Comments on Rueben-Sammartino-Stark, *Upward Mobility & State-Level EITCS*

Daniel Shaviro, NYU Law School

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Overview of issues raised

State-level variation in EITCs raises 3 main types of issues:

1) Optimal EITC design (single-government case),

2) Fiscal federalism issues (state vs. federal; effects of regional variation),

3) Interaction between state & federal policies.

A federal policymaker might distinguish between states "supplementing" & "contradicting"/"undermining" federal policy.

E.g., extra aid to EITC recipients might be viewed differently than state-level "soak-up" of the federal EITC.

Why are these questions hard/interesting?

One reason among many is the difficulty of classifying the EITC within the Musgrave 3-function framework.

Conceptually, government has allocation & distribution branches (along with stabilization).

I've argued that this helps us to make sense of the "tax expenditure" concept; often TE = allocative policy mislabeled as distribution policy (e.g., tax credit for solar panels).

The distinction may also be relevant to fiscal federalism – e.g., if the feds should handle distribution, with states just providing public goods in a Tiebout framework.

EITC: allocation or distribution?

EITC is often mislabeled as a tax expenditure, even though rate brackets aren't so classified & it's just an input to them.

But because labor supply effects are so important to optimal design, can't think about the EITC purely in terms of the distribution branch.

(Of course, the same point holds for rate brackets generally.)

In this regard, it's useful to explore how one might rationalize preferring the EITC to a negative income tax (NIT).

NIT versus EITC

Compared to the NIT, a refundable EITC provides perverse anti-insurance as between successful & unsuccessful job-seekers.

Vs. “deservingness” rationale for the EITC.

This sounds like a non-welfarist distributional preference – but it can also be rationalized within a standard welfare framework.

One can analogize it to the case for universal health insurance (HI).

Rationalizing the EITC: HI analogy

Allocation branch: given that we provide urgent care in the ER, we should comparably (at the margin) subsidize pre-urgent care.

Getting very sick -> negative fiscal &/or altruistic externality.

Strictly speaking, the allocation branch might “want” to charge everyone a market price for their health insurance.

But the distribution branch could then adjust overall distribution as it liked, including by reason of a view concerning the distributional relevance of health levels.

From HI to the EITC

Here the point is that we won't let people starve, & thus will at least informally provide in-kind guaranteed income.

From this standpoint, demogrants might be viewed as having a negative fiscal externality re. those who would have worked.

The analogy admittedly breaks down a bit if we start looking for an analogy to the allocation branch's charging a market price for HI.

Also 2 further rationales for EITC instead of NIT.

(1) If current work -> longer-term work affiliation, may want to encourage due to paternalism &/or positive fiscal externalities.

(2) Given multiple income-conditioned benefits, the phase-in might help to rationalize overall MTRs.

Implications for state-level EITCs

EITC is a complex, multi-purpose instrument that (a) serves both allocative & distributional goals, & (b) interacts with other fiscal instruments that affect work incentives.

This complicates all 3 of my "headline" issues.

Obviously, optimal EITC design – but also fiscal federalism & assessing the consistency of state-level with federal-level EITC policy.

Four types of state-level EITCs

The paper notes 4 distinct approaches:

(1) No state-level EITC (e.g., Texas)

(2) Piggyback EITC (e.g., Maryland)

(3) Extra EITC for childless households (e.g., DC)

(4) Extra EITC at low wage levels that's rapidly phased out (California)

Federal EITC's MTRs are negative, then positive. Maryland ratably scales them up, DC does so for childless households, California turns much of the (40) bracket into (74), (6).

Fiscal federalism and state-level demogrants

Say we had NIT instead of EITC, & that states could charge pure Tiebout-style fees for local benefits (despite local public good pricing issues).

And say states therefore faced only the question: Should we also use income taxes on residents to fund additional demogrants?

They would face intrastate competitive pressures against doing this – favoring the Texas approach.

But we'd be unsurprised if California had leeway to do more of it than North Dakota.

With EITCs rather than NIT/demogrants …

That mode of analysis may still apply to a degree.

So could study, e.g., does market power (however best proxied) seem to increase the size of state-level EITCs?

This is Texas vs. the other 3, but could also look for effects on design (Maryland vs. D.C. vs. California, adjusting for size).

Hypothesis: household targeting (from # of children) might operate differently than earnings-level targeting.

Just how is for the authors to say – I'm just noting it as food for thought.

Supplementing vs. contradicting federal EITC policy

How do state-level modifications of the overall EITC affect federal EITC policy, or other federal objectives?

Again, reversing the entire EITC through a state-level soak-up (even if effective rather than explicit) would be an example of undermining or contradicting it.

Expanding the EITC proportionally through piggybacking looks like supplementing it.

But does that automatically settle things, from the federal standpoint?

Do the feds necessarily want EITC policy to be supplemented?

Making the EITC bigger may increase take-up.

But on the other hand, in the federally refundable portion it may reduce net federal revenues.

The feds could have independently made the EITC bigger had they wanted to.

So the real advantage, from the federal standpoint, is that the state pays part of the freight.

Hence, the feds may get a better ratio of take-up to federal revenue cost than if they had simply expanded the EITC themselves.

D.C. / California & federal policy

How does the analysis change if states expand the EITC selectively rather than proportionately?

Feds still get increased take-up, possibly at a net revenue cost, but without having to pay the full freight.

But is a harder problem posed by California's converting the EITC's (40) bracket into (74), (6)?

While no EITC participant ends up with less $$ overall than if the state EITC had not existed, California does reduce the marginal gain from working more in the (6) range.

Assessing the California offset

What should the feds' allocation & distribution branches "think" about this?

Allocation branch: It's still all good (albeit, possibly at a revenue cost) at the extensive margin.

But a further tradeoff at the intensive margin. The incentive to add hours increases in the (74) part, but declines in the (6) part.

Good news, presumably, that the extensive margin seems to matter more empirically than the intensive margin.

Distribution branch: If focused just on total effects, it's all good (apart from any federal revenue cost of increased take-up).