UNIVERSITY OF MICHIGAN

SCHOOL OF SOCIAL WORK

Elimination of the Michigan EITC Will Cause Some People to Work Less and May Raise the Costs of Some Employers

Statement by H. Luke Shaefer, Ph.D.
Assistant Professor
University of Michigan School of Social Work
lshaefer@umich.edu
734.936.5065

My research focuses on the empirical analysis of public programs that support low-wage workers and their families in the US, including the Earned Income Tax Credit. Governor Snyder and some lawmakers have suggested that elimination of the Michigan EITC (MiEITC) would have no effect on low-wage labor supply in the state. Based on the best available empirical evidence, I can say with a high level of certainty that this is not true. Elimination of the state EITC, on net, would cause some people to reduce their work effort. It may also have the effect of raising the costs paid by some Michigan employers.

It is true that the federal EITC provides a much larger benefit than the MiEITC, and thus has a much larger impact on labor supply. However, it is important to remember that there are always individuals for whom even small reductions in wages (or wage subsidies like the MiEITC) will spur changes in labor market behavior.

Further, the MiEITC represents a sizable boost to the family incomes of recipients. Consider a single mother with one child working full-time at minimum wage in 2010. She would gross approximately $12,500 annually, making her eligible for the maximum federal EITC credit of $3,050 and a MiEITC of $610. If we sum up her net earnings (subtracting FICA) plus EITC credits, the MiEITC represents roughly half of a month's income for this family, certainly not an inconsequential amount. (If we add in the "additional child tax credit," the MiEITC is approximatey 45% of a month's pay.)

The best way to empirically test the effects of a state EITC on labor supply is to use the natural variation across states that have implemented such a credit. These credits were established at different times and under different macroeconomic conditions over the course of two decades. Thus, if such an analysis identifies an effect on labor force participation associated with state EITC implementation, researchers can have confidence that it is related to the credit itself.

To my knowledge, there is only one study that has undertaken such an analysis using nationally representative data. It is a 2010 study published in the *B.E. Journal of Economic Analysis & Policy* by Andrew Leigh, who received his PhD from the Harvard Kennedy School of Government. Leigh uses the same data from which we calculate our national unemployment rate.

He finds that implementation of a state EITC is associated with a substantial increase in work among low-educated adults with children. This supports the assertion that State EITCs lead some people to work, who would not do so otherwise.

Leigh's study also suggests that elimination of the MiEITC may force firms that employ low-skilled workers to pay higher wages than they would have otherwise. As more workers enter the labor force as a result of an expanded EITC, Leigh's study shows that employers are able to pay lower wages than they would have if the number of jobseekers was smaller. In fact, he finds that a 10 percent increase in the EITC is associated with a 5 percent decrease in the wages earned by adult workers without a high school degree, even those who don't access the tax credit. Eliminating the MiEITC would likely reduce the number of job seekers and force some employers to pay higher wages, which is an effective tax increase. In response, firms are likely to hire fewer workers than they would have otherwise.

It is important to understand the benefits and costs associated with any policy change. In the case of the elimination of the MiEITC, the empirical evidence is quite clear: this would lead some low-wage workers to leave the labor market, which may in turn would force firms that employ low-wage workers to pay higher wages.

In closing, I would just mention that my research, and that of others, finds that workers use their EITC to pay overdue utility and other bills. Often recipients turn their benefits into a "rainy day" fund for emergencies during the year. For this reason, elimination of MiEITC might result in additional evictions or foreclosures, and possibly bankruptcy filings. Further, the elimination of the credit will likely reduce spending at local businesses and thus reduce state sales tax revenues.