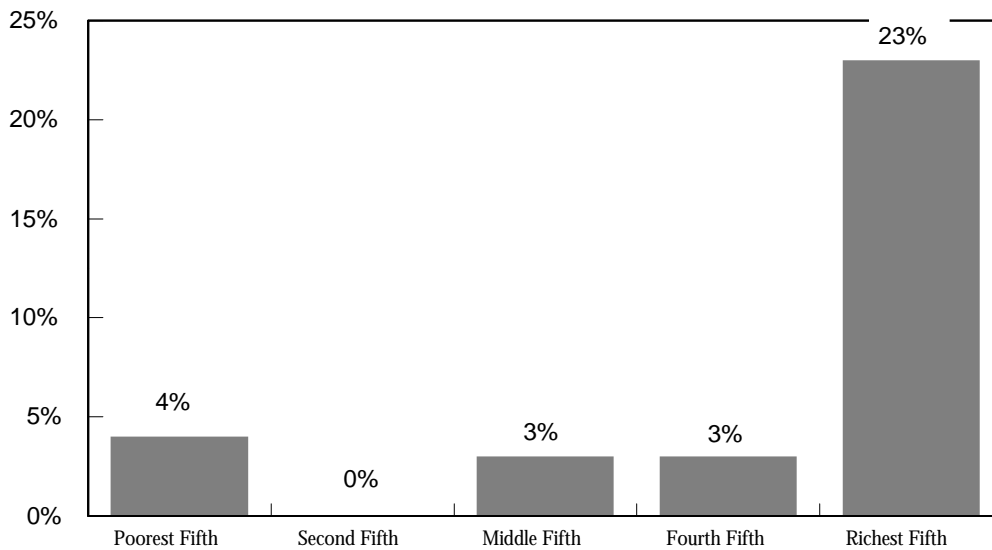
Source: U.S. Bureau of the Census, Current Population Survey, March 1999 and 2000.

**Changes in Real Incomes of Maryland Families, by Fifth of Families
From Late-1970s to Late-1990s**



Source: Analysis of Census Data, Center on Budget and Policy Priorities and Economic Policy Institute, "Pulling Apart: A State by State Analysis of Income Trends," January 2000

**Changes in Real Incomes of Maryland Families, by Fifth of Families
From Late-1980s to Late-1990s**



Source: Analysis of Census Data, Center on Budget and Policy Priorities and Economic Policy Institute, "Pulling Apart: A State by State Analysis of Income Trends," January 2000

**Impact of Refundable EIC Rates
And Fully Phased In Income Tax Changes
on the Tax Liability of Low and Moderate Income Families**
(numbers in parentheses indicate the size of a family's refund)

TWO PARENTS, TWO CHILDREN

Income	Current Law 15 Pct. TY 2001	Proposed Increase to 20 Pct. TY 2001
10,300	(601)	(802)
15,000	(422)	(602)
17,050	(259)	(418)
20,000	(24)	(152)
25,000	0	0

ONE PARENT, TWO CHILDREN

10,300	(581)	(782)
14,150	(389)	(578)
15,000	(321)	(502)
20,000	0	(51)
25,000	0	0

TWO PARENTS, ONE CHILD

10,300	(344)	(466)
14,150	(160)	(273)
15,000	(99)	(205)
20,000	0	0

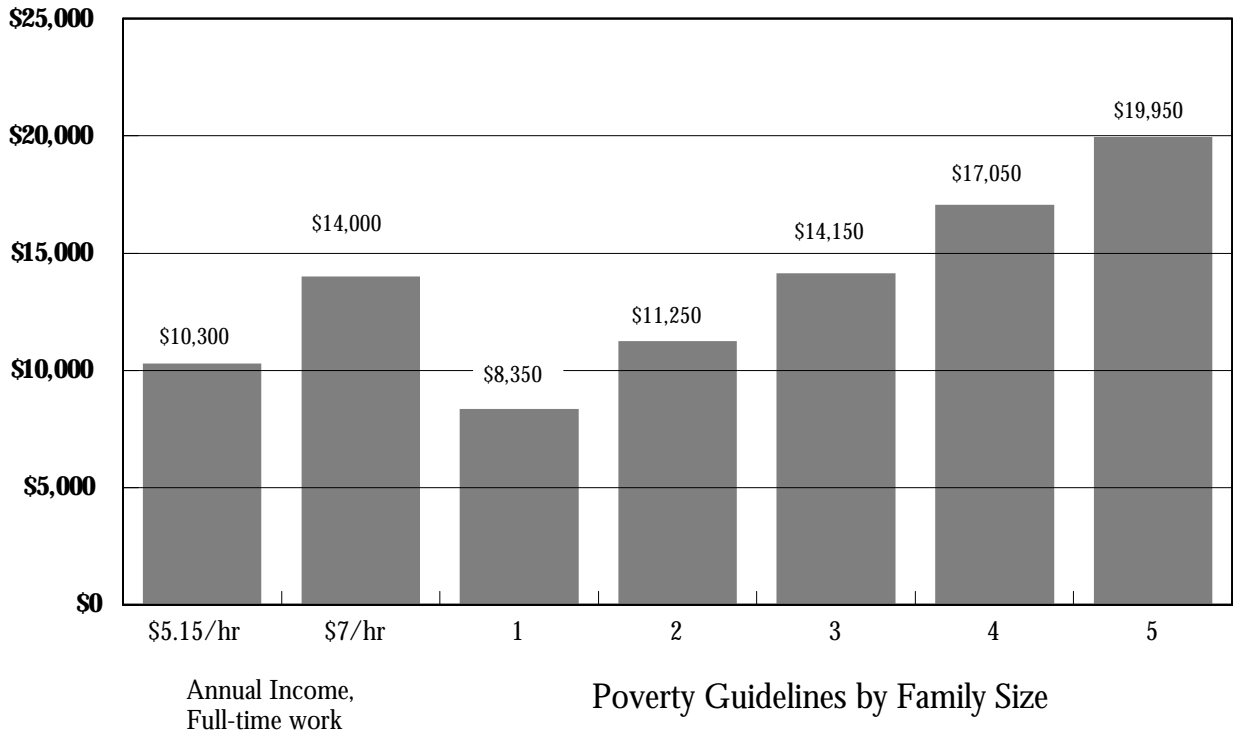
ONE PARENT, ONE CHILD

10,300	(269)	(486)
11,250	(224)	(345)
15,000	0	(104)
20,000	0	0

Notes:

\$10,300 is equivalent to full-time, year-round earnings at the minimum wage.
Bold text indicates the federal poverty level for that family size in 2000.

2000 Poverty Guidelines



Source: Federal Register Vol. 65, No. 31, Feb. 15, 2000