

The Economic Impact of the Earned Income Tax Credit (EITC) in the City of Fresno

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EXECUTIVE SUMMARY

This policy paper is intended to contribute to a better understanding of the merits and drawbacks of implementing a local and/or statewide Earned Income Tax Credit (EITC) and its anticipated effects in the City of Fresno and on its economically disenfranchised residents. In addition, the paper aims at broadening the understanding of the overall economic impact of the federal EITC in the City of Fresno. Only then can local and state legislators, policy makers, employer organizations, labor unions and voters make informed decisions regarding the impact of such policies on the local community and local economy.

The federal credit is a very powerful anti-poverty tool. Extensive research bears out the federal EITC as the single, most important factor in lifting people out of poverty. Furthermore, a city and state EITC may be also very helpful to economically disenfranchised residents, although the impact would not be near the benefit of the federal EITC.

The federal Earned Income Tax Credit, initiated in 1975 and substantially expanded in 1993 by the Clinton Administration, was originally created to offset the burden of increasing Social Security payroll taxes for low-wage workers. Since that time, the EITC has mushroomed into more than \$39 billion worth of assistance to almost 19 million low-income, working families. Twenty-eight percent of the families receiving the EITC had incomes below \$10,000 and 60 percent had incomes below \$20,000, according to the Joint Committee on Taxation.

Since the EITC's introduction, 20 states and a handful of cities have initiated local and statewide EITCs, which piggyback on the federal program. State EITCs range from 4 percent to 35 percent of the federal EITC. The local eligibility requirements are the same as federal requirements. State credits generally emanate from a mix of philanthropy, Temporary Assistance to Needy Families (TANF), and state or city general funds.

As this report explains, the EITC is a key contributor to local economies, as those eligible for the credit spend the bulk of the refund in the cities in which they live. Neither California nor Fresno has an EITC, although thousands of residents are eligible for, and take advantage of, the federal credit, which is filed with federal income-tax forms. The federal EITC pays for any taxes owed to the IRS and the remainder is a pure refund.

Key findings of the paper:

- In the City of Fresno, of nearly 190,000 federal tax returns filed in 2005, 26.8 percent claimed the EITC for \$105.6 million. The majority of refunds are spent on immediate needs, such as food and clothing, but the refund is also used to purchase “big ticket” items, such as appliances or television sets. Evidence suggests the vast majority of federal EITC funds benefits the City of Fresno's working-poor families.
- Each additional EITC dollar received and spent in the City of Fresno is estimated to generate a further \$1.40 in local economic activity, and one additional permanent job would be generated for each \$100,000 claimed.
- Poor families in zip codes 93701, 93702 and 93706 (south and west Fresno) show the largest number of EITC returns as percentage of the total returns (all above the average of 26.85 percent) and also the largest EITC payment checks (all above the average of \$2,027). Not surprisingly, families living in north Fresno (zip codes 93711 and 93720)

show the smallest number of EITC returns as percentage of the total returns and also the smallest EITC payment checks.

- Through the multiplier effect, federal EITC dollars spent in the local economy can generate up to \$7.9 million in tax revenue.
- The amount of federal EITC payments that poor and near-poor families receive in the City of Fresno is equivalent to what more than 6,300 workers making minimum wage would receive annually.
- More than \$95.6 million (more than 90 percent of the total Federal EITC payments) go to poor or near-poor families in the City of Fresno. For comparison purposes, according to American Community Survey U.S. Census data for 2006, the aggregate Food Stamp Benefits for the City of Fresno were more than \$50 million, which means that the federal EITC payments to poor or near-poor families are almost twice as large.
- More than \$26.4 million in federal unclaimed EITCs is lost because eligible residents did not apply for the credit. A coordinated approach is being undertaken by the United Way of Fresno County to gather free tax-preparation sites. Central California Legal Services has long campaigned for more residents to file. This is an important component to EITC outreach: The IRS reported in 2004 that 69 percent of low-income residents in the City of Fresno used a tax-preparation service. Many such companies are part of the payday-lending industry, which charge fees for tax preparation and filing for EITCs, and then lock residents into high-interest, refund-anticipation loans.
- The cost of tax preparation to claim the credit can substantially increase the administrative costs of the state- and city-level EITC programs. Even when such costs are included — bringing total administrative costs to about 7 percent — the EITC is still more administratively efficient than traditional welfare programs, and has a greater participation level than Temporary Assistance to Needy Families (TANF) and food stamps.
- If a full EITC-outreach campaign were undertaken by the City of Fresno, one in which every eligible resident claimed the credit, unclaimed federal EITC payments would create an estimated additional \$29.6 million in business sales, more than 250 jobs and \$8 million in labor income.
- The Assembly Revenue and Taxation Committee analysis reports a state EITC would cost \$686 million in fiscal year (FY) 2007-08, \$696 million in FY 2008-09, and \$706 million in FY 2009-10. A state of California EITC is unlikely because of ongoing structural deficits.
- The California Budget Project contends California's poorest families pay the most in taxes. Those with an average income of \$11,100 – the poorest fifth of the state's households – spend 11.7 percent of their income on state and local taxes. In comparison, the wealthiest 1 percent, with an average income of \$1.6 million, spends 7.1 percent of their income on state and local taxes. California is one of nearly half of all states in the country that imposes an income tax on working-poor families; most states levy income tax on families with incomes only slightly above the poverty line.
- Given the data constraints (for example, we don't know the exact number of eligible families at the local level), it is simply not possible to calculate the effect of the federal EITC program in reducing the poverty rate or to count the number of families that are

lifted out of poverty. The only evidence (albeit weak) that a more generous, federal EITC program can, in fact, reduce the poverty rate is that, for the 2000-2005 period, there is a small, negative correlation (-0.25) between the average federal EITC credit received by Fresno residents and the poverty rate in the City.

Conclusions:

1. Even if the state were to enact a 30 percent EITC (highly improbable), and the City created a 10 percent EITC (which it may be considering), the total combined tax credit of both programs would amount to a \$30 million impact to eligible City residents. Therefore, evidence presented in this report shows that a state or city EITC would have a significant positive effect on Fresno's economy, and on its population of poor and working poor, although not to the extent of the federal program.
2. In January 2007, Council Members Henry T. Perea and Brian Calhoun raised the issue of a city-wide EITC, which would have an impact on many of the city's poor and the economy. This report details the EITC and its costs, and authors invite all policy makers, including City Council, to read the report in its entirety.

Given the amount of EITC funding flowing into the City, and its tremendous ripple effect on the economy, the Fresno City Council and Mayor Autry should consider a city-wide EITC and a widespread marketing campaign to encourage eligible residents to apply for the federal EITC. Even zip code 93702, which has the highest participation rate at 30 percent to 45 percent, is still well below what it could be, as are many other City neighborhoods considered as being in extreme poverty. Central California Legal Services has historically conducted extensive EITC-outreach campaigns, and The United Way of Fresno County is developing a list encompassing the city and locations where residents may file taxes and apply for an EITC at no cost. Equally importantly is that such a campaign discourage the use of the payday-lending industry, whose products (such as refund-anticipation loans) can easily place poor and working-poor families into debt with fees and interest rates.

Without knowing exactly how many residents in the city live in poverty or the exact number of eligible residents to the EITC program, a key finding of this report notes that of nearly 190,000 federal tax returns filed in 2005, 26.8 percent claimed the EITC for \$105.6 million. Fresno has 47 neighborhoods whose residents are living in extreme poverty. A coordinated outreach campaign, particularly focused on zip codes with high eligibility but low participation rates, serves multiple purposes: Through door-to-door campaigns, billboards and information posted on buses, more residents will be made aware of the EITC benefits, and may be less inclined to have taxes prepared by payday lenders; the City stands to gain by a greater influx of EITC funds, which is immediately absorbed into the economy; and most importantly, more residents would be lifted out of poverty.

Section I.

A. Overview

This report is a discourse on the impact of the federal Earned Income Tax Credit (EITC) on socially, politically and economically disadvantaged residents and the City of Fresno's economy. The report also discusses the potential economic impact on residents and the City, if City Council and the State of California Legislature were to implement a respective local and statewide EITC.

A local and/or statewide EITC program, based on calculations contained in this report, would have sizable direct and indirect impact in terms of business sales, employment and tax revenue. However, while such legislation would have a significant impact, it would by no means approach the benefits currently produced by the federal EITC. Twenty states and a handful of cities already provide "piggyback" refunds on the federal EITC. State EITCs range from 4 percent to 46 percent.

The EITC's biggest impacts are its ease of administration and that it puts money into the pockets of those who need it most. In turn, that money is disbursed throughout communities. In 2006, the federal EITC provided an influx of \$105 million into the City of Fresno's economy.

The City of Fresno is confronted by the challenges of debilitating poverty. In the now-infamous 2005 report issued by The Brookings Institution, *The Aftermath of Katrina: Confronting Concentrated Poverty Across the Country*, Fresno was ranked as the city with highest concentrated poverty at 43.5 percent; concentrated poverty among African-Americans is an appalling 44.9 percent; and the City of Fresno is home to 47 neighborhoods with residents living in extreme poverty. Extreme poverty means more than 40 percent of residents are living – barely – below the 2000 federal poverty threshold, the report said.¹

The federal EITC, administered by the Internal Revenue Service (IRS), is responsible for lifting more residents out of poverty than any other single program, including the impact of Temporary Assistance for Needy Families (TANF) and food stamps combined, and is less costly, most researchers conclude. Every year, it lifts 4.9 million people, including 2.7 million children, above the poverty line.² Furthermore, studies have shown the credit to be the most significant contributor to the recent decreases in welfare use and recent increase in employment, labor supply and earnings in female-headed households.³ The federal EITC can put up to \$4,500 in the pockets of working parents who earn up to \$38,348 a year.

Actually counting who participates and who does not is an issue faced by many researchers and EITC support organizations alike. Participation rates are nearly impossible to calculate, says The Brookings Institution's Alan Berube. The obstacles are that "people who are not eligible claim the credits regardless; no one knows how many people in a given city are eligible for the credit; and eligible people claiming the credit are different from eligible people who don't."⁴

The discussion of additional state and city EITCs is particularly relevant to policymakers in offering a tool for city and state legislators to combat persistently high poverty rates in the City of Fresno and throughout the State of California. The city has all the major elements for economic disenfranchisement: an economy that depends on services and agriculture as its mainstay, which, in turn, produces comparatively low wages; a high rate of teenage pregnancies; and a below-par educational system, including a lack of vocational education; and large pool of unskilled labor.

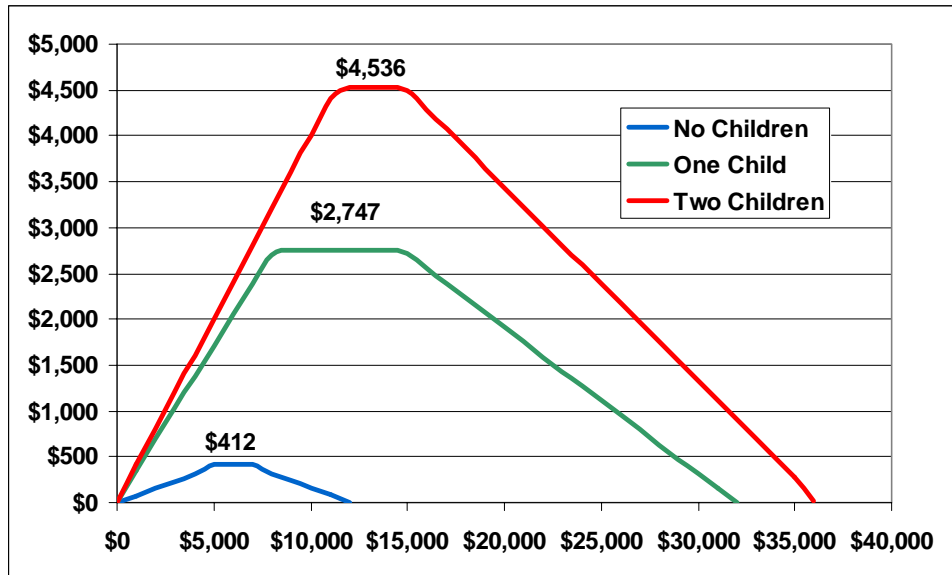
The concept of a local or statewide credit, in addition to the federal EITC, offers a new role for government. Addressing the conundrum of poverty, particularly in times of diminishing budgets, traditionally has left solutions to the complex arena of poverty under the purview of the federal government and taxpayers, which support traditional programs such as Medicare, CalWORKS, food stamps, housing vouchers and child care, to name a few.

Few understand the sizeable impact of the federal EITC in its singular ability to help lift the economically disenfranchised out of the depths of poverty. The credit is a valuable and effective tool for socioeconomic assistance. Numerous studies have shown the credit to be the most significant contributor to the recent decreases in welfare use and recent increase in employment, labor supply and earnings in female-headed households.⁵ Nationwide, about 80 percent to 85 percent of eligible taxpayers receive the EITC, “considerably higher than the ‘participation rate’ in traditional welfare programs like TANF and Food Stamps,” reports the Internal Revenue Service. U.S. taxpayers receiving an EITC refund in 2004 represented an outlay of \$36 billion.

In tax year 2005, the IRS reported more than 2.4 million Californians received a total of \$4.4 billion in EITC refunds. In the City of Fresno however, calculations in this report show more than \$26 million goes unclaimed. As the chart below shows, the more children a family has, the higher the return, however, important to note is the phase-out period, in which the family loses the benefit at about \$38. Critics call the phase out a disincentive to work, a subject discussed later in this narrative.

To receive the federal EITC, an individual must have earned income in 2007; be a U.S. citizen or legal resident; and have a valid social security number. A qualified claimant may have investment income of less than \$2,600 and a maximum annual earned income of varying levels based on the number of qualifying children, illustrated in Table I.

Table 1. Tax Year 2006 EITC Structure



Source: IRS

Table 2 below lists maximum income limits for EITC eligibility.

Table 2. EITC Maximum Eligibility

	Single	Married
25-65 Years Old with No Children Living at Home	\$12,120	\$14,120
One Child Living At Home	\$32,001	\$34,001
Two or More Children Living At Home	\$36,348	\$38,348

Source: IRS

As a refundable credit, the EITC provides assistance to families even if they do not face any tax liabilities. The vast majority of EITC refunds go to families with one or more eligible children and to those with incomes between \$10,000 and \$20,000 per year. The EITC can offset taxes owed, resulting in a partial refund, or more commonly, as a pure tax refund.

The precise amount of the refund depends upon the taxpayer's earned income. In its present form, the EITC wage subsidy has three distinct ranges:

- A phase-in range, over which the amount of the credit increases as the worker's earned income increases;
- A plateau range, in which the amount of the credit is constant regardless of changes in income level; and
- A phase-out range, over which the amount of the credit gradually declines until it reaches zero.⁶

The federal EITC emphasizes that work does indeed pay. Workers qualifying for the EITC and filing a federal tax return can get back some or all of the federal income tax that was taken out of their pay during the year or can opt to have the EITC spread out throughout the year in their paychecks. Even workers whose earnings are too small to owe income tax can get the EITC. In addition, the EITC offsets any additional taxes workers may owe, such as payroll taxes.

The EITC is not, in and of itself, a silver bullet to end poverty but rather a potent tool to help combat decades-long and misguided policies and attitudinal perspectives of policy makers and the community. Collectively, poverty is closely tied to the decline of manufacturing, suburbanization, rural dependence on agriculture, land-use policies creating racially segregated neighborhoods, the influx of immigrants, and children growing up in single-parent households, maintains The Brookings Institutions' Alan Berube.⁷

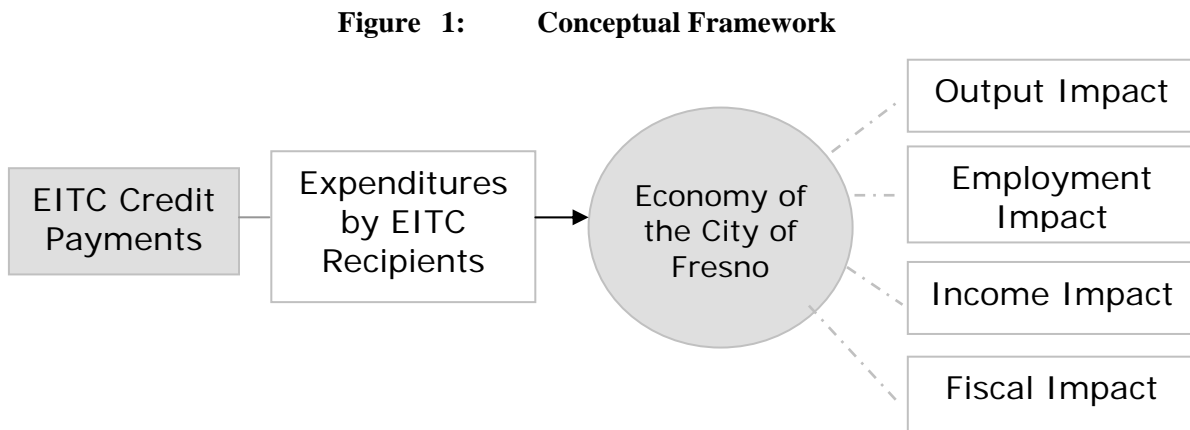
The consequences are serious and deadly for residents living in poverty and for the community as a whole. Berube stressed low-income neighborhoods result in private-sector disinvestment; underinvestment in education and training; children who attend school with other poor children; higher crime rates, especially violent crimes; negative and potentially fatal health outcomes; a higher incidence of teenage pregnancy; and high costs for local government.

B. Federal EITC Economic Impact in the City of Fresno

The large sums of EITC dollars claimed in the City of Fresno provide a substantial amount of expendable cash to its residents. This implies that the city's economy can greatly benefit from this annual infusion of money. Using EITC payments data for the City of Fresno from the IRS, this section assesses the economic impact of the EITC program in the City of Fresno. The impact attributable to the tax-credit payments to city residents filing for EITC is obviously linked to the impact attributable to the manner in which recipients of the credit spend this income in the City of Fresno. Such impact is measured in four different areas:

1. Additional output (business sales);
2. Number of jobs that these benefits payments support directly and indirectly;
3. Additional labor income; and
4. Additional local and state tax revenue.

Following the North American Industry Classification System (NAICS) at the 3-digit level, the distribution by industry of this impact is assessed.⁸ Figure 1 illustrates the conceptual framework of the economic impact analysis.



The analysis mainly relies on the use of input-output models and associated databases, which are techniques for quantifying interactions between firms, industries and social institutions within a local economy. In particular, the examination makes extensive use of IMPLAN, which is a computer software package, produced by the Minnesota IMPLAN Group, Inc. (MIG, Inc.) and used widely around the country.⁹

It is worth mentioning that despite the substantial economic benefits the EITC program currently provides to the local economy, it is possible that this impact be even larger for two reasons:

1. Not all taxpayers claim the credit (either because they are not well informed, they face cultural or language barriers or some other reasons); and
2. Not all taxpayers claiming the EITC credit get as much as they could (mainly because 70 percent of low-income taxpayers use the services of tax preparers, mostly payday lenders, which charge excessive interest rates on loans, in addition to fees).

In addition, it is equally important to draw attention to the following: According to the Assembly Revenue and Taxation Committee analysis, a state EITC would cost \$686 million in fiscal year (FY) 2007-08, \$696 million in FY 2008-09, and \$706 million in FY 2009-10. Committee staff estimated that this measure would reduce revenues, as a result of reduced tax liability, by \$14 million in each of these fiscal years.¹⁰

As it shown below, calculations resulting from this report estimate a state EITC in 2005 would have cost \$495 million. If California had a state EITC credit set at 10 percent of the federal EITC, the amount that Fresno City residents would get is \$7.9 million. Typically, state EITC programs are set at higher percentages of the federal EITC credit than city EITC programs.

Moreover, based on the experiences of other states and cities, a substantial number of federal EITC claimants fail to claim the state or city EITC credits, particularly in the first couple of years after being enacted. The primary reason for not applying is a limited awareness of the programs.

Table 3 shows the estimated cost of state- and city-level EITC programs at different percentages of the federal EITC program. The ‘cutoff’ rate of 7.5 percent that creates the two table rows – a city level and state level – is arbitrary; that is, the rate is based on state and city EITC programs launched across the country. Important to note is that even if California were to enact a 30 percent EITC, which is highly improbable, and the City developed a 10 percent EITC, the total combined benefits amount to a \$30 million impact to City residents, \$4 million more than the \$26 million amount currently unclaimed. Evidence, however, reveals that a state and city EITC, coupled with the federal credit, would have a significant effect on Fresno’s economy, and on its population of poor and working poor.

Table 3: Estimated Cost of State- and City-Level EITC Programs

	Percent of Federal EITC Credit	Amount of Federal EITC Claims TY, 2005	Estimated Cost of EITC Program at State or City Level	Adjusted Cost by Estimated Participation Rate (75%)
City Level	3.5%	\$105,617,000	\$3,696,595	\$2,772,446
	5.0%	\$105,617,000	\$5,280,850	\$3,960,638
	7.5%	\$105,617,000	\$7,921,275	\$5,940,956
State Level	10.0%	\$105,617,000	\$10,561,700	\$7,921,275
	15.0%	\$105,617,000	\$15,842,550	\$11,881,913
	20.0%	\$105,617,000	\$21,123,400	\$15,842,550
	25.0%	\$105,617,000	\$26,404,250	\$19,803,188
	30.0%	\$105,617,000	\$31,685,100	\$23,763,825

Source: IRS Statistical Information Services Office and authors’ calculations

The last column of the table shows the estimated cost of state- and city-level EITCs set at different percentages of the federal EITC credit. These amounts represent the dollars claimants would receive as credits, but do not include the costs of administering the programs, which are discussed below. For example, if Fresno City had a local EITC credit set at 3.5 percent of the federal EITC, the total amount eligible Fresno city residents would receive is \$2.7 million.

In practice, the cost of a refundable state of city level EITC during the first few years after enactment is likely to be lower than the numbers shown in the last column of Table 3.

Finally, a 2001 US General Accounting Office (GAO) reported the average participation rate for the whole country is approximately 75 percent;¹¹ this report assumes the same participation rate would be observed at the state and city level.

Table 4 shows that of nearly 190,000 federal tax returns filed in 2005 in the City of Fresno, some 26.8 percent of eligible residents claimed the EITC for a total of \$105.6 million. Table 4 also shows federal EITC payments made to city residents by zip code.

Not surprisingly, poor families in zip codes 93701, 93702 and 93706 (south and west Fresno) show the largest number of EITC returns as percentage of the total returns (all above the average of 26.85 percent) and the largest EITC payment checks (all above the average of \$2,027). Families living in north Fresno (zip codes 93711 and 93720), a much wealthier area of the city, show the smallest number of EITC returns as percentage of the total returns and the smallest EITC payment checks.

Again, readers should note that given the data available, the ability to estimate the EITC participation rate is limited, because calculations of how many local families may be eligible is not possible, therefore, it follows one cannot accurately estimate how many eligible families fail to claim the EITC or to calculate with precision the amount of unclaimed EITC dollars.

Following GAO's estimate that the average participation rate for the whole country is approximately 75 percent, the amount of unclaimed EITC payments in the City of Fresno are also estimated.¹² The federal unclaimed EITC payments to Fresno City residents total more than \$26.4 million; the average credit is \$2,027. To give a sense of the geographical distribution of EITC participation, Table 4 on the following page shows the EITC returns as percentage of total returns by zip code while Figure 2 maps federal participation based on zip codes in the City of Fresno.

Figure 3 illustrates the area served by Fresno Works for Better Health, inclusive of zip codes 93701 and 93702, which have the highest participation rates at 45.01 to 60 percent; 93703, which has a participation rate of almost 40 percent; 93706 at 43.59 percent; 93721 at 35.46 percent; 93727 at 29.64 percent; and 93728 at 31.97 percent.

These zip code areas are among the City of Fresno's 47 neighborhoods whose residents live in extreme poverty. The City of Fresno faces poverty rates similar to large metropolitan areas and other states. For example, recent Census figures indicate a California median household income of \$55,318 and a 12.2 percent poverty rate. This poverty figure represents a 1 percentage point drop from 2005 to 2006. The California Budget Project noted the decline was essentially insignificant.

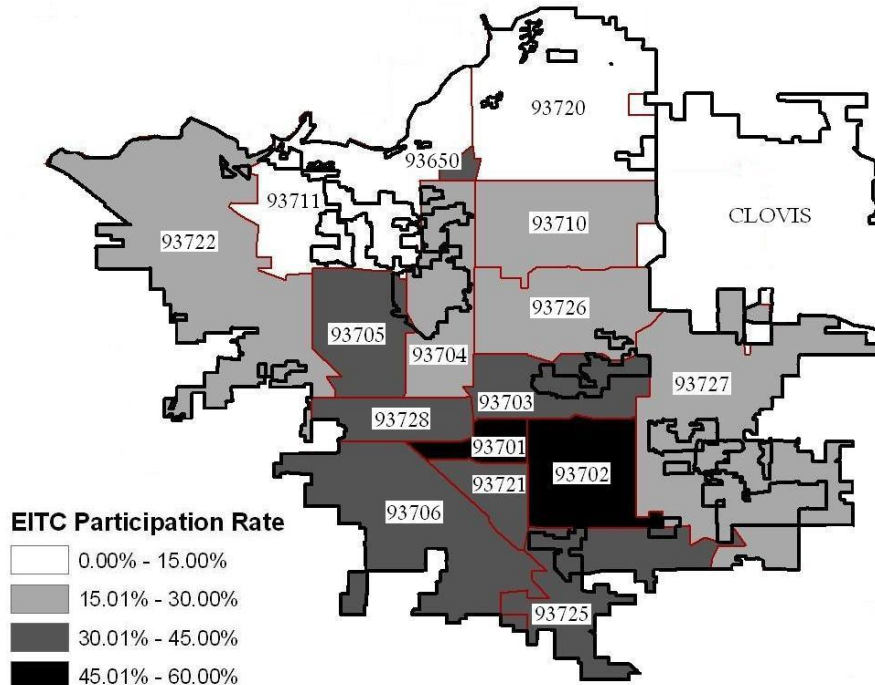
Table 4: Federal EITC Payments to City of Fresno Residents and Estimated Unclaimed EITC Payments by Zip Code, FY 2005

Zip Code	Total Returns	EITC Returns	EITC Returns as % of Total	Federal EITC Payments	Average EITC Credit	Estimated Unclaimed EITC Payments
93650	1,527	480	31.43%	\$1,031,000	\$2,148	\$257,750
93701	2,835	1,586	55.94%	\$3,607,000	\$2,274	\$901,750
93702	13,073	6,496	49.69%	\$14,804,000	\$2,279	\$3,701,000
93703	10,248	4,065	39.67%	\$8,806,000	\$2,166	\$2,201,500
93704	11,530	2,075	18.00%	\$3,783,000	\$1,823	\$945,750
93705	12,678	4,227	33.34%	\$8,913,000	\$2,109	\$2,228,250
93706	10,574	4,609	43.59%	\$10,321,000	\$2,239	\$2,580,250
93710	11,155	1,982	17.77%	\$3,804,000	\$1,919	\$951,000
93711	17,447	1,390	7.97%	\$2,226,000	\$1,601	\$556,500
93720	21,392	1,718	8.03%	\$2,902,000	\$1,689	\$725,500
93721	1,049	372	35.46%	\$717,000	\$1,927	\$179,250
93722	26,897	6,565	24.41%	\$12,856,000	\$1,958	\$3,214,000
93725	7,517	2,880	38.31%	\$6,319,000	\$2,194	\$1,579,750
93726	14,603	4,303	29.47%	\$8,623,000	\$2,004	\$2,155,750
93727	21,191	6,280	29.64%	\$13,260,000	\$2,111	\$3,315,000
93728	5,734	1,833	31.97%	\$3,645,000	\$1,989	\$911,250
TOTAL	189450	50,861	26.85%	\$105,617,000	\$2,027	\$26,404,250

Source: IRS Statistical Information Services Office and authors' calculations

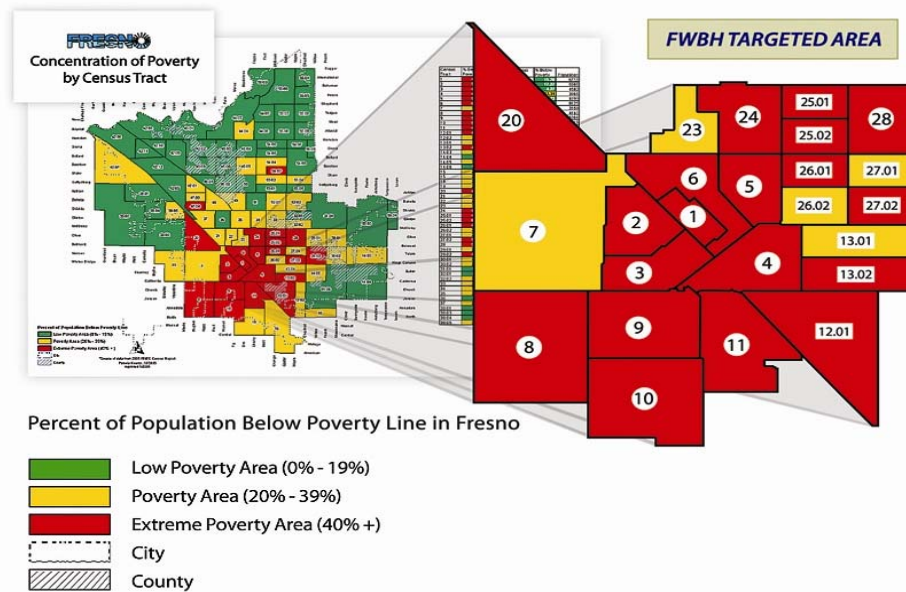
Note: zip codes 93701, 93702, 03703, 93706, 93721, 93727 and 93728 are the FWBH Advocacy Center's areas of concentration, and are also served by Fresno Works for Better Health's Neighborhood Employment Resource Centers in southeast Fresno, west Fresno and the downtown urban core.

Figure 2: EITC Returns as Percentage of Total Returns in the City of Fresno, FY 2005



Source: IRS Statistical Information Services Office and authors' calculations

Figure 3: Fresno Works for Better Health Target Areas



C. The Economic Ripple Effect

EITC payments to Fresno City residents are injected into the city’s economy when the refund is spent. As interactions among firms, industries and social institutions naturally occur within the local economy, EITC expenditures circulating within the income stream initiate a series of repetitive rounds of income creation, consisting of spending and re-spending, resulting in multiple effects. EITC payments spent in the economy of the city become income for residents, business and local government.

Obviously, the amount of actual EITC refunds spent in the City of Fresno can be smaller than EITC payments received by city residents due to leakages, primarily from payment of taxes owed, savings withheld and dollars spent outside the local economy. Exact determination in which a fraction of the EITC payments is spent within the city’s economy would probably require a more extensive survey than this report is able to consider. Instead, following what other researchers have done in similar studies, this report assumes 80 percent of the EITC payments made to Fresno City residents were spent within the city’s economy.

This assumption is conservative in that it considers the low mobility of low-income families and empirical evidence showing the low savings rate (and negative, in some cases) for low-income families. This report also assumes that EITC dollars would be spent on a pattern similar to household expenditures with incomes between \$15,000 and \$25,000, which would be spent on food, clothing and sometimes, bigger-ticket items, such as replacing worn appliances, all depending on the refund’s size.

Table 5 on the following page shows the economic impact of EITC payments spent locally and the potential economic impact of the unclaimed EITC credits, if the credits were claimed. The first column represents the actual economic impact produced by injection of EITC payments into the local economy; the second column represents the feasible economic impact of all the

unclaimed EITC dollars by city residents. As explained earlier, in both cases, the assumption is that 80 percent of the EITC payments are spent locally.

Estimates indicate that spending resulting from families receiving the federal EITC creates a total of \$118.7 million in business sales in the city (output), supports more than 1,000 jobs and creates \$32.2 million in labor income paid by city companies.

Each additional EITC dollar received and spent is estimated to generate a further \$1.40 in local economic activity, and one additional permanent job would be generated for each \$100,000 claimed.

It is worth noticing that, if all eligible residents claimed the credit, total federal EITC payments would create an estimated additional \$29.6 million in business sales, more than 250 jobs and \$8 million in labor income.

Table 5: Economic Impact of the EITC in Fresno City, TY 2005

	Claimed EITC Payments	Unclaimed EITC Payments
Federal EITC Payments	\$105,617,000	\$26,404,250
% of Federal EITC Payments Spent Locally	80%	80%
Local Spending	\$84,493,600	\$21,123,400
Economic Impact:		
Output	\$118,741,874	\$29,685,469
Employment	1,018	254
Labor Income	\$32,251,649	\$8,062,912

Source: IMPLAN Data and authors' calculations

Table 6 details output and employment impact following NAICS at the 3-digit level. Retail Trade, Real Estate and Health & Social Services industries clearly register the bulk of the economic impact generated by EITC payments spent within Fresno City's economy. The impact on these three industries would amount to almost 40 percent of the total business sales and almost 50 percent of the supported jobs. A similar impact distribution by industry would be clearly observed if every resident eligible for the credit claimed it.

Table 6: Economic Impact of the EITC in Fresno City by Industry, TY 2005

INDUSTRY	Claimed EITC Payments		Unclaimed EITC Payments	
	Output	Employment	Output	Employment
Ag, Forestry, Fish & Hunting	\$406,558	3	\$101,639	1
Mining	\$103,291	0	\$25,823	0
Utilities	\$1,732,035	3	\$433,009	1
Construction	\$911,109	7	\$227,777	2
Manufacturing	\$6,382,688	21	\$1,595,671	5
Wholesale Trade	\$7,447,040	48	\$1,861,759	12
Transportation & Warehousing	\$2,660,008	22	\$665,002	5
Retail trade	\$15,158,276	199	\$3,789,569	49
Information	\$4,792,552	14	\$1,198,138	4
Finance & insurance	\$9,503,643	50	\$2,375,910	13
Real estate & rental	\$10,085,255	45	\$2,521,314	10
Professional-scientific & tech services	\$5,224,211	42	\$1,306,053	11
Management of companies	\$1,216,228	8	\$304,057	2
Administrative & waste services	\$2,806,094	41	\$701,524	9
Educational services	\$1,210,149	22	\$302,537	5
Health & social services	\$22,170,769	241	\$5,542,693	61
Arts- entertainment & recreation	\$1,054,165	21	\$263,542	5
Accommodation & food services	\$6,228,397	106	\$1,557,099	27
Other services	\$6,363,966	115	\$1,590,991	29
Government	\$13,285,440	10	\$3,321,360	3
TOTAL	\$118,741,874	1,018	\$29,685,469	254

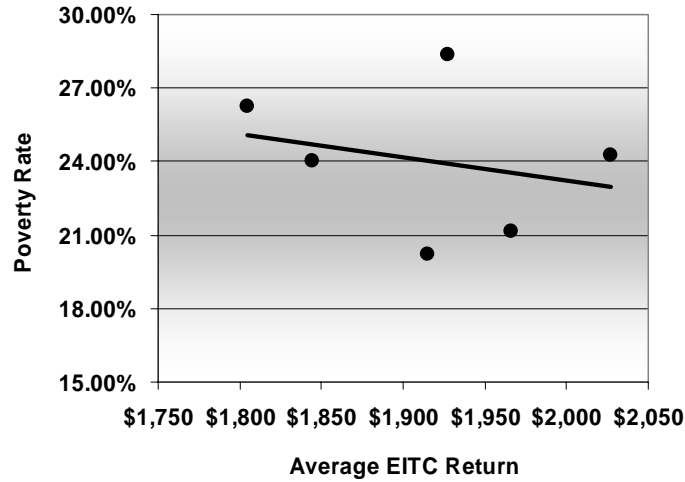
Source: IMPLAN Data and authors' calculations

Although insightful and informative, the analysis so far shows little about one of most attractive features of the EITC: its effect on poverty. As mentioned, the EITC program is generally recognized for its simplicity and administrative efficiency, but most of all, for its effectiveness in lifting working-poor families out of poverty.

Given the data constraints (for example, we don't know how many eligible families are at the local level), it is not possible to calculate the effect of the federal EITC program in reducing the poverty rate or to count the number of families that are lifted out of poverty.

The only evidence (albeit weak) that a more generous federal EITC program can, in fact, reduce Fresno's poverty rate is that for the 2000-2005 period, there is a small negative correlation (-0.25) between the average federal EITC credit received by Fresno residents and the poverty rate in the City as shown in Figure 4 on the next page.

Figure 4: Negative Correlation between Poverty Rate and Average Federal EITC Credit for the City of Fresno, 2000-2005



Sources: US Census American Community Survey, California Department of Finance, California Employment Department and IRS Statistical Information Services Office.

However, it is possible to assess the positive impact of the Federal EITC on poor and near-poor working families. The EITC data produced by the IRS decomposes the Federal EITC payments by zip code and also by income categories. The closest category to the approximately \$20,000 poverty threshold established by the U.S. Census for a family of four is income levels between \$10,000 and \$20,000. Therefore, it is not possible to totally isolate poor families. Nevertheless, considering that all families making less than \$25,000 a year are either poor or near poor, it is possible to calculate the amount of Federal EITC payments that these families receive.

As shown in Table 7 on the following page, more than \$95.6 million, or more than 90 percent of the total federal EITC payments, go to poor and near poor in the City of Fresno. For comparison purposes, according to American Community Survey U.S. Census data for 2006, the aggregate food stamp benefits for the City of Fresno were more than \$50 million, which means that the federal EITC payments to poor or near-poor families are almost twice as large.

Similarly, the amount of federal EITC payments that Fresno's poor and near poor receive is equivalent to what more than 6,300 workers making minimum wage would receive annually. Alternatively, the amount of federal EITC payments that poor and near-poor families receive is equivalent to almost 50 percent of the General Fund of the City of Fresno Budget for 2006.

Table 7: Fresno City Families with Income of Less than \$25,000 Receiving EITC Benefits by Zip Code, TY 2005

Zip Code	Percent	Federal EITC Payments
93650	84.38%	\$944,000
93701	87.83%	\$3,367,000
93702	83.24%	\$13,500,000
93703	81.82%	\$7,922,000
93704	81.54%	\$3,388,000
93705	83.25%	\$8,104,000
93706	84.99%	\$9,517,000
93710	83.65%	\$3,471,000
93711	80.94%	\$1,978,000
93720	80.21%	\$2,570,000
93721	89.25%	\$678,000
93722	80.44%	\$11,430,000
93725	81.22%	\$5,660,000
93726	83.13%	\$7,821,000
93727	81.39%	\$11,922,000
93728	85.00%	\$3,329,000
Total	83.27%	\$95,601,000

Source: IRS Statistical Information Services Office and authors' calculations

Looking at the number of poor or near-poor families as a percentage of the total number of families receiving the EITC benefits, evidence strongly bears out researchers' conclusions that the vast majority of federal EITC funds benefits working-poor families.

As has been shown, the EITC dollars spent in the economy of the City of Fresno generate additional sales and income for local firms and residents, which subsequently lead to further spending and income in an economic ripple effect. This additional spending and income can also generate additional tax revenue for the City of Fresno and California (presented in Table 8 on the following page).

The multiplier effect of federal EITC dollars spent in the local economy can generate up to \$7.9 million in local and state tax revenue. IMPLAN software does not produce separate reports for the state and local government; thus, these estimates include total estimated tax revenue for both levels of government. However, assuming that all property tax and sales tax are captured at the local level, it is possible to assess the relative magnitude the fiscal impact of the federal EITC program.

Together, property tax and sales tax represent more than 2.2 percent of the General Fund of the City of Fresno Budget for 2006. The property tax and sales tax generated by the federal EITC program produce more than three times what the City of Fresno spent in community development in 2006. Moreover, if a full EITC program occurred, the unclaimed federal EITC payments would create an estimated additional \$1.9 million in local and state tax revenue.

Table 8: Local and State Tax Impact of the EITC in Fresno City, TY 2005

		Employee Compensation	Household Expenditures	Corporations	Indirect Business Taxes	TOTAL
S t a t e a n d L o c a l T a x e s	Corporate Profits Tax			\$369,812		\$369,812
	Dividends			\$825,716		\$825,716
	Indirect Bus Tax: Motor Vehicle License				\$40,077	\$40,077
	Indirect Bus Tax: Other Taxes				\$404,453	\$404,453
	Indirect Bus Tax: Property Tax				\$1,923,649	\$1,923,649
	Indirect Bus Tax: S/L NonTaxes				\$233,191	\$233,191
	Indirect Bus Tax: Sales Tax				\$2,563,512	\$2,563,512
	Indirect Bus Tax: Severance Tax				\$715	\$715
	Personal Tax: Income Tax		\$865,902			\$865,902
	Personal Tax: Motor Vehicle License		\$35,999			\$35,999
	Personal Tax: NonTaxes (Fines- Fees)		\$455,545			\$455,545
	Personal Tax: Other Tax (Fish/Hunt)		\$5,677			\$5,677
	Personal Tax: Property Taxes		\$18,355			\$18,355
	Social Ins Tax- Employee Contribution	\$41,362				\$41,362
	Social Ins Tax- Employer Contribution	\$134,174				\$134,174
TOTAL		\$175,536	\$1,381,477	\$1,195,528	\$5,165,597	\$7,918,138

Source: IMPLAN Data and authors' calculations

Section II.

A. Expansion of the EITC

Since it was initiated in 1975, the EITC historically received bi-partisan support and grew substantially between its creation and the 1990s. It has been broadened several times under the 1986 Tax Reform Act and indexed for inflation. In 1990, the Omnibus Budget Reconciliation Act added a general expansion, added separate schedule for families with two or more children and added EITC for childless filers.

A Harvard study notes the EITC's popularity rose with the passage of Temporary Assistance to Needy Families (TANF), an overhaul of the welfare systems, whose primary goal continues to be "ending welfare as we know it." TANF is defined by the use of incentives to work, as opposed to subsidizing the massive number of U.S. residents characterized as economically disadvantaged. The use of work incentives peaked in the 1990s under the Clinton Administration, substantially broadening the EITC's impact.

"A watershed moment in the credit's history was President Clinton's landmark expansion of the EITC in 1993, which completed the transition of the credit from "modest bonus" to a major anti-poverty initiative. The budget bill that contained that expansion was a watershed event in another way as well: the bill passed by one vote in the Senate and received not a single supporting Republican vote. For the first time, the EITC became a policy linked exclusively to Democrats, and was no longer a bipartisan initiative," the Harvard study reported.¹³

Numerous studies prior to 1998, when the EITC was substantially expanded, indicated the profound impact of the credit, particularly among women and children, compared to traditional welfare programs:

- More than half the increase in the proportion of single mothers in the labor force was found to be due to the effects of the EITC, especially those occurring after the expansion of maximum credit benefits in 1993;
- Between one-fourth and one-third of the decline in the national share of income received by the poorest fifth of households with children over a 20-year period.
- Child poverty was reduced by one-fourth, a key outcome among poor and working-poor families in Fresno. U.S. Census data continues to show the EITC moves more children out of poverty than any other program or category of programs, especially among Hispanic children (overrepresented in Fresno poverty numbers) and among children in the South, and similar to Fresno, where lower wages prevail and more low-income workers are likely to qualify.

The credit itself more than tripled in size from its inception through the 1990s. Growth has proceeded to the point where, in 2000, the EITC provided roughly the same level of federal assistance to low-income families nationwide as the TANF and food stamp programs combined.¹⁴

Dr. Elizabeth Sawhill, a senior fellow at the Brookings Institution, recommends three ways in which poverty may be addressed: working full time; don't get pregnant as a teenager; and get a good education. While explaining in depth her rationale for taking a strategic approach to each of these issues, she notes, "Work is essential, but I fear the kind of increased employment we've

seen among welfare mothers will be a Pyrrhic victory if we don't find a way to provide more assistance in the form of a higher minimum wage, a more generous Earned Income Tax Credit (EITC) . . .”¹⁵

The EITC benefit has also had the effect of deepened polarization among legislators. But as costs increase and budgets shrink, states continue to enter what Harvard researchers call the “era of retrenchment,” defined as reducing expenditures in exchange for financial stability. “In response to the pressures driving retrenchment, many liberal states have turned to administering tax-based wage supplements in place like the EITC of public assistance programs. A focus on retrenchment encourages the growth of apparently costless programs like the EITC, which limit direct public expenditures while still providing social assistance,” the report said.

Conceivably, California could create a state EITC, say many think-tanks, and similar to most state EITCs, could link such a program to the federal EITC and have the same eligibility rules. Given the high personal-tax thresholds, the credit should be refundable. A California family of three with one full-time worker earning minimum wage would be raised out of poverty if they could receive both a state and federal EITC.

B. Cost of a Statewide EITC

The Center for Budget and Policy Priorities estimates a state EITC at 15 percent of the federal EITC would cost slightly more than \$600 million. Compared with the federal outlay of more than \$39 billion for the credit, however, a state or city credit without being coupled with the power of the federal credit has comparatively minimal ability to reduce poverty by adding a few hundred dollars into the pockets of the poor. One can argue, however, that any money directed toward the poor, when effectively managed as the federal EITC is, could have an impact on poor and near-poor families. For example, according to the New American Foundation, “a state EITC equal to 15 percent of the federal credit could provide up to \$583 more a year for a family with more than one child and up to \$353 more a year for a family with one child.”¹⁶

According to co-author Dr. Antonio Avalos's calculations, however, a 15 percent state EITC would have cost \$495 million in FY 2005, close to the Assembly Revenue and Taxation Committee analysis. Although his estimates are lower, this is explained by the different years in which the estimates are made. Avalos does not have access to the information the Assembly Committee has, so he was unable to calculate costs for subsequent years.

Avalos calculates that in FY 2005, California residents filed a total of 14,991,003 returns. From this total, 2,354,287 residents filed for EITC for a total of \$4,358,254,000 in credits given to California residents that qualified. Notice that the average EITC credit for California was \$1,815.19. To estimate the total cost of a refundable state EITC program if the credit is set at a flat percentage of the federal EITC credit, Avalos followed these steps (see Table 9):

1. Estimated the total amount of federal EITC claims in a given year for California;
2. Multiplied federal claims by the percentage at which the state EITC credit is to be set;
3. Adjusted the estimate for the fact that not all federal EITC claimants will claim the state EITC credit; and
4. Assumed California administrative costs would run as high as 1 percent of the total credits payments, and the total cost must include this percentage.

Table 9: Total Cost of a Refundable State EITC Program

	Percent of Federal EITC Credit	Federal EITC Claims TY, 2005	Estimated Cost of EITC Program at State Level	Adjusted Cost by Estimated Part. Rate (75)%	Administrative Costs Running the Program (1%)	TOTAL COST OF EITC PROGRAM State Level
State Level	10.0%	\$4,358,254,000	\$435,825,400	\$326,869,050	\$3,268,691	\$330,137,741
	15.0%	\$4,358,254,000	\$653,738,100	\$490,303,575	\$4,903,036	\$495,206,611
	20.0%	\$4,358,254,000	\$871,650,800	\$653,738,100	\$6,537,381	\$660,275,481
	25.0%	\$4,358,254,000	\$1,089,563,500	\$817,172,625	\$8,171,726	\$825,344,351
	30.0%	\$4,358,254,000	\$1,307,476,200	\$980,607,150	\$9,806,072	\$990,413,222

Source: IRS Statistical Information Services Office and authors' calculations

In any case, California Budget Project Executive Director Jean Ross is not optimistic legislation to create a state EITC will be forthcoming anytime soon. "California faces significant budget deficits through the end of the decade and potentially beyond. A [California EITC] credit of 15 percent of the federal credit would be costly, while a smaller credit would still require a significant commitment of state resources, while providing relatively minimal benefits to qualifying families," Ross said. She believes an offsetting funding source is necessary to support creation of a state EITC, given ongoing California's structural deficits. "There is little to no Republican support for an EITC, which requires approval by a two-thirds vote of the Legislature, and the Legislature is unlikely to increase the revenues needed to pay for one," Ross said in an interview with an author.

Further, the State EITC Basics website shows California as a potential EITC state, but notes, "California continues to face ongoing budget shortfalls of approximately \$5 billion per year that limit the state's ability to enact major program initiatives."

C. State Legislative Efforts

Over the past several years, several iterations of a state EITC have been introduced and just as quickly, failed, although EITC programs typically enjoy public support because taxpayers are enthusiastic about programs that help those who work. The latest effort to create a state was AB 21, introduced in 2007 by Assembly Member Dave Jones, who represents California's 9th District. AB 21 passed out of the Assembly Revenue and Taxation Committee along party lines and was referred to the Assembly Appropriations Committee, where the author postponed the first hearing, after which the bill became moot because it did not leave the Assembly by the deadline.

According to the Assembly Revenue and Taxation Committee analysis, Jones's version of a state EITC would have cost \$686 million in FY 2007-08, \$696 million in FY 2008-09, and \$706 million in FY 2009-10. Committee staff estimated that this measure would reduce revenues, as a result of reduced tax liability, by \$14 million in each of these fiscal years.¹⁷

Like many other states, the Jones measure would have provided a 15 percent maximum of the federal EITC. In addition, for each taxable year beginning on or after January 1, 2007, the credit would be computed by multiplying the federal EITC refund by 15 percent, and then subtracting whatever amount may be owed to the IRS. Married couples filing a separate return would be ineligible for the state credit. Non-residents who reside in California for a least part of the year

and are eligible for the federal EITC would receive a state refund computed by multiplying the "part-year resident credit amount" by 15 percent and subtracting the balance that may be owed to the IRS.

A similar bill SB 224 (Cedillo, D-Los Angeles) was introduced in the Assembly in the 2003-04 legislative session and would have provided a refundable EITC equal to 15 percent of the federal EITC. SB 224 did not pass out of Senate Revenue and Taxation.

Minor downsides come with the EITC. Researchers point out the EITC may have the effect of discouraging work because of the loss of diminishing benefits. As the credit phases out, each dollar of earnings reduces the amount of credit a worker receives, until a worker reaches a maximum of about \$38,000, which results in fewer hours worked. Evidence suggests those conclusions may be correct, although no data is available to support it. "The EITC does result in an increase in the number of people working and an increase in the hours of work for workers in the subsidy range. For those already working and earning more than about \$750 per month, however, the EITC discourages additional work effort for some workers, causing them to reduce their hours of work," the Legislative Analyst's Office said.

D. The EITC's Downside in Context

Fraud and non-compliance is an issue with the EITC, but in the overall scheme, is neither as troublesome nor as costly as other IRS breakdowns, such as the hundreds of billions of dollars a year lost due to tax evasion. The last study conducted by the IRS on non-compliance issues was in 1998. Few agree the issue is comparatively problematic when put in context of overall IRS problems with uncollected taxes. "The apparently high rates of noncompliance are troubling, but it is necessary to put them in context. Indeed, it is likely that much EITC noncompliance reflects compliance problems that are endemic to the entire income tax. If that is true, then targeting compliance activity at EITC participants alone may not be the most effective use of IRS resources," says Leonard E. Burman, senior fellow at the Urban Institute, co-director of the Urban-Brookings Tax Policy Center; and research professor at Georgetown's Public Policy Institute.¹⁸ Burman said the IRS' preoccupation with EITC non-compliance is a waste of time, given other, more costly issues faced by the short-staffed IRS."

"Although the IRS is doing many things right in this area [to correct tax evasion], its preoccupation with EITC noncompliance is not one of them. For example, EITC errors amount to less than 3 percent of all noncompliance, but would garner 45 percent of the IRS's new enforcement dollars. More generally, EITC noncompliance is, unfortunately, a symptom of systemic problems and the appropriate solution is a broad-based attack on noncompliance and the causes of noncompliance throughout the income tax system," Burman said.

Section III:

A. Welfare Reform Effects

Despite systematic problems within the IRS, 20 states, including the District of Columbia, have enacted the Earned Income Tax Credit, which piggybacks as a percentage of the federal EITC. The Center for Budget and Policy Priorities (CBPP) explains the high incidence and collective impact of welfare reform and low wages, in which recipients are generally placed into low-wage jobs, and tax changes, which collectively prompted the introduction and passage of EITC legislation among states.

As the CBPP reported in 2004, 7.7 million children in working families remained poor. And many families with incomes modestly above the official poverty line – roughly \$20,000 for a family of four – also face significant difficulty in meeting the costs of food, housing, transportation, clothing and other necessities. Sluggish wage growth for low-earning families in Fresno means that many families are likely to continue to struggle. Again without knowing how many poor or near-poor families may or may not claim the federal EITC, this report cites statistics from CalWORKS 2006 Client Profile, issued by the Fresno County Department of Employment and Temporary Assistance. CalWORKS is California’s version of the reforms emanating from passage of Temporary Assistance to Needy Families (TANF).¹⁹

1. Welfare reform and low wages: Fresno County’s 2006 Client Profile reported the average cash grant to CalWORKS recipients was \$632 a month; the average food stamp allotment was \$262 a month. The average wage for a person placed into work by CalWORKS is \$7 per hour. Over the last several years, several million welfare recipients have left welfare and entered the workforce; many other families have accepted the challenge of making ends meet on low-paying jobs without seeking public assistance. Many such families, however, cannot make ends meet on their earnings alone. California’s minimum wage is currently \$7.50 an hour and is slated to increase to \$8 an hour in January 2008; however, even a fulltime job at minimum wage is insufficient. An Oct. 22, 2007 report by the California Budget Project said, “The hourly wage needed to earn the basic family budget for families with children in California is two to four times the state’s minimum wage (\$7.50 per hour).”
2. The amount of cash aid a family in Fresno receives varies by the number of family members; for example, a family of two is eligible to \$521 a month if they have no other income. This family may earn up to \$1,187 before aid is discontinued. The Fresno County Employment and Temporary Assistance Public Assistance Overview said as the family earns income, “assuming the family of two receives \$500 in earnings; of that amount, \$225 is subtracted leaving a balance of \$275, minus 50 percent which is \$137.50. This leaves \$137 to be applied against the grant of \$481. The client is then eligible to receive \$344 in aid payment, plus their earnings for the month for a total income of \$844. The same family would also be eligible to receive \$107 in food stamps plus a Medi-Cal card for each family member.”

Compare the disparity between CalWORKS figures of \$1,051 per month, and food stamp benefits of an average of \$262 per month, plus Medi-Cal, against the Economic Policy Institute’s Family Budget calculator. Assuming a two-member family, a parent with one child would have to earn \$25,236 just to cover basic expenses.

Table 10: Economic Policy Institute’s Family Budget calculator (one parent, one child)

Monthly housing	\$616
Monthly food	\$265
Monthly child care	\$485
Monthly transportation	\$272
Monthly health care	\$221
Monthly other necessities	\$238
Monthly taxes	\$6
Monthly total	\$2,103
Annual total	\$25,236

Source: http://www.epinet.org/content.cfm/datazone_fambud_budget

The federal poverty line has traditionally been used to measure whether families have incomes high enough to enable them to meet basic needs. Yet most researchers now agree that a "poverty line" income is wholly insufficient (and painfully outdated) to support most working families. "Basic family budgets," individualized for communities nationwide and for type of family (e.g., one parent/one child, two parents/two children) offer a more realistic measure of the income required to have a decent standard of living, however basic, the Economic Policy Institute maintains.

3. Tax changes. The California Budget Project contends California’s poorest families pay the most in taxes. Those with an average income of \$11,100 — the poorest fifth of the state’s households — spend 11.7 percent of their income on state and local taxes. In comparison, the wealthiest 1 percent, with an average income of \$1.6 million, spends 7.1 percent of their income on state and local taxes.²⁰ California is one of nearly half of the states that impose an income tax on working-poor families, and most states levy income tax on families with incomes only slightly above the poverty line. A state EITC can help offset such taxes, but so can the existing federal EITC. The California State Franchise Board reports California collects income tax from its residents at the following rates, which are the highest in the country. Table 9 shows California rates.

Table 11: California Tax Rates

One percent on the first \$6,622 of taxable income
Two percent on taxable income between \$6,623 and \$15,698
Four percent on taxable income between \$15,699 and \$24,776
Six percent on taxable income between \$24,777 and \$34,394
Eight percent on taxable income between \$34,395 and \$43,467
9.3 percent on taxable income of \$43,468 and above.
A 1 percent surcharge is collected on taxable incomes of \$1 million or more, making California's highest marginal rate 10.3 percent.

Source: Cal Fact 2006 State Budget, Legislative Analyst’s Office, lao.ca.gov/2006/cal_facts/2006_calfacts_budget.htm

An additional consideration is whether the state EITC is refundable or non-refundable, which can add or delete the value of the credit. Of the 20 states with an EITC, only four — Delaware, Iowa, Maine and Virginia — have non-refundable tax credits, which mean the credit is useful only to the extent it can pay all or part of the taxes owed to the IRS. It does nothing to add to a family’s income. Like the federal EITC, a refundable state EITC is also used to offset any taxes owed, however, the remainder goes into the pockets of those eligible.

According to State EITC Basics, a comprehensive online source, “If the amount of the EITC exceeds the amount of income tax owed, the difference is paid back to the filer in the form of a rebate. At least part of the refundable credit offsets payroll and sales taxes, which, for low-income working families, are often larger than income taxes. “It is the refundable nature of the EITC that makes it such a powerful poverty-fighting tool. The EITC provides a very considerable boost to low-income workers' take home pay, making each hour worked far more valuable to a struggling family.”²¹ Table 12 on the next page cites states with an EITC, the percentage of the credit, state income tax rates and whether the credit is refundable or non-refundable. States with an EITC percentage higher than 15 percent are highlighted.

Table 12. States with an EITC

States with EITCs	Calculated as a percentage of federal refund (after any payment due to the IRS)	State Income Tax:	Refundable or Non-Refundable
Colorado	10 percent	4.63% of federal adjusted income	Refundable
District of Columbia	35 percent	Graduated- 5% to 9.3%	Refundable
Delaware	20 percent	2.2% to 5.95%	Non-refundable
Illinois	3 percent	3% of federal adjusted gross income	Refundable
Indiana	6 percent (sunsets in 2011)	3.4% of federal adjusted gross income	Refundable
Iowa	7%	Graduated .36-8.98%	Non-refundable
Kansas	15% of Federal EITC	Graduated 3.5-6.45%	Refundable
Maine	5 percent		Non-refundable
Maryland	20 percent	Graduated- 2% to 4.75%	Refundable
Massachusetts	15 percent		Refundable
Michigan	10% in 2008, 20% in 2009 and after	3.9 % of federal adjusted gross income	Refundable
Minnesota	22 percent to 46 percent, depends on no. of children. 15 percent for no children; average 33% of federal credit	Graduated 5.35-7.85%	Refundable
Nebraska	10 percent	Graduated 2.51-6.68%	Refundable
New Jersey	20% (if income below \$20,000). Childless workers are ineligible	Graduated 1.4-8.97%	Refundable
* New Mexico	\$10-\$450	Graduated 1.7-8.2%	Refundable
New York	30 percent	Graduated 4-6.85%	Refundable
Oklahoma	20 percent	Graduated .5-6.25%	Refundable
Oregon	5% of federal EITC	Graduated- 5% to 9%	Refundable
Rhode Island	25 percent	25% of federal income liability	Refundable
Vermont	32 percent		Refundable
Virginia	20 percent	Graduated 2-5.75%	Non-refundable
Wisconsin	4 percent for one child; 14 percent for two children; 46 percent for more than three children	Graduated 4.6-6.75%	Refundable

New Mexico offers a "[low-income Comprehensive Tax Rebate](#)" program, which resembles an EITC. It offers a refund of between \$10 and \$450.

Source: <http://www.stateeitc.com/basics/index.asp>

B. State and City EITC Programs: Costs and Outreach

As previously explained, states and cities (including New York City and San Francisco) have implemented versions of the federal EITC program. Typically, both states and cities have launched refundable programs that use federal eligibility rules and set the state or city EITC credit as a specified percentage of the federal EITC credit. These percentages vary significantly across states and among cities. At the state level, for example, it can range from 5 percent in Oklahoma and Oregon to as high as 35 percent in the District of Columbia.

At the city level, given the potential cost of the program, the percentage of the refund is generally lower. For example, in San Francisco, the EITC is 10 percent; in New York City, the refund is 5 percent. In some cases, the program has been costly and relatively unsuccessful, but in other cases, it has been less burdensome and more effective.

In lieu of a city credit, many more cities across the country conduct concerted, widespread EITC campaigns to encourage eligible residents to apply for the federal programs. Like the City of Fresno, nationwide city campaigns have used tax-preparation services, such as H&R Block and Liberty. Council Member Henry T. Perea announced in February 2007 that the city and H&R Block “shared a total of \$32,154 in reduced fees to help secure the following return amounts for the Fresno area,” citing \$1.6 million in total refunds and \$1.1 million in EITCs refunds. No information was available regarding the terms of the outreach agreement, or whether H&R Block was permitted to sell its refund-anticipation loans (RALs) to low- and moderate-income residents.

These tax preparers have been widely criticized as predatory lenders for pushing RALs on consumers, mostly low-income residents. Tax preparers defend the product, saying it is in high demand because their customers believe the EITC as “free money” and do not consider the fees for preparation and the excessive interest rates associated with RALs.

In 2004, the IRS reported 69 percent of City of Fresno residents filing tax returns used tax-preparation services; of that number, 25.2 percent of those filing for an EITC also applied for a refund-anticipation loan, at a loss of more than \$65 million in fees and interest.²²

Section IV. Cost/Benefit Analysis of State and City EITCs

Exploring the costs and benefits of similar programs for the City of Fresno is not only a useful exercise in terms of policy design, but it is also intriguing and potentially revealing in terms of its feasibility and efficacy. This section, by assuming that a state-level and a city-level EITC program exist, examines the economic impact for the City of Fresno of such programs as calculated under alternative scenarios. In general, the costs and benefits for the City of Fresno of state- and city-level EITC programs basically depend on the following five factors:²³

1. The number of families in the city claiming the federal credit.
2. The percentage of the federal credit at which the state and city programs are set.
3. Whether the credit is refundable or non-refundable.
4. How many city residents that receive the federal EITC credit also claim the state- and city-level EITC.
5. The amount of EITC payments made to Fresno City residents that are spent within the City’s economy.

In tax year 2005, 50,861 families in the City of Fresno claimed the federal EITC. In terms of the percentage of the federal EITC at which the program is set, to gauge the costs and benefits of alternative program sizes at the state and city levels, the following percentages are used: 3.5 percent; 5 percent; 7.5 percent; 10 percent; 15 percent; 20 percent; 25 percent; and 30 percent.

As shown in Table 13, due to the program’s costs, the first three percentages, which are lower, seem more appropriate for the city EITC, while the last five are more suitable for the state-level program. However, cities can implement programs with large percentages just as states can implement programs with small percentages.

Consequently, the amount of EITC dollars that could be injected to the local economy is limited.

First, the amount of the tax credit remaining unclaimed by City of Fresno residents, as well as its effect (or lack of) in the city, is assessed. Second, assuming that state- and city-level EITC programs existed, the economic impact of such programs is estimated. The hypothetical exercise includes analyzing the cost and benefits under alternative scenarios, based on different percentages of the federal EITC program that qualifying City of Fresno residents could claim.

To estimate the cost of a refundable state or city EITC program as shown in Table 13, assuming the credit is set at a flat percentage of the federal EITC credit, this report follows these steps:²⁴

1. Estimates the total amount of federal EITC claims in a given year for Fresno City;.
2. Multiplies federal claims by the percentage at which the state or city EITC credit is to be set; and
3. Adjusts the estimate for the fact that not all federal EITC claimants will claim the state or city EITC credit.

Table 13: Estimated Total Cost of State- and City-Level EITC Programs

	Percent of Federal EITC Credit	Adjusted Cost by Estimated Participation Rate (75%)	Administrative Costs of Running the Program (1%)	TOTAL COST OF EITC PROGRAM
City Level	3.5%	2,772,446	\$27,724	\$2,800,171
	5.0%	3,960,638	\$39,606	\$4,000,244
	7.5%	5,940,956	\$59,410	\$6,000,366
State Level	10.0%	7,921,275	\$79,213	\$8,000,488
	15.0%	11,881,913	\$118,819	\$12,000,732
	20.0%	15,842,550	\$158,426	\$16,000,976
	25.0%	19,803,188	\$198,032	\$20,001,219
	30.0%	23,763,825	\$237,638	\$24,001,463

Source: IRS Statistical Information Services Office and authors’ calculations

With regard to the administrative costs of EITC programs, scholars and policy makers agree that using the tax system rather than the welfare system to transfer income would reduce managerial costs and create incentives to work. Although the costs of administering state and local EITC programs depend on an assorted list of factors, studies have shown these are relatively low. For example, GAO estimates that EITC administrative costs are about 1 percent of the total credits

payments. In comparison, administrative costs for traditional cash-assistance programs and food stamps can run as high as 15 percent of the total payments. Similarly, the IRS estimates administrative costs of about 0.5 percent of the total annual EITC benefits.²⁵

Assuming for the City of Fresno these costs would run as high as 1 percent of the total credits payments, Table 13 also shows the estimated total costs of both the state- and city-level EITC programs at different percentages of the federal EITC program.

Again, this report underscores the cost of tax preparation to claim the credit, which substantially increases the administrative costs of the state- and city-level EITC programs. For example, the Federal Reserve Bank of Minneapolis reports that in 2003 about “\$2 billion in Federal EITC payments were diverted for tax preparation, electronic filing and high-cost loans (which put the money in filers' hands about eight to 10 days earlier than a standard tax return, but for an elevated fee)”, representing close to 6 percent of the total Federal EITC payments.²⁶ Interestingly, even when such costs are included — bringing total administrative costs to about 7 percent — the EITC is still more administratively efficient than traditional welfare programs.

Scholars and policy makers alike have called attention to the numerous positive effects of the EITC program in terms of reducing poverty, promoting work, reducing income inequality and even helping low-income families to finance educational or transportation expenses. Data at the city level is limited and therefore, assessing all these positive impacts is difficult at this level of aggregation. Nevertheless, it is possible to estimate some of the benefits at the state and city level using the economic-impact approach described earlier (see Figure 1). Table 14 below shows the estimated benefits of both the state- and city-level EITC programs at different percentages of the Federal EITC program. Before discussing the results, four comments are relevant.

- First, the benefits at the city level for percentages above 7.5 percent are not estimated, since it is assumed the costs of a program above this level would be high enough to make it unfeasible in the City of Fresno.
- Second, since it is possible to have both city-level and state-level EITC programs simultaneously, the combined benefits can be calculated by simply adding the relevant indicator for both programs. For example, it is possible to have a 3.5 percent EITC program at the city level and a 15 percent EITC program at the state level.
- Third, the IMPLAN software does not produce separate reports for the state and local governments, so the tax revenue column includes both state tax and local tax revenue collection.
- Finally, the comparison between the monetary costs and monetary benefits of both state- and city-level EITC programs reveals that benefits are larger, which is encouraging from a purely financial perspective. However, it is essential to realize that the benefits of state and local EITC programs also include non-monetary advantages. Expenditures derived from these programs can create jobs, for example, and can ameliorate a host of obstacles for those residents able to escape poverty.

Table 14: Estimated Benefits of State- and City-Level EITC Programs

Percent of Federal EITC Credit	State Level EITC				City Level EITC			
	Output	Jobs	Income	Tax Revenue	Output	Jobs	Income	Tax Revenue
3.5%	\$3,116,974	27	\$846,606	\$207,851	\$3,116,974	27	\$846,606	\$207,851
5.0%	\$4,452,820	38	\$1,209,437	\$506,144	\$4,452,820	38	\$1,209,437	\$506,144
7.5%	\$6,679,230	53	\$1,814,155	\$445,395	\$6,679,230	53	\$1,814,155	\$445,395
10.0%	\$8,905,641	76	\$2,418,874	\$593,860				
15.0%	\$13,358,461	115	\$3,628,310	\$890,791				
20.0%	\$17,811,281	153	\$4,837,747	\$1,187,721				
25.0%	\$22,264,101	191	\$6,047,184	\$1,484,651				
30.0%	\$26,716,921	229	\$7,256,621	\$1,781,581				

Source: IMPLAN Data and authors' calculations

At the state level, estimates show that spending resulting from families receiving the state EITC credit can create from \$3.1 million up to \$26.7 million in business sales in the city (output), and can support between 27 and 229 new full-time and part-time jobs, depending of the size of the program. Similarly, at the city level, estimates show that spending resulting from families receiving the city EITC can create from \$3.1 million up to \$6.6 millions in business sales in the city (output), and can support between 27 and 53 full-time and part-time jobs, depending of the size of the program.

Although it seems like the impact of the state- and city-level EITC programs only depends on the percentage of the federal EITC at which they are set, in reality, a very important difference must be highlighted: All the benefits derived from the state EITC program (output, jobs, income, and tax revenue) are produced by new dollars injected to the city's economy.

Regardless of how the state finances the state EITC program, for the City of Fresno, these dollars represent funds that would not circulate in the local economy without the state EITC program. In contrast, assuming that the city EITC program in Fresno is financed with local funds (similar to other cities around the country), no additional dollars are injected into the local economy (as is the case of the state EITC program). Therefore, all observable estimated benefits derived from the city EITC program (output, jobs, income, and tax revenue) are produced by a redistribution of income among city residents.

Finally, assuming that the number of poor or near-poor families as a percentage of the total number of families receiving the state and city EITC benefits is the same as the federal EITC credit (83.27 percent), it is possible to calculate the amount of dollars working-poor families would receive in the City of Fresno, as seen in Table 15.

Table 15: Fresno City Families with Income of Less than \$25,000 Who Would Receive State and City Level EITC Benefits

Percent of Federal EITC Credit	State Level EITC	City Level EITC
3.5%	\$2,308,616	\$2,308,616
5.0%	\$3,298,023	\$3,298,023
7.5%	\$4,947,034	\$4,947,034
10.0%	\$6,596,046	
15.0%	\$9,894,069	
20.0%	\$13,192,091	
25.0%	\$16,490,114	
30.0%	\$19,788,137	

Source: IRS Statistical Information Services Office and authors' calculations

Conclusion

Clearly, poor or near-poor families would capture a significantly large amount of resources. Assuming that both city-level and state-level EITC programs were implemented at their lowest respective sizes (3.5 percent and 10 percent of the federal EITC program), the credit would amount to \$8.9 million, representing almost 10 percent of the federal EITC credit that poor or near-poor families currently receive. Therefore, if city-level and state-level EITC programs were implemented, the current benefits of the federal EITC credit would increase by approximately 10 percent.

Appendix I

The Center for Economic Research and Education of Central California is an ancillary unit of California State University, Fresno. The center provides valuable economic analysis for local business, community groups and policymakers, and provides educational material to local educators. Recent activity of the Center has focused on analysis of the labor market in the central San Joaquin Valley, the creation of an index of economic indicators and business survey, and providing workshops for educators.

The Center's economic research agenda depends on the expertise of its diverse faculty to analyze large data sets and generate useable data for regional economic development, urban planning and new business development. Faculty's regionally focused economic-research activities serve as the basis for wider discussion, deeper analysis and ultimately meaningful program initiatives. The research arm of the Center will help improve the Valley's economy by providing a means for exploring the root causes of unemployment, pollution, poverty and a host of other issues affecting the economy of this region and state. It will provide policymakers with alternatives they can consider and implement to address these issues

The Fresno Works for Better Health Advocacy Center is a nonprofit, nonpartisan advocacy organization dedicated to promoting civic participation and addressing obstacles to the economic, social and health needs of the urban core. The Advocacy Center is a free community resource, which encourages the empowerment of economically, socially and politically disenfranchised neighborhood citizens to become more informed, active and effective participants in government decision-making. The Center monitors key local, state and federal government policies to ensure accountability to the City of Fresno's low-income neighborhoods. Through its policy papers, the center can assist public officials in developing policies that promote economic, social and health vitality in Fresno's poorest areas, specifically zip codes 93701, 93702, 93703, 93706, 93721, 93727 and 93728. Policy papers currently underway, in addition to the Earned Income Tax Credit, are a paper of the correlation between the use of methamphetamines and youth violence, and predatory lenders.

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- ³ From Understanding the Political Impact of the EITC, <http://www.cityofboston.gov/bra/eitc/pdf/thesis.doc> See Elwood, David T, "The Impact of the Earned Income Tax Credit and Social Policy Reforms on Work, Marriage, and Living Arrangements." Mimeo, Kennedy School of Government, 2000; Grogger, Jeffrey, The Effects of Time Limits, the EITC, and Other Policy Changes on Welfare Use, Work, and Income Among Female-Headed Families, UCLA and NBER, Feb. 2002.
- ⁴ Berube, Alan, Earned Income Credit Participation—What We (Don't) Know, The Brookings Institution, Brookings Institution Metropolitan Policy Program, brookings.edu/metro/eitcparticipation.pdf
- ⁵ Dilworth, Thomas K, Raising the minimum wage raises questions about who it will benefit, Nation's Restaurant News, June 7, 1999, findarticles.com/p/articles/mi_m3190/is_23_33/ai_54853430.
- ⁶ Stark, Kirk, J, Should California Adopt an Earned Income Tax Credit? Dissertation, UCLA School of Law 2004.
- ⁷ Alan Berube, Rewarding Work Through the Tax Code: The Power and Potential of the Earned Income Tax Credit in 21 Cities and Rural Areas, The Brookings Institution EITC Series, January 2003, 1-2.
- ⁸ The North American Industry Classification System (NAICS) replaced the U.S. Standard Industrial Classification (SIC) system and was developed jointly by the U.S., Canada, and Mexico to provide new comparability in statistics about business activity across North America.
- ⁹ Minnesota IMPLAN Group, Inc. was founded in 1993 by Scott Lindall and Doug Olson as an outgrowth of their work at the University of Minnesota starting in 1984. This developmental work closely involved the U.S. Forest Service's Land Management Planning Unit in Fort Collins, and Dr. Wilbur Maki at the University of Minnesota. Currently, there are over 1,500 active users of IMPLAN databases and software in the United States as well as internationally.
- ¹⁰ Nagle, Ami and Johnson, Nicholas, A Hand Up: How State Earned Income Tax Credits Help Working Families Escape Poverty in 2006, Center on Budget and Policy Priorities, Washington DC. cbpp.org/3-8-06sfp.pdf
- ¹¹ US General Accounting Office, 2001, Earned Income Tax Credit Participation, GAO-02-290R.
- ¹² The Jacob France Institute of the University of Baltimore in its 2004 study "The Importance of the Earned Income Tax Credit and Its Economic Effects in Baltimore City" assumes that two-thirds of the payments made to city residents were re-spent within the City. Similarly, John Haskell at Vanderbilt University in his 2006 study "The State of the Earned Income Tax Credit in Nashville: An Analysis of Economic Impacts and Geographic Distribution of the 'Working Poor' Tax Credit, TY 1997-2004" assumes that 87% of the EITC disbursements would be spent within the Nashville region.
- ¹³ http://info.sen.ca.gov/pub/07-08/bill/asm/ab_0001-0050/ab_21_cfa_20070518_111534_asm_comm.html
- ¹⁴ Burman, Leonard E, Tax Evasion, IRS Priorities, and EITC Precertification Statement , presentations before the United States House of Representatives Committee on Ways and Means; On Waste, Fraud, and Abuse, The Tax Policy Center <http://www.taxpolicycenter.org/publications/url.cfm?ID=900644>, July 17, 2003
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²⁰ From Making Ends Meet: How Much Does It Cost to Raise a Family in California, the California Budget Project, October 2007, cbp.org/pdfs/2007/0710_mem_003.pdf 18 Who Pays Taxes in California, California Budget Project, Policy Points 2006, http://www.cbp.org/pdfs/2006/0604_pp_whopaystaxes.pdf

²¹ stateeitc.com/basics/cost_state_eitc.asp

²² Total Dollars Lost to Tax Preparation and the Purchase of RALs in Cities with the Highest Total Number of Returns Filed, Tax Year 2004 Source: Internal Revenue Service SPEC Information Database, Tax Year 2004 (December 2006). Poverty figures from US Census Bureau 2000 Census. CDF calculations, Of those who received a refund, calculated based on a \$150 average tax preparation fee and a \$100 average RAL fee.

²³ Adapted from Ami Nagle and Nicholas Johnson (2006), “A Hand Up: How State Earned Income Tax Credits Help Working Families Escape Poverty in 2006”, Center on Budget and Policy Priorities, Washington DC.

²⁴ As discussed in “How Much Would a State Earned Income Tax Cost?”, 2003, Center on Budget and Policy Priorities, Washington DC.

²⁵ In fact, EITC programs typically enjoy public support because taxpayers are enthusiastic about programs that help those who work.

²⁶ “Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY2003”, 2003, U.S. Internal Revenue Service.