

The EITC and Racial Income Inequality

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Income inequality between Black and white Americans has persisted for generations, largely because of a range of historical and current social, political, and economic barriers aligned against black people (Darity and Mullen 2020; Huang and Taylor 2019; Gale 2021; Williams et al. 2021). Low incomes among many American families—including Black families—are associated with diminished socioeconomic outcomes, including lower educational attainment, health status, and wealth (Brooks-Gunn and Duncan 1997; Duncan et al. 2010). In this brief, we synthesize our findings on the role of the earned income tax credit (EITC)—a redistributive tax policy—as a tool to reduce after-tax income inequality between Black and white households from 1980 to 2020. The EITC, which provides a refundable tax credit to workers with low wages, was introduced in 1975 and expanded over time, most recently through a temporary expansion under the American Rescue Plan Act of 2021. By the late 1990s, the program was the primary tool delivering income support for families with dependent children headed by nondisabled adults—above and beyond traditional cash welfare. Although the EITC was initially available only at the federal level, over half of states have enacted refundable supplements that their residents receive on top of the federal EITC.

Summary of Findings

- We find evidence of rising income inequality throughout the overall US population, consistent with inequality trends documented by Autor (2014), Autor et al. (2008), and Burkhauser et al. (2012).
- The EITC lowers income inequality by 5 to 10 percent in a typical year, supplementing the after-tax earnings of workers with lower earnings.
- The EITC has no effect on inequality in the top half of the income distribution (e.g., P9050 ratios), but it is associated with relatively large inequality reductions in the bottom half of the income distribution.
- The EITC is associated with lowering Black-white income inequality at both the median and 25th percentile, especially after the EITC expansions of the early 1990s.
- The EITC does not reduce inequality at the 10th percentile of pre-tax income. Instead, from the early 2000s onward, the EITC may even slightly widen the Black-white income gap at the bottom of the distribution.
- Notwithstanding economic assistance provided throughout the COVID-19 pandemic, social welfare policy in the US has shifted over the past 25 years to a system where benefits are provided on a more temporary basis and conditioned on work. This system provides greater support for the near-poor and less support for families and households in relatively deep poverty (Ben-Shalom et al. 2012; Hardy et al. 2018; Shaefer et al. 2015).

Policy Context for EITC Expansion throughout the 1990s

The rising value of the EITC occurred as one component of a broader policy shift, reshaping the nation’s social welfare policy toward *temporary* income support that emphasizes the pursuit of employment opportunities (Moffitt and Ziliak 2019). Known as “welfare reform,” the policy changes in 1996 transitioned cash welfare from the Aid to Families with Dependent Children program to Temporary Assistance for Needy Families, a system of state-level block grants providing state policymakers with substantial autonomy with respect to whether and how they provide economic assistance to low-income families. Around the same period, the Omnibus Budget Reconciliation Act of 1993 expanded the EITC. A very large literature traces out a link between the EITC and a host of outcomes, from labor supply to child academic achievement over both the short and long run (see surveys in Hotz and Scholz 2003; Nichols and Rothstein 2016; Hoynes 2019). Yet most of the EITC literature does not examine whether the EITC has affected income differences and inequality between Black and white households.

How Could the EITC Shape Income Inequality?

Because of the unique design of the EITC, there are specific ways the EITC may affect after-tax racial income gaps. These policy effects are dependent on several factors. As a wage subsidy, the EITC could reduce Black-white after-tax income gaps if there is a larger positive Black employment response to the credit, whether because the credit brings a larger share of Black adults into work participation, because white adults have higher rates of nonparticipation, or because the credit creates economic incentives for Black adults—who are disproportionately situated in lower-wage occupations—to work more than white adults. Several studies demonstrate that EITC expansions in the 1990s stimulated employment among unmarried mothers (Eissa and Leibman 1996; Hoynes and Patel 2018; Meyer and Rosenbaum 2001; Schanzenbach and Strain 2020), but evidence of different responses by race is lacking. Second, even if there are no racial differences in the labor-supply response to the credit, the EITC could reduce the Black-white after-tax income gap

if Black workers are systematically paid lower pre-tax wages than white workers, and the EITC does more to narrow the gap between the post-tax wages of Black workers and those of white workers. Interestingly, there is long-standing evidence that pre-tax hourly wages of Black men are well below those of white men, but gaps among women are much less pronounced (Bayer and Charles 2019; Blundell et al. 2018; Smith and Welch 1989). Third, conditional on eligibility, the EITC could reduce Black-white income gaps if Black households are more likely to file and take up the credit. Evidence from Jones (2014) shows that take-up rates of the EITC are nominally higher among Black people than white people (82 versus 78 percent, respectively, in 2009). Whether the EITC reduces Black-white after-tax inequality, and by how much, remains an open question we address in our study (Hardy, Hokayem, and Ziliak 2022), summarized here.

Data and Measures

This research brief, which is based upon results from Hardy, Hokayem, and Ziliak (2022), uses the US Census Bureau's Current Population Survey Annual Social and Economic Supplement (CPS-ASEC) for the 1980-2020 survey years. For more information on our data and methodological approach, see the discussion of Data and Measures in Hardy, Hokayem, and Ziliak (2022).

Our inequality measures compare incomes between households at different positions, or “percentiles,” of the income distribution in the US. Here, we focus on four household percentile comparisons, or “ratios”: the 90th to the 10th percentiles (P9010), the 90th to 50th percentiles (P9050), the 50th to 25th percentiles (P5025), and the 25th to 10th percentiles (P2510) based on pre-EITC and post-EITC income that includes receipt of federal and state EITC.¹ These ratios provide insight into how the top of the income distribution (90th percentile) is changing relative to the bottom (10th percentile), the P9010; whether the top half of the income distribution is increasing disproportionately (P9050); or, whether the middle of the income distribution is gaining more compared with the lower end (P5025 and P2510). We present trends in these ratios for all races combined and, to specifically examine the effect of the EITC between Black people and white people, we present trends in the household Black-white percentile ratio using the P10, P25, and P50 levels for each group with pre-EITC and post-EITC income.² These pre-EITC and post-EITC ratios measure income differences between Black and white households at each

percentile. The comparison of trends in these ratios allows us to gauge the effect of the EITC on inequality at P10 and similarly for P25 and P50.

Evidence on the Link between the EITC and Black-White Income Inequality

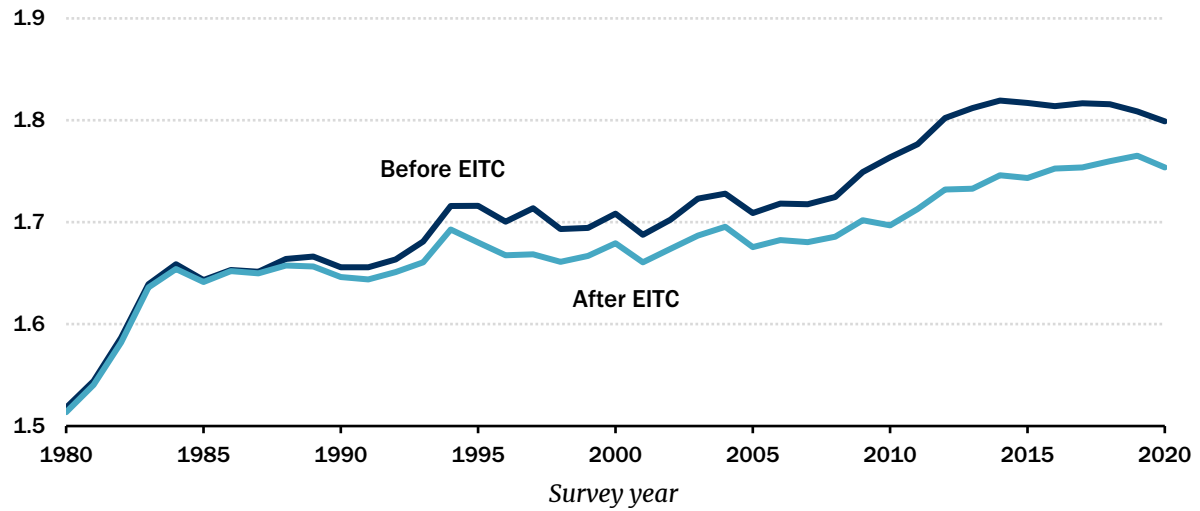
Figure 1 shows overall inequality trends before and after accounting for federal and state EITC benefits at the household level. Panel A depicts the trend in P5025 inequality; Panel B depicts the trend in P2510 inequality. Here, we find that the EITC reduces the P5025 ratio at an increasing rate from 1985 onward, by 0.006 (1988) to as much as 0.07 (2015), or about 10 percent. We find that the EITC is associated with particularly large reductions in P2510 inequality; the post-EITC inequality reduction begins to widen after the Tax Reform Act of 1986, and especially after the Omnibus Budget Reconciliation Act of 1993, from a level reduction of roughly 0.02 (1989) to 0.10 by 2005, or about 10 percent. After the Great Recession of 2007–09, the descriptive inequality reduction after accounting for the value of the EITC falls in absolute terms, with ratio differences as low as 0.03 in 2014 and 2015, suggesting that the redistributive effect of the EITC is less at lower levels of income.³

FIGURE 1

Trends in Lower-Tail After-Tax Household Income Inequality before and after the EITC

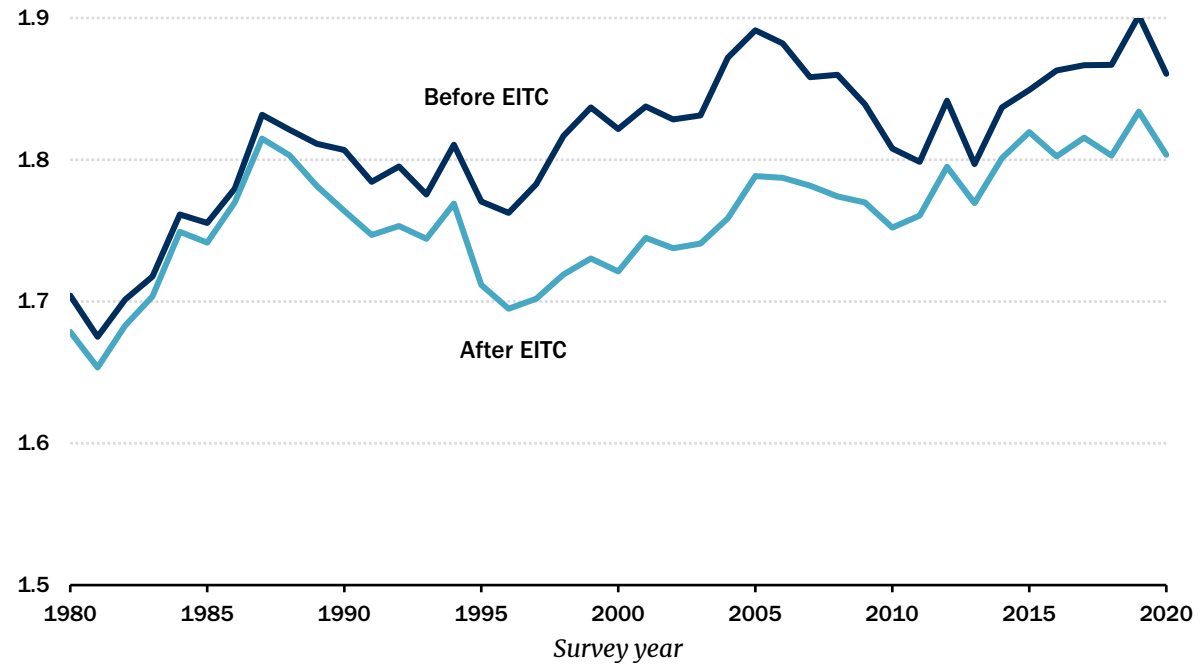
Panel A: P5025 Inequality

P5025 inequality ratio



Panel B: P2510 Inequality

P2510 inequality ratio



Source: US Census Bureau, Current Population Survey, 1980 to 2020 Annual Social and Economic Supplements.
Notes: This figure displays trends in lower-tail equivalized after-tax household income inequality, pre- and post-EITC. Panel A depicts the trend in the P5025 ratio. Panel B depicts the trend in the P2510 ratio.

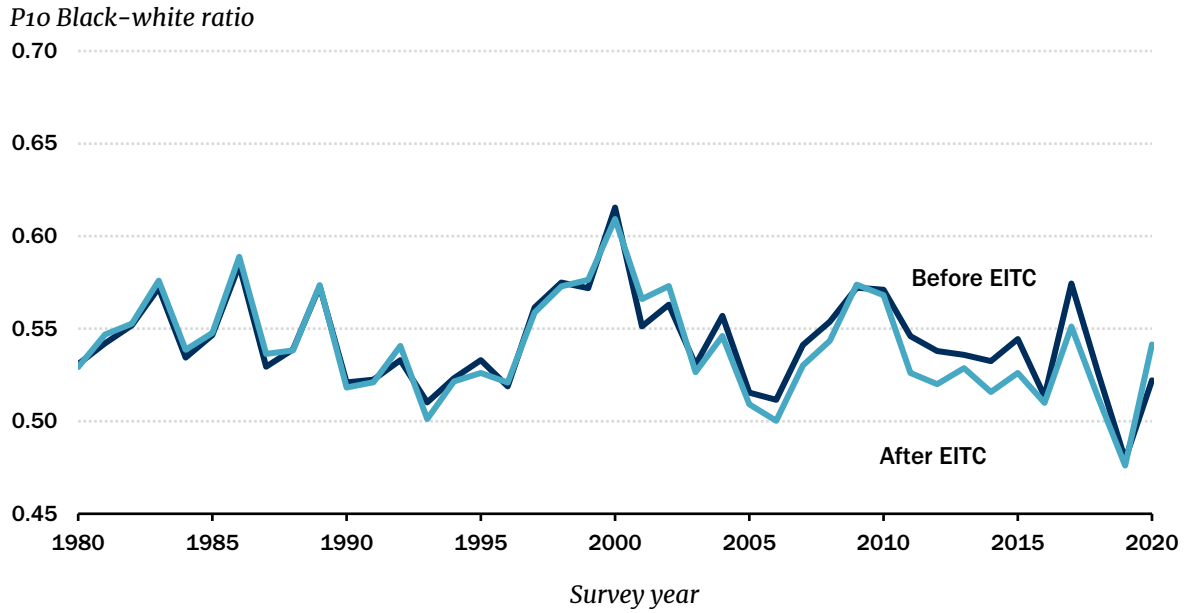
Figure 2 summarizes racial inequality trends by showing the Black–white percentile ratio across the pre-EITC/post-EITC household income distributions at the 10th, 25th, and 50th percentile of each group’s respective pre- or post-EITC household income distribution. The results demonstrate clear differences with respect to where and how the EITC operates as a racial inequality-reducing policy intervention, focusing on various percentiles of the income distribution. Beginning with the bottom of the income distribution, comparing Black incomes at the 10th percentile of the pre-EITC Black income distribution to white incomes at the 10th percentile of the pre-EITC White income distribution (Panel A), the EITC is associated with no substantive reduction in racial inequality and, if anything, a widening of income inequality.

On the other hand, the EITC is consistently associated with reduced Black–white inequality at the 25th and 50th percentiles (Panels B and C, respectively). At those percentiles, the EITC’s racial inequality reduction rises after the Omnibus Budget Reconciliation Act of 1993. At the 25th percentile, the reduction in racial inequality from the EITC peaked in 2005 at about 10 percent, then tapered off to about 5 percent in a typical year thereafter. Black–white inequality reduction from the EITC at the 50th percentile is smaller, consistent with the higher incomes across race at the middle of the distribution, but we also do not see a diminution over time as we do at the 25th percentile, except in 2020. This reduction at the 50th percentile is driven by Black–white income level differences rendering a larger share of Black households eligible for the EITC (figure 4). The other notable feature in figure 2 is that at both the 25th and 50th percentiles, there was a substantial reduction in the Black–white income gap starting in the early 1990s that persisted over time. This reduction is at both the pre-EITC income measure and the post-EITC measure, suggesting Black households had a different labor–supply response to the EITC. We explore this in further detail in the next section.

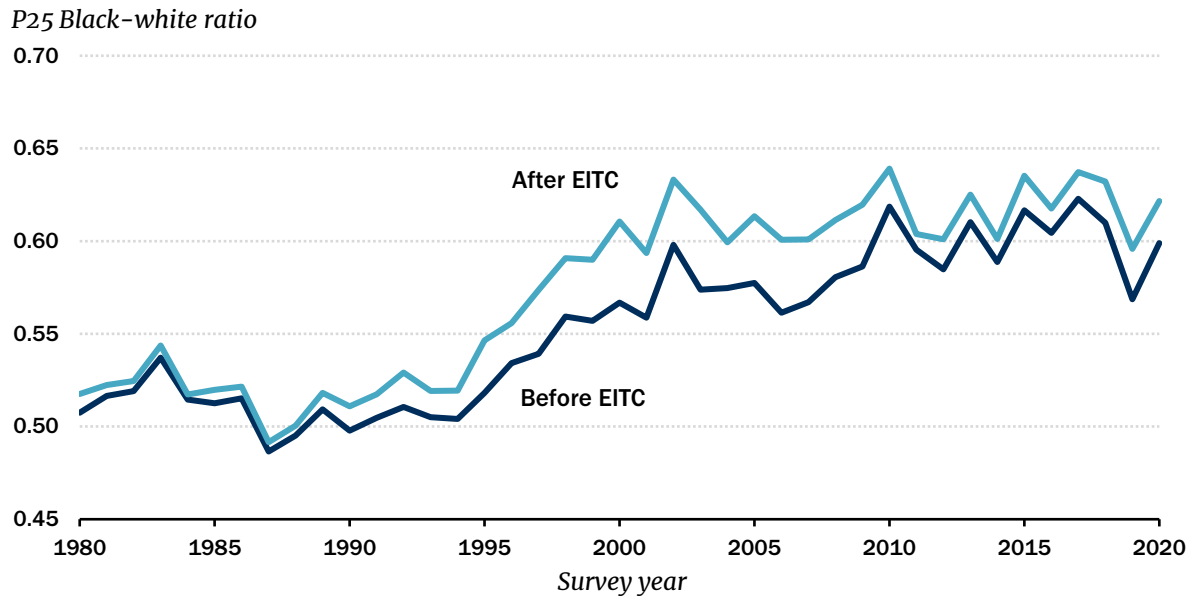
FIGURE 2

Trends in Lower-Tail Racial After-Tax Household Income Inequality, Pre- and Post- EITC

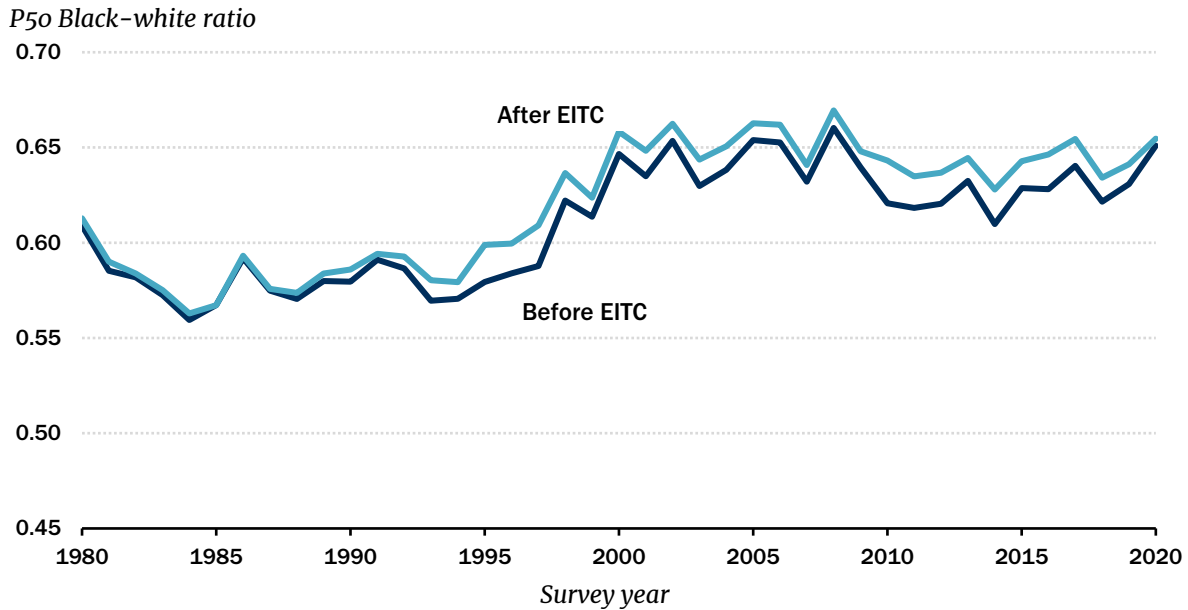
Panel A: P10 Black-White Ratio



Panel B: P25 Black-White Ratio



Panel C: P50 Black-White Ratio



Source: US Census Bureau, Current Population Survey, 1980 to 2020 Annual Social and Economic Supplements.
Notes: This figure displays trends in Black-white percentile ratios of equivalized after-tax household income pre- and post-EITC. Panel A depicts the trend in the P10 Black-white ratio. Panel B depicts the trend in the P25 Black-white ratio. Panel C depicts the trend in the P50 Black-white ratio.

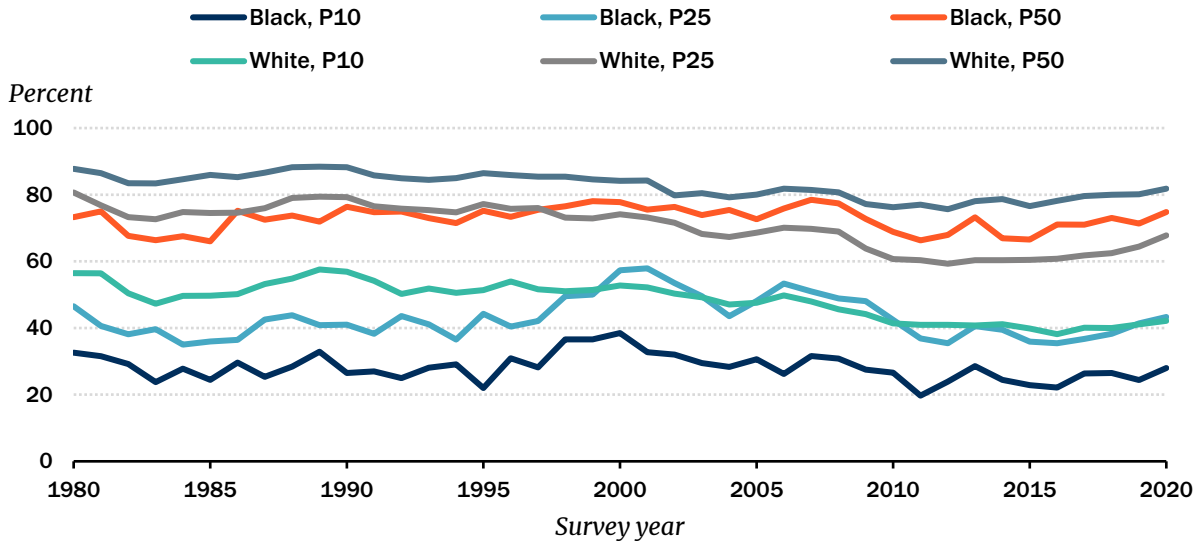
Can the Labor Supply Response to the EITC Explain Trends in Black and White Inequality?

Figure 2 documents differential inequality reduction in the lower half of the income distribution. This suggests differences in employment levels and intensity could be responsible for this observation. To explore this possibility, we use two measures to examine labor market outcomes on inequality: employment and annual hours worked.⁴ Figure 3 documents trends in trends in these measures overall and at percentiles in the bottom half of the distribution.

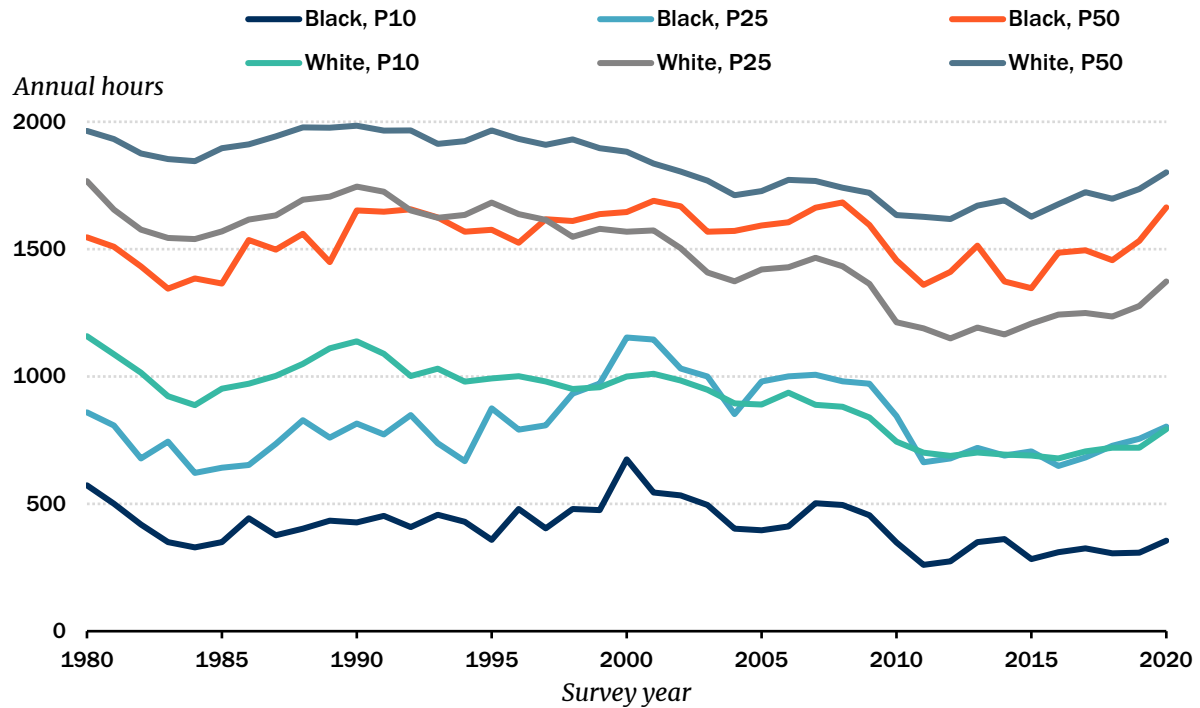
FIGURE 3

Trends in Lower-Tail Racial Work Outcomes

Panel A: Employment Rate



Panel B: Annual Hours of Work



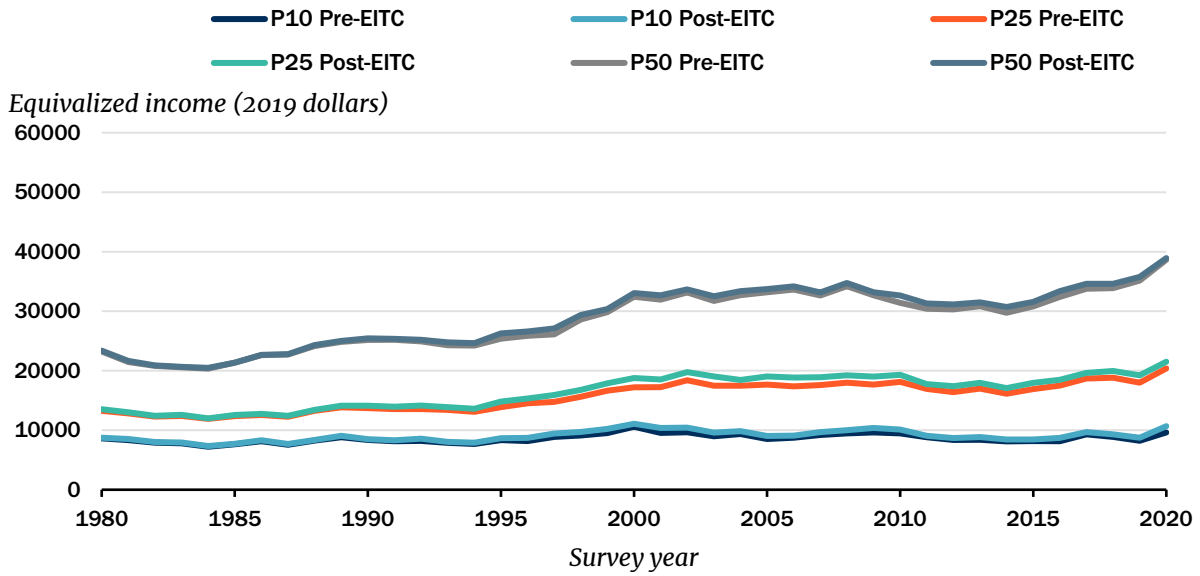
Source: US Census Bureau, Current Population Survey, 1980 to 2020 Annual Social and Economic Supplements.
Notes: This figure displays trends in the employment rate (Panel A) and annual hours of work (Panel B) by race of household head at percentiles of equivalized after-tax household income (P10, P25, and P50).

As was the case with the previous overall racial inequality trends, important patterns emerge as we disaggregate employment across the income distribution in Panel A of figure 3. Here we see that Black employment at the 10th and 25th percentiles of the income distribution increases by 74 and 30 percent, respectively, between 1995 and 2000. The economic and employment expansion throughout the mid-1990s coincides with policy expansions to the EITC and large-scale changes to the design of traditional cash assistance policy in the US. The employment trends reveal a potentially important mechanism through which racial income inequality operates. Employment levels for Black people at the 25th percentile of the Black pre-EITC income distribution lag those of their white counterparts at the 10th percentile of the white pre-EITC income distribution from 1980 up until 2000, when Black employment (57.3 percent) briefly overtakes white employment (52.8 percent). This reveals stark differences in employment across race and income level, which can in turn render a “conditional-on-work” cash transfer program ineffective. Racial employment inequality emerges higher up the distribution also, with employment levels for Black people at the middle of the Black pre-EITC income distribution positioned below such levels for white people at the 25th percentile of the white pre-EITC income distribution until 1998.

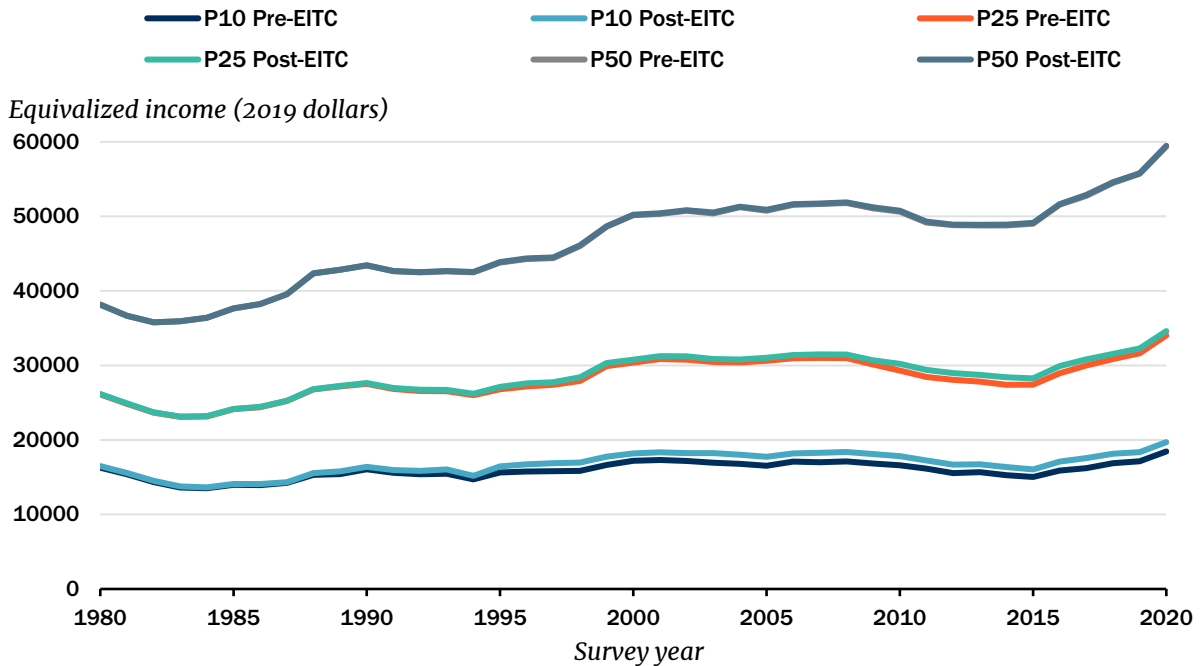
FIGURE 4

Trends in Racial After-Tax Household Income, Pre- and Post- EITC

Panel A: Black After-Tax Household Income



Panel B: White After-Tax Household Income



Source: US Census Bureau, Current Population Survey, 1980 to 2020 Annual Social and Economic Supplements.
Notes: This figure displays trends in percentiles of equivalized after-tax household income, pre- and post- EITC for Black (Panel A) and white households (Panel B).

Not only does the EITC condition payments on work, but benefits rise with income up to some maximum level—based upon the number of dependents, taxable income, and marital status—before phasing out. The intensive margin of work, or how many hours people work for pay, may also drive EITC-induced inequality. We explore racial differences in annual hours worked in Panel B of figure 3. Black-white gaps vary across the distribution, and white people with relatively lower incomes (10th percentile of the white distribution) report higher hours worked than Black people at the 25th percentile of their group’s distribution, though these are roughly the same after 2000. Of course, this is also a statement on the underlying group-level inequality. As shown in figure 4, the scale of Black-white inequality is large enough that white people at the 10th percentile of the distribution report mean equivalized income of \$16,720, higher than mean Black income of \$16,460 at the 25th percentile.

Conclusion

Our study documents lower Black-white income inequality in the bottom half of the after-tax income distribution in response to the increased generosity of the EITC, especially after the 1993 EITC expansion. This redistributive effect of the EITC varies across the bottom half of the income distribution. For households at the 10th percentile of the income distribution, the EITC is not linked to improvement in the Black-white income gap; however, there is evidence of inequality reduction at the 25th and 50th percentiles. Racial gaps in the employment response across race to the 1993 EITC expansion help explain the large inequality reduction. In Hardy, Hokayem, and Ziliak (2022), we show the response is at least twice as large for Black people than for white people. These results are consistent with a shift in social welfare policies—especially the provision of income support and cash welfare—to a system where benefits are conditioned upon work participation. This system provides greater support for the near-poor and less support for families and households in relatively deep poverty (e.g., Ben-Shalom et al. 2012; Hardy et al. 2018; Shaefer et al. 2015).

Although the EITC can provide thousands of dollars of income support for poor and near-poor families, work participation and tax filing operate as preconditions of receipt. Black Americans face a range of well-documented historical and current-day structural barriers to work and economic opportunity, including diminished labor market networks,

explicit racial discrimination, and higher rates of incarceration, which in turn reinforce the barriers they are more likely to face in the labor market (Western and Pettit 2010).

Racial differences in take-up of the EITC are relatively understudied. Recent work by Anderson (2021) documents that families with eligible child “nonfilers” were more likely to reside in low-income zip codes containing mostly people of color. Families from socioeconomically disadvantaged groups may be less likely to file taxes for several reasons, including the misperception that because they do not have tax liability, there is no requirement or benefit to filing. EITC outreach efforts, conducted by local nonprofits such as tax clinics housed within law schools, have worked to increase participation in the program. Scholars of both race and tax policy have connected these issues to the ways that tax policy may contribute to racial economic inequality (e.g., Brown 2021; Gale 2021).

The EITC incentivizes work and supplements earnings for workers with lower wages, including many Black families. Yet for a subset of Black people and others facing high earnings instability and barriers to stable employment, the EITC is limited as a viable income support tool. Targeted expansions of the EITC that supplement very low earnings (e.g., Burman 2020), as well as policies not conditioned on work participation, such as the 2021 expanded child tax credit, may better protect families at the lowest end of the income distribution.

Notes

- ¹ We use an equivalized definition of income that accounts for household size and composition based on a modified scale produced by the OECD. All estimates in our analysis are weighted using the household weight provided in the CPS ASEC.
- ² For example, at the P10 level, we calculate the Black-White percentile ratio with pre-EITC income as $P10\ Pre - EITC = \frac{Black\ P10\ Pre - EITC}{White\ P10\ Pre - EITC}$, and with post-EITC income as $P10\ Post - EITC = \frac{Black\ P10\ Post - EITC}{White\ P10\ Post - EITC}$.
- ³ In our full paper, we also examine trends in P9050 inequality and P9010 inequality, finding no effect of the EITC on P9050 inequality and some reduction in P9010 inequality. Because of this finding, we focus the remainder of this research brief on Black and white respondents at or below the median of the income distribution.
- ⁴ Both are observed in the prior year and correspond to when income is measured.

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