

# The EITC and Illegal Immigration

BY EDWIN S. RUBENSTEIN

*Edwin S. Rubenstein delivered the following speech at the National Press Club on April 14, 2009. The event—held the day before American taxpayers file their annual income taxes—marked the release of the Social Contract’s new report: The Earned Income Tax and Illegal Immigration.*

**T**he Earned Income Tax Credit (EITC) is the largest anti-poverty program in the United States. In 2007 more than 23-million households received \$47 billion in EITC payments. *That dwarfs traditional welfare and food stamp spending combined.*

Yet unlike those programs, the EITC is fairly unknown outside of the policy wonks who study it, and the low income individuals who receive it.

One reason for its relative anonymity is that credit is embedded in the tax code. (That’s why we chose the day before tax day to roll out this study.) The tax code is vast—it contains many different deductions, allowances, and credits—of which the EITC is one of the most generous—and important.

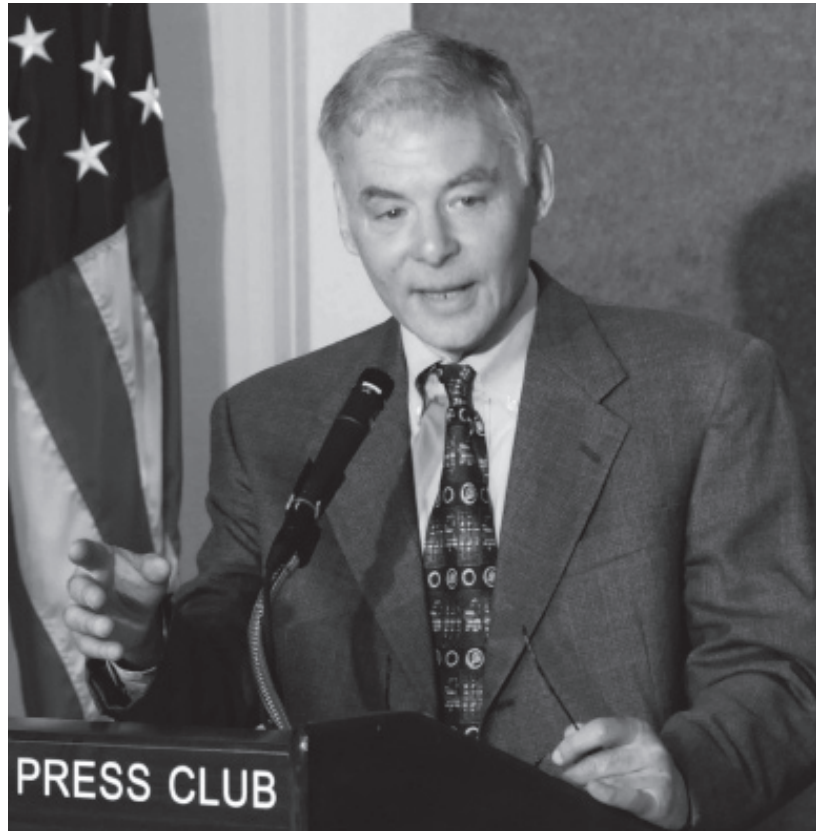
The other reason for its low profile is that credit is widely regarded as a success. (Nothing succeeds like failure when it comes to making a splash in public opinion.) Politicians from Ronald Reagan to Michael Bloomberg, Bill Clinton to George W. Bush, have not only supported the EITC but have moved to expand it over the years. They regard it as the one poverty program that works.

Their enthusiasm reflects the perception that—unlike welfare—the credit is only available to people

who work—the working poor, especially families with children. Unlike welfare benefits, which decline as a recipient’s earnings go up, EITC benefits go up as you earn more—actually increasing work incentives for low income individuals.

The credit does phase out—but only when income approaches the poverty level.

By the way, this is a very generous program. For a household with two children, the credit is equal to 40 percent of earnings. In effect, taxpayers



Edwin Rubenstein responds to a reporter during the question and answer session at the National Press Club, April 14, 2009.

give these folks a 40 percent raise if their income is below a certain level. Even if recipients have not paid a single cent in taxes, they are eligible for the full credit amount—up to \$4,800 in 2008.

From a distance, the EITC looks like a winner. The devil is in the details.

For starters, the program is dominated by fraud.

Between one-quarter to one-third of all EITC claims are “improperly paid” according to the GAO. Much of the fraud relates to immigrants. Immigrants account for 13 percent of the U.S. population, but receive an estimated 26 percent of EITC benefits in 2008.

Technically, only people authorized to work in the U.S. are eligible for the credit—you need a valid Social Security number. But identity theft, stolen Social Security numbers, and other scams effectively nullify the restriction. As a result, illegal aliens actually receive the EITC at even greater rates than legal immigrants.

The illegals have very powerful enablers in this regard. Foremost among them: the IRS itself. The agency does little to verify the validity of SSNs on tax returns, or the existence of immigrant children, or to ascertain that they’ve lived with the taxpayer for more than 6 months as required by law. Illegal alien husbands and wives often file separate returns in which BOTH claim the same children.

The EITC—like most of the tax code—operates on the honor system. It relies on the taxpayer’s self-assessment that he or she meets EITC eligibility criteria. This is very different from welfare and food stamps—where applicants are interviewed and required to present proof of eligibility.

H&R Block and other tax preparation services are also complicit in the fraud. Nearly three-quarters of all EITC recipients hire commercial tax preparers to do their returns. (In 2005 almost 71 percent did so.) It’s not the tax preparation per se—it’s the loans—the instant cash—that attracts so many poor taxpayers to these companies. And for the H&R Blocks of the world, it’s big money. When you add up the interest payments, preparation costs, and other fees, EITC recipients often spend more than

10 percent of the credit just to get the credit.

Activists are understandably annoyed that for-profit tax preparation companies have monopolized the EITC business. They want a piece of the action—for ideological reasons, though it’s also good for fund raising. So they have financed extensive EITC outreach efforts—including free tax help—for immigrants. The largest player in this group is a Washington based think tank—the *Center on Budget and Policy Priorities*. They are widely regarded as the most powerful poverty lobby in Washington. No legislation relating to the EITC is passed without passing muster with the Center. Their EITC outreach kit has flyers in 21 languages—from English and Spanish to Tagalog and Hmong—all designed to hook immigrants into the EITC culture.

The overarching assumption of liberal activists is that the credit is underutilized. This is simply not the case. As I show in the feature section of this issue, EITC is one of the most accessible of all anti-poverty programs. *Three-quarters of all households eligible for EITC receive EITC.* That’s a higher utilization rate than Food Stamps, Medicaid, and Supplemental Security Income (SSI).

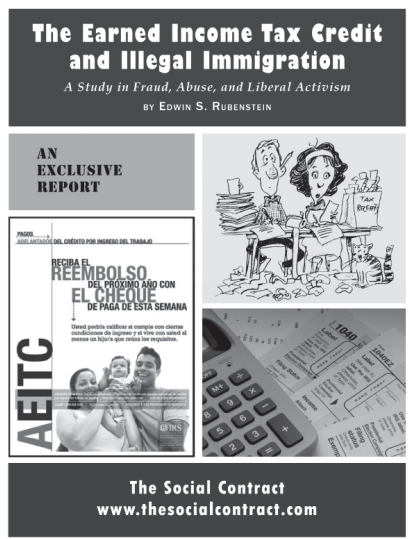
As an economist, I am particularly interested in the economic impact of EITC. The conventional wisdom is that it’s more effective at reducing poverty than the minimum wage—and that is undoubtedly true. Any program that gives over \$40 billion to the working poor is going to push many of them—most of them—above the poverty line.

*But this begs the question: what would the labor market look like without EITC?*

Let’s do a thought experiment.

Let’s suppose that no worker is willing to work for less than \$10 per hour. Even illegal immigrants with no education demand \$10 per hour.

If there is no EITC, employers would have to pay their workers at least \$10 per hour.



Let's put an EITC into effect. Let's make it a 50-percent credit—so that low income workers get a credit of 50 cents for every dollar of wages. Other things equal, low wage workers would get \$15 per hour—\$10 from the employer, and \$5 from the federal government—i.e., the taxpayers.

But other things would not be equal. The EITC would, in effect, allow companies to cut wages below the level that workers required before the credit. If they were to cut wages to, say, \$7 per hour, the employees would get an EITC of \$3.50 per hour—for a total of \$10.50 per hour.

The incentive to cut wages is irresistible. Even companies that pay high wages—because they invest in technology that makes their employees more productive—will be tempted to cut wages to take advantage of the credit. Otherwise they may find themselves unable to compete with their low-wage competitors.

Workers themselves face negative incentives under the EITC. That's because the credit goes down above a certain income. Why upgrade your skills and education if you are going to lose a chunk of your tax credit as your wages go up? If there were no EITC that would not be an issue.

The bottom line is that low wage employers are the big winners under EITC. Walmart is a prime example. The company launched a massive campaign to promote the credit a few years ago. A company spokesman at the time said "The momentum behind it is education—ways our employees can save money and live better." He said that with a straight face—but we all know that his company is notorious for short changing its employees. Walmart is arguably the largest employer of illegal aliens in the U.S.

The same business groups that tout the virtues of EITC also support mass immigration. That should come as no surprise: the influx of unskilled, uneducated foreign workers depresses wages for all American workers—foreign and native-born alike. Lower wages mean higher profits, higher share prices, and a net transfer of hundreds of billions of dollars from workers to their employers.

The EITC and immigration share responsibility for one of the most pernicious economic trends

of our time: the obscene income gap between rich and poor. Low wages are not the only unintended consequence.

Although the EITC started as a program to help the working poor, it has developed into a program where benefits are heavily contingent on parenthood; the tax credit rises sharply with children: A childless family receives a maximum EITC payment of \$438 in 2008; a family with one child receives up to \$2,917; two or more children bumps the maximum credit to \$4,824.

The presence of children thus triggers an 11-fold increase in EITC payment.

That's an irresistible windfall for low-income workers, a big incentive to procreate—or at least claim to. The IRS estimates that roughly half of the incorrect filing claims under the EITC involve fraudulent child custodial claims.

But most children claimed on EITC tax returns are real—and therein lies the problem. The decision to have children may often be influenced, at least in part, by the generous tax credit.

Parenthood incentives in the tax credit are far more acute for minority households and immigrants—for the simple reason that their incomes are lower and the credit represents a larger share of their total incomes.

It would be absurd to suggest that anyone has a child solely to get a larger tax credit. But at the same time, the groups with the highest EITC eligibility rates also have the highest fertility rates. Even a tiny increase in fertility rates, if maintained over the decades, will have enormous consequences.

The role of the EITC in the nation's demographic destiny cannot be denied.

What had started as a tax offset for low income workers is now simply another federal welfare program; a welfare program that subsidizes children in families least likely to afford them; a welfare program that benefits corporations more than the poor; a welfare program replete with fraud; a welfare program kinder to people here illegally than to natives.

Liberal activists have betrayed the EITC's original goals. At one time EITC was part of the solution. Today it is part of the problem. ■