# The Earned Income Tax Credit and Illegal Immigration

*A Study in Fraud, Abuse, and Liberal Activism*

BY EDWIN S. RUBENSTEIN

## Introduction

Since the Earned Income Tax Credit (EITC) became part of the income tax code in 1975, it has quietly become the largest cash transfer program in the United States. At a cost of more than $44 billion per year, EITC spending dwarfs that of the traditional welfare program—Temporary Assistance for Needy Families (TANF)—and food stamps combined. More than 23 million households currently receive the credit.

Whether measured in dollars or tax returns, the EITC had grown continuously for more than two decades:

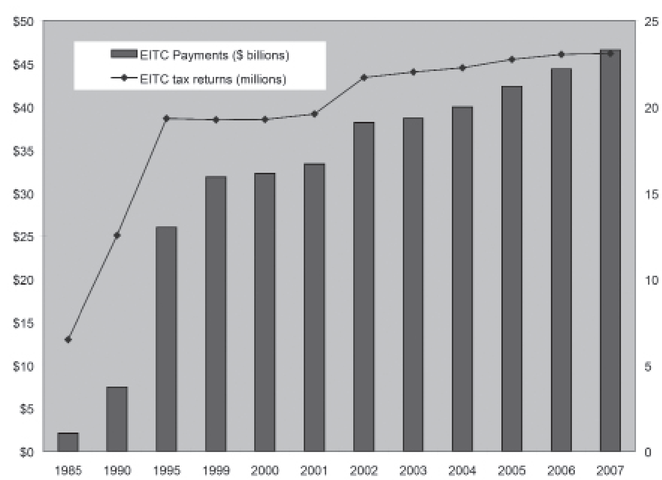
From 1985 to 2006, EITC payments grew from $2.1 billion to $44.4 billion, or by an eye-popping 2,014 percent. Total federal income tax revenues rose by 217 percent over that same period. Similarly, the number of returns claiming the EITC rose from 6.4 million to 23.0 million—an increase of 255 percent—over a period when the total number of federal income tax returns increased by 36 percent.

More than one in four immigrant households received the EITC in 2000—nearly twice the 13.2 percent rate of households headed by native Americans. And because immigrant households are larger (primarily because of higher fertility), their EITC payments are larger than those received by native households.

Bottom line: Immigrants accounted for about 13 percent of the U.S. population in 2008 but receive an estimated 26 percent of EITC benefits—about $12 billion.

Yet politicians from Ronald Reagan to Michael Bloomberg have touted the EITC as the one anti-poverty program that works. Their enthusiasm reflects the perception that the EITC, unlike welfare, helps only the working poor—especially families with children. While welfare benefits are phased out as a recipient's private earnings increase, the EITC credit is *phased in*—increasing work incentives for low-income individuals. The EITC payment is only phased out as income approaches the poverty level.

**The Rise, and Rise, of the Earned Income Tax Credit, 1985-2007**




Bipartisan support for the credit extends beyond the Beltway: As of 2006, some 20 states had their own EITCs. These state plans generally mimic the federal structure on a smaller scale, with individuals receiving a state credit equal to a fixed percentage, generally between 15 and 30 percent—of what they receive from the federal credit. A few small EITCs have been enacted by local governments—in San Francisco, New York City, and Montgomery County, Maryland.[1]

But enthusiasm for the credit has blinded policy makers to its problems. The EITC program is dominated by fraud. Year after year about one-third of all EITC returns are based on illegal multiple returns, phony Social Security numbers, or claims of non-existent children or spouses. A disproportionate share of illegal alien households receive the benefit.

Washington's love affair with the EITC has allowed the minimum wage to decline in real value. Native workers have suffered as a result. So have labor unions. In effect, the EITC subsidizes employers who hire low-wage immigrants and reject equally qualified natives. No one should be surprised, therefore, that Walmart, the U.S. Chamber of Commerce, and most liberal activist groups are major EITC supporters.

For most poor families, the tax credit check is the largest single sum of money they will receive during the year. Most receive it after filing income taxes. But some need the money immediately, and they can get it—for a price. A niche financial sector thrives by lending EITC recipients immediate cash in return for a hefty chunk of their credit check. The cost to the poor of these so-called Refund Anticipation Loans (RALs) has been estimated at 6 percent of the entire EITC program.

Widespread availability of high-interest RALs made poor borrowers easy marks for sub-prime mortgage hucksters. The resulting defaults have pushed the entire economy to the brink of collapse. While the sub-prime story is well known, few are aware of the EITC's role in introducing the poor to the culture of debt.

## About the Author

Edwin S. Rubenstein, *president of ESR Research, economic consultants, has 25 years of experience as a business researcher, financial analyst, and economics journalist. Mr. Rubenstein joined the Hudson Institute, a public policy think tank headquartered in Indianapolis, and served as director of research from 1997–2002. While at Hudson he wrote proposals and conducted research on a wide array of topics, including workforce development, the impact of AIDS on South Africa's labor force, Boston's "Big Dig," the economic impact of transportation infrastructure, and the future of the private water industry in the United States.*

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*From 1980 to 1986 he was senior economist at W.R. Grace & Co., where he directed studies of government waste and inefficiency for the Grace Commission.*

*From 1978 to 1980 he was a municipal bond analyst for Moody's Investors Service, where he was also editor of the* Bond Survey, *a weekly review of the municipal bond market. He served as senior quantitative analyst for the Office of the Mayor of New York City from 1973 to 1978. His writings have appeared in the* Wall Street Journal, *the* New York Times, Harvard Business Review, Investor's Business Daily, *and* Newsday. *He is a regular contributor to the* Social Contract *and* VDARE.com.

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Has the EITC lived up to its hype? In answering this, consider the following:

- The EITC originated as an anti-poverty program; the number of the returns claiming EITC benefits rose 25 times faster than the poverty population over the past two decades.[3]
- EITC benefits rise sharply with parenthood; poverty rates for families with children have risen faster than those for childless families since the credit was created.
- The EITC is the most illegal-immigrant friendly of poverty programs; illegal immigrants constitute a far larger share of the poverty population now.
- The EITC's payment structure is supposedly pro-family; a larger share of poor children live in single-parent households now than when the credit started.

**Implication:** The EITC is a textbook case of unintended consequences. (Our economic meltdown may be among them.)

The **good news:** The Obama administration is well aware of these problems. As evidence, this sage advice is excerpted from a memo prepared for the incoming Obama Administration and the new Congress:

> **...The current federal EITC provides large benefits to families with children, mostly single mothers, and minimal benefits to singles, even though declining wages have affected all low-income workers. These disparities create disincentives to work in the formal labor market and for poor men and women to marry, cohabitate, and coparent. Strategies that expand the current EITC would reduce family and child poverty but could**

## Legislative history

The EITC was the brainchild of Senate Finance Committee Chairman Russell Long. An arch-conservative, Long was detested by liberals who saw him as an obstacle to expanding the welfare state. True to form, he worked to defeat President Nixon's Family Assistance Plan—a negative income tax scheme that would have effectively doubled the size of the welfare rolls.[2]

But the Senator was not averse to giving poor people a helping hand—as long as it was done in a way that encouraged rather than discouraged work. His own welfare reform plan accomplished that by *guaranteeing* a public sector job to any family head needing work. The guaranteed jobs paid less than the minimum wage, so as not to encourage people to abandon more demanding private-sector employment. To help people cope with poorly paying jobs, Long added the EITC as a "work bonus" to help the new workers pay their Social Security taxes.

At its inception in 1975 the net cost of the Senator Long's welfare plan was about $4.3 billion—with $1 billion going for the EITC—big, big money in those days and more than a 60-percent increase over what Washington was then spending on welfare. The credit has been expanded a number of times, most notably by Ronald Reagan in 1986, Bill Clinton in the early 1990s, and George W. Bush in 2001.

**perpetuate existing inequities[4]....**

The bad news: President Obama's stimulus package increased EITC payments by $600 for poor families with three or more children, while leaving the program's perverse disincentives intact. This will merely exacerbate the credit's bias against work and marriage.[5]

Our take: The more Mr. Obama "changes" things, the more they remain the same. ■

## NOTES


1. Wikipedia
2. Jodie T. Allen, "Present at the Creation," Chatterbox, Dec. 13, 1999.
3. http://www.census.gov/prod/2008pubs/p60-235.pdf.
4. http://www.mdrc.org/recommendation_8.html
5. CBPP website.