The Earned Income Tax Credit as an Instrument of Housing Policy

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Abstract

The federal Earned Income Tax Credit (EITC), which was designed to aid low-income working families and individuals, plays a role beyond that of income support. At a time when the availability of affordable housing is declining, the EITC also provides significant relief to households burdened by severe housing costs. This article examines the EITC's effect on housing cost burdens and analyzes and contrasts three proposals to increase its effectiveness as a housing tool.

Because housing policy calculates affordability on a before-tax basis, the positive effects of the EITC are often overlooked. If included in income, the current EITC, assuming full participation, reduces critical housing needs for working households by 18 percent. All three proposals analyzed would reduce the number of households with severe housing costs by considerably more, with our measure relieving these cost burdens the most. Finally, using the EITC as a housing tool specifically incorporates a work incentive into the assistance.

Keywords: Affordability; Low-income housing; Tax issues

Introduction

The problem: High housing cost burdens

High expenses for housing are a significant and growing fixture of the nation's housing landscape for low- and moderate-income families. To be considered "affordable" under commonly accepted standards in the housing community, housing costs (rent/mortgage plus utilities) should consume no more than 30 percent of income for low- and moderate-income families (Daskal 1998). According to the Joint Center for Housing Studies (2002) and Lipman (2002), 14 million of the nation's 34 million renter households spend at least this much on housing, as do nearly 2.5 million low- and moderate-income homeowners. These cost burdens have overtaken substandard housing as America's principal housing problem.

In this article, we focus on households with severe housing cost burdens—those spending 50 percent or more of income on housing. Researchers, policy makers, and advocates have developed several yardsticks to measure the incidence of these burdens, all of which point in a similar direction:

1. *Worst-case needs* households (a term coined by Congress) are eligible for assistance under programs administered by the U.S. Department of Housing and Urban Development (HUD), but do not receive such assistance. These households consist of very low income renters (those with incomes below 50 percent of the local area median) who spend at least half of their income on rent or live in severely inadequate housing. According to HUD, there were more than 5 million of these households in 2001. Over three-quarters of them lived in adequate, uncrowded housing, but spent more than half their income on rent (HUD 2003b).

2. The population with *critical housing needs* has characteristics similar to those of worst-case needs households, but includes home owners as well as renters. This population consists of low- to moderate-income working households that spend at least half of their income on housing or live in substandard units.[1] According to the National Housing Conference, more than 4 million working households occupied standard housing in 2001, but spent more than half their income on mortgage or rent (by contrast, less than 1 million households lived in substandard housing alone) (Lipman 2002).

3. The *national housing wage* ties measures of local housing costs to wage levels. Created by the National Low Income Housing Coalition (NLIHC), the national housing wage is the amount a household must earn per hour in order to pay no more than 30 percent of income for the local HUD fair market rent (FMR) for a two-bedroom apartment. In 2002, the median national housing wage was $14.66, up 5 percent from a year earlier, up 18 percent from 2000, and nearly three times the federal minimum wage (NLIHC 2002).

An inadequate response

Given the growth of the housing affordability gap in recent years, Congress has failed to mount a sufficient response in terms of dedicated housing programs. Today, all forms of HUD-administered housing assistance serve less than one out of the four households that qualify for aid. At the same time, the stock of permanently affordable housing

[1] Low- and moderate-income working families are defined as households that receive the majority of their income from wages and whose annual incomes range from $10,700 (the equivalent of one full-time worker paid the minimum wage) to 120 percent of local area median income.

under HUD oversight continues to dwindle. A massive public housing demolition campaign and the expiration of long-term subsidy contracts with private owners are removing tens of thousands of affordable units from the low-income sector (Stegman 2001).

Funding for tenant-based rent assistance—most notably, what HUD now calls the Housing Choice Voucher Program (previously known as Section 8 rental assistance)—has also fallen short of market need.[2] Independent evaluations have shown vouchers to be highly effective in helping to close the affordability gap in markets with an ample supply of decent rental housing. Yet in the 30-year history of the Section 8 program, Congress has funded a total of just over 2 million portable rental certificates and vouchers. As of September 2000, there were fewer than 1.5 million families with vouchers (HUD 2003a). Also, vouchers are still largely limited to very low income renters at a time when nearly 60 percent (2.6 million) of cost-burdened households with critical housing needs are homeowners (Lipman 2002).

Meanwhile, the queue for federal housing assistance lengthens. A 1999 HUD examination of 40 waiting lists found several that had been closed because of their overwhelming size. Those that remained open contained almost 1 million families and had grown between 10 and 25 percent in a year. The average waiting period for Section 8 rental assistance vouchers was 28 months in 1998, but it was much longer in some metropolitan markets—10 years in Los Angeles and Newark, 7 years in Houston, and 5 years in Memphis (TN) and Chicago (HUD, Office of Policy Development and Research 1999).

The opportunity: The Earned Income Tax Credit as housing policy

As the affordability crisis affects an increasing number of families and as the significance of dedicated housing programs declines, tax expenditures that benefit these families become more important. Most notably, the value of the federal Earned Income Tax Credit (EITC), a refundable tax credit for low- and moderate-income workers, particularly those with children, has increased dramatically over the past two decades. However, tax benefits such as the EITC are not generally considered as income in calculating housing cost burdens (including worst-case needs, critical housing needs, or the national housing wage), even though they often represent a significant addition to the annual earnings of low-income families.

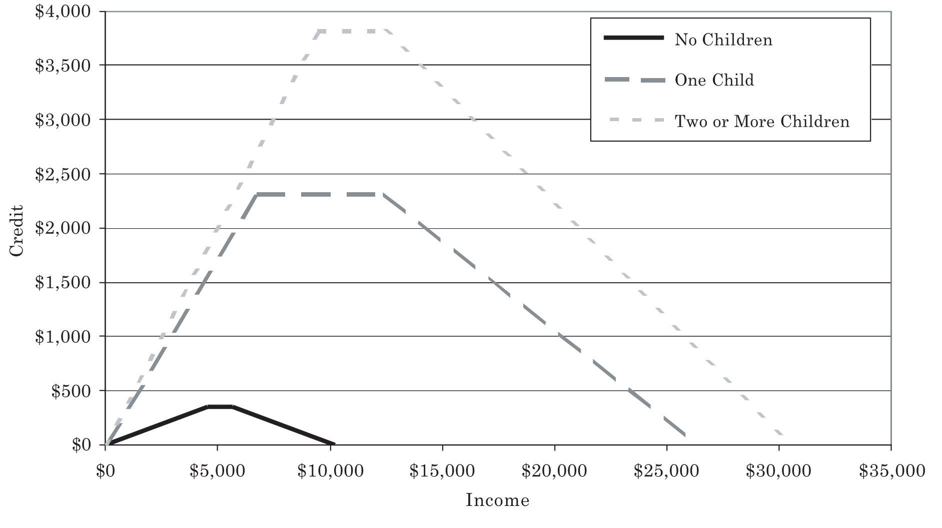
[2] In this article, we refer to tenant-based assistance generally as "vouchers," even though such assistance occasionally takes other forms.

In this article, we argue that policy makers should explore the potential of the EITC as an instrument of national housing policy. The credit was created in 1975 to "help offset the Social Security payroll taxes paid by low-income working parents, and to encourage parents to work" (Phillips 2001, 1). Since that time, its value has grown nearly ninefold in real terms (Carasso and Steuerle 2003). On the principle that the poor should be exempt from income taxes and that full-time low-income workers should be able to afford the basic necessities of life for themselves and their families, the EITC was significantly expanded in 1986, 1990, and 1993. Today, it provides more than $34 billion a year in benefits to 21 million working families (Center for Budget and Policy Priorities 2003; Joint Committee on Taxation 2002).

Because it is intended to encourage and reward work, the EITC differs from many other safety net programs in that its benefits initially *increase* with earnings (figure 1). Plotting its structure produces an inverted U shape. In the *phase-in range*, the value of the credit increases at a constant rate with each marginal dollar of earnings. In the *plateau range*, the credit remains fixed at a maximum amount even as earned income increases, while in the *phase-out* range, the value declines at a constant rate with each additional dollar of earnings until it reaches zero.

Although the shape of the benefit curve is similar for each EITC-eligible class, the size of the various ranges and the maximum benefit differ

Figure 1. **Structure of the EITC in 1999**



Source: New York State Department of Taxation and Finance 1999, page 3, and the authors' calculations.

according to family size (table 1). In particular, because the EITC is designed primarily to help families with children, the maximum credit and the income range over which it is available are much smaller for childless workers than for families with children. In tax year 1999 (the year on which our analysis is based), the maximum EITC for a childless worker was $347. For a working family with one child, it was $2,312, and for a family with two or more children, it was $3,816—more than 10 times as much as a childless worker gets.

Table 1. **EITC Parameters, Tax Year 1999**

	No Children*	One Child	Two or More Children
Phase-in rate	0.0765	0.34	0.40
Plateau begins	$4,530	$6,800	$9,540
Plateau ends	$5,670	$12,460	$12,460
Phase-out Rate	0.0765	0.1598	0.2106
Maximum earned income	$10,200	$26,928	$30,580
Maximum benefit	$347	$2,312	$3,816

Source: Tax Policy Center 2003.
*For families without children, there are also age restrictions: The taxpayer (or spouse if present) must be between the ages of 25 and 65. These restrictions do not apply to families with children.

This article demonstrates that many families with severe housing cost burdens benefit from the EITC. In fact, we find that treating it as part of household income would reduce estimates of the number of households that face such burdens. Still, too many families that work and play by the rules struggle mightily to cover their housing expenses on low incomes. By expanding our notion of basic necessities to include modest but adequate housing, we argue for using the EITC to close a significant portion of the growing housing affordability gap for millions of working families. This, in turn, would relieve pressure on inadequately funded assistance programs dedicated to expanding the housing supply for special populations like elderly or disabled persons or the very poor (Dolbeare 2001).

A major challenge to adapting the EITC to housing is that subsidies vary in proportion to local housing costs—they are higher in high-cost markets and lower in low-cost markets—while the credit does not. Our proposal, which we discuss later in this article, addresses this issue.

Why not vouchers?

As noted earlier, research has shown vouchers to be effective in reducing the housing affordability gap for low- and moderate-income renter households. Why, then, do we focus on the potential of an income tax credit? Might the goal of providing adequate, affordable housing be better achieved through a significant expansion in vouchers?

For several reasons, we believe that expanding and tailoring the EITC is a more promising strategy for making housing affordable for low-income families. First, Congress has shown little inclination in recent years to increase support for rental assistance vouchers. The sharp rise in the size and benefit levels of the EITC stands in stark contrast to the painfully slow growth of vouchers. Although the annual value of the average EITC is about one-fourth that of the average Section 8 voucher—$1,500 versus $6,012 (HUD 2002)—more than six times as many individuals and families receive the EITC as receive vouchers. The EITC in aggregate dollar terms is more than two and a half times the size of total Section 8 rental assistance ($30 billion a year versus $13 billion) (HUD 2002; National Council of La Raza 2000).[3]

In some metropolitan areas, the disparity is even more dramatic (table 2). In 2000, there were at least 15 times as many families receiving the EITC as households receiving Section 8 assistance in Atlanta, Detroit,

Table 2. **EITC Filers and Section 8 Voucher Households: Selected Metropolitan Areas, 2000**

Metropolitan Area	Section 8 Households	EITC Filers (Families)	EITC Families for Each Section 8 Household
Atlanta, GA	18,900	278,972	14.8
Baltimore, MD	12,797	153,062	12.0
Boston, MA–NH	27,422	227,438	8.3
Chicago, IL	42,218	477,294	11.3
Dallas, TX	17,411	239,672	13.8
Detroit, MI	13,561	232,998	17.2
Houston, TX	13,039	332,244	25.5
Miami, FL	13,586	262,752	19.3
New York, NY	96,400	756,669	7.8
Oakland, CA	23,567	90,145	3.8
Philadelphia, PA–NJ	20,306	281,831	13.9
San Antonio, TX	12,702	154,185	12.1
San Diego, CA	17,548	160,350	9.1
San Jose, CA	10,688	47,878	4.5
Seattle-Tacoma, WA	11,787	88,632	7.5

Source: HUD 2003b and unpublished data from the Brookings Institution, Center on Urban and Metropolitan Policy.

[3] Even if we expand our comparison to include the more than 4 million low-income households receiving any kind of housing assistance, whether or not they have any earned income, the EITC remains a much larger program.

Miami, and Houston. In more expensive West Coast markets such as Oakland and San Jose (CA), Seattle-Tacoma, and San Diego, the ratio of EITC filers to voucher holders ranged between 4 to 1 and 10 to 1.

The second reason for our interest in exploring the EITC as a form of housing policy stems from the implicit limits in the capacity of the voucher program. Recent experience suggests that the voucher delivery system is incapable of handling the increase in program activity that would be required to effectively deal with the recent escalation of housing affordability problems. Although the situation is improving, HUD finds that about one-fourth of all voucher programs across the country have substandard lease-up rates—less than 95 percent (2002). Moreover, even when agency-wide lease-up rates are high, large numbers of families with vouchers cannot use them. Nationally, more than 30 percent of families with vouchers in large metropolitan areas in 2000 had to turn them back in because they could not find housing that met both their needs *and* program standards in the time allotted. This is a marked increase from a decade ago, when the turn-back rate in large metropolitan areas was 19 percent (Finkel and Buron 2001).[4]

The declining willingness of property owners to rent to households with vouchers also acts to constrain significant increases in the size of the program (Sard 2001).[5] One recent study found that approximately half of Chicago "landlords refused to rent to testers posing as apartment seekers when the 'renter' told them they would use a [Housing Choice] Voucher to pay rent, despite the fact that such behavior violates the city's fair housing laws" (Valerie Denney Communications n.d.).

State and local agencies have recently recognized this problem. In 2002, Fairfax County, VA, decided not to ask HUD for additional vouchers "because there were not enough apartments for people already in the program" (Kunkle 2002). In California, the State Senate Judiciary Committee noted a "growing trend among landlords to flatly refuse to rent to anyone on Section 8 housing, or more blatantly, to evict an

[4] Turn-back rates should not be confused with overall utilization rates because vouchers not used by the original recipients are available to other families, which means that housing authorities can simultaneously experience high utilization rates and high turnback rates. Both are affected by program features, family demographics, management practices, and local housing market conditions, among other things. The most recent data indicate that overall voucher utilization rates approached 91 percent in fiscal year 2001, and the overall spending rate was about 95 percent (e-mail correspondence with Will Fischer, Housing Policy Analyst, Center for Budget and Policy Priorities, November 1, 2002).

[5] In a survey of members by the Council of Large Public Housing Authorities, the unwillingness of landlords to accept vouchers was identified as a primary cause of lease-up problems in such organizations.

existing Section 8 tenant because the landlord no longer wants to accept Section 8 vouchers" ("The Case for Applying California's Source of Income Anti-Discrimination Statute" 2001). This practice has led to a precipitous decline in housing access in Los Angeles. According to the director of that city's Section 8 program, the share of all voucher holders able to find landlords who accept vouchers has fallen by more than half—from 90 percent three years ago to just 41 percent today (Stewart 2001).

Ironically, one of the voucher program's historic strengths is implicated in its growing unpopularity with landlords. Vouchers were traditionally lauded for delivering the subsidy directly to landlords—so that even if the family's portion of the rent was late, the government's portion would be received on time. Today, according to the trade organization of realtors, "[W]hile tenants may pay their portion of the rent in time, [because of local administrative problems] the government's share of the payment is often delayed" (National Association of Realtors 2001, 1). It is difficult to imagine that the situation would improve if the number of vouchers expanded significantly.

Although it could be argued that anecdotes like these are not always an accurate reflection of program performance, HUD-sponsored research found that several factors that could be controlled by public housing authorities, including whether the authority had a landlord relations program and provided search assistance to families, affected voucher utilization rates (Finkel et al. 2003). The researchers also found that "programs with higher utilization rates are typically administered more strategically" (Finkel et al. 2003, ix).

Unlike a voucher, the EITC goes directly to a working family. Direct delivery not only enhances family choice, but also minimizes the type of discrimination discussed earlier since the tax credit is indistinguishable from other earnings.

Another advantage that the EITC has over housing vouchers is its relatively low administrative cost, which is estimated at less than 3 percent of total payments, compared with around 7 percent for housing vouchers ("Notice of Annual Factors" 2002).

To be sure, any effort to expand the EITC explicitly to relieve housing cost burdens must consider timing. Almost since the program's inception, recipients have been able to receive at least a portion of their anticipated credit in every paycheck (the advance payment option). Yet over 98 percent of families receive all of the credit as a lump sum along with their income tax refund (Romich and Weisner 2001).[6] Families paying half or more of their income for rent clearly cannot afford to wait until the end of the year to receive a subsidy intended to help them with their monthly housing costs. Thus, our proposals to expand the EITC should be coupled with new efforts by the Internal Revenue Service (IRS) to increase participation in the advance payment option, particularly in markets where a significant portion of working families face housing cost burdens.

For the reasons outlined in this section, we believe that the EITC is better than housing vouchers for dealing with the steep and persistent increase in housing cost burdens for millions of low- and moderate-income working families. We believe that the affordability problem has escalated to the point where it can no longer be addressed by housing programs alone. For any significant progress to be made, the problem must be incorporated into a broader working families agenda and embraced by a larger and more politically influential community of common interest (Sawhill and Thomas 2001).

Analysis

The remainder of this article is divided into five sections, plus a technical appendix. The next section explores the EITC's structure and benefit levels, and the housing affordability problems of the families that qualify. The third section assesses the impact of the current EITC on the incidence of housing cost burdens among eligible families, households with HUD-defined worst-case needs, and low- and moderate-income working households with critical housing needs. These last two groups constitute overlapping universes of great concern to housing policy makers.

The fourth section, the core of our analysis, presents a menu of possible ways to expand the EITC to better target families with severe housing costs. We examine three proposals:

1. An increase in EITC benefits for childless workers and for families with three or more children contained in a legislative proposal (H.R. 3574) by former Pittsburgh Democratic Congressman William J. Coyne (U.S. House Committee on Ways and Means 2001d)

[6] Under the advance payment option, a family with children is eligible to receive up to 60 percent of its projected total credit. For a one-child family in 1999, this translated into as much as $1,387 with paychecks (Romich and Weisner 2001).

2. A rent-based proposal targeted to individual families with severe housing cost burdens, put forth by the nationally recognized housing expert, Cushing Dolbeare (2001)

3. Our own proposal based on the national distribution of median housing costs across many markets

We evaluate the impact of these proposals in four ways:

1. Total costs above and beyond the baseline costs of the existing EITC

2. The relative decline in the incidence of severe housing costs for various segments of the working poor, including families/households with children

3. Their impact on poverty

4. Their targeting efficiency

Our policy recommendations are contained in the last section, which is followed by a technical appendix.

Modeling the EITC: Methodology

Using the American Housing Survey to model the EITC

Our article is based primarily on an analysis of the national files from the 1999 American Housing Survey (AHS). We use these data to model EITC eligibility, benefit levels, housing cost burdens, and related measures. The AHS is the foundation for most research on national housing policy, including HUD's worst-case needs assessment, *The State of the Nation's Housing* by the Joint Center for Housing Studies (2002), and the continuing analysis of the housing needs of America's working households by the National Housing Conference (Stegman, Quercia, and McCarthy 2000).[7]

We could have pursued our research questions using other data sources, such as the U.S. Bureau of the Census's Current Population

[7] We recognize that the tendency of the AHS to underestimate incomes and overestimate poverty suggests that we might overestimate EITC eligibility and benefit levels relative to Current Population Survey–based measures ((U.S. Department of Commerce and HUD 2002b). However, despite this bias, we are comforted by the fact that our estimates of average benefits by number of children are within 6 percent of the official IRS numbers (see table A.2). This suggests that the earned incomes reported in the AHS may be understated by the same order of magnitude.

Survey (CPS) and Survey of Income and Program Participation (SIPP). The CPS has been used by several researchers to model the effects of the EITC on family and labor market outcomes (Eissa and Liebman 1996; Ellwood 2000), but it lacks the geographic specificity we need to differentiate among housing markets. The SIPP is more "EITC-friendly" than the AHS in that it contains more precise information on sources of income, relationships among family members, and length of time in the residence during the survey year—all of which are important criteria for determining EITC eligibility. However, that data source has a far smaller sample size than either the AHS or the CPS and does not contain information on HUD FMRs or area median incomes, which are essential to our estimates of the impact of EITC-based policy alternatives on housing.

One challenge in using the AHS to analyze the EITC is that it surveys dwelling units, or households, while the taxable unit for purposes of the individual income tax is the family. These similar but distinct terms often cause confusion in discussions like this. Households may contain more than one family, so we use this term when discussing household-based measures such as worst-case needs, critical housing needs, and so on. We also use the term "working households" in our discussion of critical housing needs; these are defined as households that receive a majority of their income from wages and have an income between $10,700 and 120 percent of the area median income. In this article, "family" is the equivalent of "tax unit" and refers primarily to an adult, a spouse if present, and any children for whom the adult and spouse are the parent or guardian. We recognize that there are numerous alternative forms of families these days, but most of them are not yet recognized in the tax code and those that are (e.g., three-generation families, which may qualify for deductions for elder care) cannot be fully modeled using the AHS. We use "families" when discussing analyses based on tax units rather than households.

Because a household can contain more than one family, it may have more than one tax unit, or EITC-eligible worker/family. Our AHS data contained 46,589 households, which in turn were composed of 60,104 families. We define an EITC-eligible household as one that has at least one eligible tax unit—such as a single mother and her child. We estimate that in 1999, more than 40 percent of all EITC-eligible households lived in housing units containing more than one family—that is, they were doubled-up. Further, 6 percent of EITC-eligible households in the AHS that year contained more than one eligible family—roughly 900,000 households and over 1.8 million families.[8]

[8] Again, the distinction between families and households requires us to do some analysis using the former and some using the latter. The unit of analysis is clearly marked in each table.

While almost a million households are eligible to receive more than one EITC benefit check, multi-tax-unit households do not necessarily contain large families and do not always receive large benefits. In fact, the opposite is more often true. Single-tax-unit households have more than twice the average number of eligible children as multi-tax-unit households, since the latter generally contain one or more EITC-eligible childless workers. Because tax credits for childless workers are much smaller than they are for families with children (figure 1), average EITC benefits are generally higher for single-tax-unit households (see table A.1).

Characteristics of the EITC population in the AHS

Because the AHS data are for 1999, we used 1999 IRS rules for determining EITC eligibility and credit levels (IRS 1999a). However, our analysis of the policy proposals recognizes certain post-1999 changes in tax policy, such as the partially refundable child credit enacted in the 2002 tax legislation. To qualify for an EITC in 1999, the earned income of the head of household, spouse (if present), and qualifying children had to be

1. More than $0 and less than $10,200 with no children[9]

2. More than $0 and less than $26,928 with one child

3. More than $0 and less than $30,580 with two or more children

Although we do not propose to substitute an EITC-based program for housing vouchers or other dedicated housing assistance, it is helpful for policy makers and housing professionals to know the extent to which the two systems overlap. Of the 14.6 million households that contained at least one EITC-eligible tax unit or family in 1999, about 8 out of 10 had incomes of less than 80 percent of their respective area medians, thus placing them squarely within HUD's program limits (table 3). More than a quarter of all these EITC-eligible households were working adults without children.

EITC-eligible households were distributed pretty evenly across HUD's three most important income categories: 26 percent had incomes of less

[9] For families with no children, there are also age restrictions—at least one member of the unit (head or spouse) must be between the ages of 25 and 65. Further, married couples are not allowed to file separately. See the appendix for additional eligibility information.

Table 3. **Total Household Income as a Percentage of Area Median Income, by Presence of Children, EITC-Eligible Households, 1999**

Household Income	With Children*	Without Children*	All Households*
≤ 30% of the area median income	2,447 (22.5%)	1,347 (35.9%)	3,794 (26.0%)
31–50% of the area median income	3,434 (31.7%)	617 (16.4%)	4,051 (27.7%)
51–60% of the area median income	1,687 (15.6%)	166 (4.4%)	1,853 (12.7%)
61–80% of the area median income	1,877 (17.3%)	411 (11.0%)	2,288 (15.7%)
81–120% of the area median income	896 (8.3%)	621 (16.6%)	1,517 (10.4%)
>120% of the area median income	504 (4.6%)	589 (15.7%)	1,093 (7.5%)
Total	10,845 (100%)	3,751 (100%)	14,596 (100%)

Source: U.S. Department of Commerce and HUD 2002a and the authors' calculations.
*In thousands.

than 30 percent of the area median, placing them in the extremely low income group; 28 percent had incomes between 30 percent and 50 percent of the area median; and 28 percent had incomes between 50 percent and 80 percent of the area median.[10]

Slightly less than half of all EITC-eligible households consist of racial/ethnic minorities, with blacks and Hispanics each accounting for about 3 million households, or 20 percent of the total pool (table 4). More important, the fact that the distribution of race/ethnicity among EITC-eligible families varies significantly across family sizes has important implications for the average benefit levels within each racial/ethnic group. For example, non-Hispanic whites account for almost 60 percent of all EITC-eligible families without children, but represent less than 40 percent of all working families with three or more children. Conversely, EITC-eligible Hispanic families make up just 18 percent of all childless families but 30 percent of all families with three or more children. Thus, because of demographic differences, expanding the EITC only for families with children or only for childless workers would also provide varying benefits by race and ethnicity (table 4).

The impact of the current EITC on housing cost burdens

The indexes introduced earlier—worst-case needs, critical housing needs, and the national housing wage—demonstrate that housing has

[10] These three income groups define certain priorities in the allocation of HUD housing assistance. For example, housing agencies are required to provide at least 75 percent of their housing vouchers to extremely low income households, while the initial incomes of families admitted to public housing are up to 80 percent of the area median, with the majority falling between 30 percent and 50 percent of the median.

Table 4. **Number of Children per Tax Unit by the Race/Ethnicity of the Head, EITC-Eligible Tax Units, 1999**

Children	Non-Hispanic Whites*	Blacks*	Hispanics*	Other*	Total*
None	2,914 (58.5%)	871 (17.5%)	876 (17.6%)	319 (6.4%)	4,980 (100%)
One	2,489 (55.8%)	987 (22.1%)	777 (17.4%)	212 (4.7%)	4,465 (100%)
Two	1,863 (49.8%)	762 (20.4%)	879 (23.5%)	237 (6.3%)	3,741 (100%)
Three or More	915 (38.2%)	637 (26.6%)	718 (29.8%)	131 (5.4%)	2,401 (100%)
Total	8,181 (52.5%)	3,257 (20.9%)	3,250 (20.8%)	899 (5.8%)	15,587 (100%)

Source: U.S. Department of Commerce and HUD 2002a and authors' calculations.
*In thousands.

become much less affordable in recent years for low- and moderate-income households. Yet these measures discount a large and critical-source of income for many households that face housing cost burdens—the EITC. This section examines the degree to which the current EITC, when considered along with other sources of income in calculating housing cost burdens, serves to reduce their overall incidence.

The incidence of severe housing cost burdens

Consistent with most housing needs assessments, the primary measure we use to identify the most serious affordability problems is severe housing costs, defined as paying more than half of *household* gross income before taxes for housing.[11]

We first ask what portion of families with severe housing costs[12] might benefit from the EITC. Table 5 provides a rough estimate of this figure. Overall in 1999, the EITC had the potential to reach about 63 percent of working families of all sizes in households with severe housing costs. That proportion differed by family type. For instance, while childless workers account for 52 percent of all working families living in

[11] Generally speaking, both housing program income limits and household contributions to housing costs are defined using before-tax measures of income. Thus, for example, while Temporary Assistance for Needy Families benefits are counted as income for determining both household eligibility and rent payment in the public housing and Section 8 programs, the EITC is not. Moreover, most low-income housing studies, including HUD's periodic worst-case needs assessments, are also based on before-tax measures of household income and do not consider the EITC or payroll or other federal and state taxes the household might pay.

[12] For family-level analyses, a family is considered to have severe housing costs if it lives in a household with severe housing costs.

Table 5. **Families Living in Households with Severe Housing Costs by Gross Income and Number of Children, Families with Earned Income Only**

Gross Income	Number with Severe Housing Costs*	Rate	Percentage of Total Severe Housing Costs within the Child Category	Percentage of Total Severe Housing Costs
No children				
$1–4,999	735	37.2	23.1	11.9
$5,000–9,999	668	24.8	21.0	10.9
$10,000–14,999	548	14.0	17.3	8.9
$15,000–19,999	374	9.3	11.8	6.1
$20,000–24,999	208	5.5	6.6	3.4
$25,000+	640	1.9	20.2	10.4
Total—No children	3,173	6.3	100.0	51.6
One child				
$1–4,999	266	57.5	22.6	4.3
$5,000–9,999	286	48.1	24.3	4.6
$10,000–14,999	268	28.2	22.8	4.4
$15,000–19,999	100	10.4	8.5	1.6
$20,000–24,999	49	4.7	4.2	0.8
$25,000–29,999	54	5.8	4.6	0.9
$30,000–34,999	46	4.2	3.9	0.7
$35,000+	107	1.3	9.1	1.7
Total—One child		1,176	8.2	100.0
19.1				
Two children				
$1–4,999	164	67.1	14.7	2.7
$5,000–9,999	164	46.3	14.6	2.7
$10,000–14,999	270	37.1	24.2	4.4
$15,000–19,999	126	17.5	11.2	2.0
$20,000–24,999	62	8.8	5.6	1.0
$25,000–29,999	84	11.7	7.5	1.4
$30,000–34,999	59	6.4	5.3	1.0
$35,000–39,999	31	4.2	2.7	0.5
$40,000+	159	2.0	14.2	2.6
Total—Two children	1,119	9.1	100.0	18.1
Three or more children				
$1–4,999	110	69.2	16.0	1.8
$5,000–9,999	148	53.4	21.5	2.4
$10,000–14,999	133	31.4	19.3	2.2
$15,000–19,999	105	22.2	15.2	1.7
$20,000–24,999	62	12.7	9.1	1.0
$25,000–29,999	42	9.5	6.0	0.7
$30,000–34,999	28	5.8	4.1	0.5
$35,000–39,999	12	3.1	1.8	0.2
$40,000+	47	1.3	6.9	0.8
Total—Three or more children	687	10.2	100.0	11.2

Source: U.S. Department of Commerce and HUD 2002a and the authors' calculations.
Note: Totals may not equal 100 percent because of rounding.
*In thousands.

households with severe housing costs, less than half of these families (44 percent) have gross incomes in the range that qualifies for the EITC (shaded rows). Even for those workers, EITC benefits are small and unlikely to substantially reduce housing cost burdens.

For families with children, the EITC's broader income ranges and higher benefit levels heighten its potential impact on housing cost burdens. Between 78 and 87 percent of families that have one or more children and severe housing costs have incomes in the EITC-eligible range. Together, families with children represent about half of all families with severe housing cost burdens, and a greater proportion of them (8 to 10 percent) than childless workers (6 percent) face those burdens.

How participation affects the EITC's reach

While the EITC has the potential to reach a significant number of families with severe housing cost burdens, IRS-sponsored research suggests that a sizable portion of eligible families fail to file taxes and therefore miss out on the credit altogether. According to the IRS (2002), between 2.3 and 3.4 million EITC-eligible individuals (13 percent to 18 percent of eligible recipients) did not file for the credit in 1996, the most recent year for which such data are available. As a result, they failed to claim between $2.1 and $3.5 billion (IRS 2002).

The IRS (2002) further finds that the eligible families least likely to receive the credit are from populations at substantial risk for severe housing cost burdens: Up to 40 percent of all EITC-eligible nonfilers were childless workers, who represent half of all families with severe housing costs. Compared with eligible families that did receive the EITC, nonfilers were more likely to be renters, had lower incomes, and were highly clustered, with 40 percent living in just four states—California, Texas, New York, and Florida. The IRS (2002) also found that about a quarter of all nonfilers had been born in "Hispanic countries" (vi), a fact not unrelated to their geographic location.[13]

[13] Of additional relevance to the housing affordability crisis, the IRS (2002) found that low-income workers living in public and assisted rental housing had particularly low EITC participation rates. Roughly 28 percent of EITC-eligible public housing residents and 25 percent of EITC-eligible workers in other types of assisted rental housing did not claim the credit. Taken together, about 1.7 million individuals living in public or assisted rental housing were EITC eligible in 1996, but almost 448,000 failed to file for benefits (IRS 2002).

Several high-cost housing markets had above-average nonfiling rates, which had serious implications for the budgets of low-income families. For instance, almost 300,000 EITC-eligible workers (28 percent) in metropolitan Los Angeles failed to file for benefits in 1996, as did nearly 23 percent of eligible workers in metropolitan New York (table 6). More than 71,000 low-income workers in the Washington, DC–Baltimore area (22 percent) failed to file in 1996, as did some 59,000 EITC-eligible workers in the San Francisco Bay Area, one of the most expensive housing markets in the country. Across the country, the financial value of forgone EITC benefits averaged $1,025, or about $85 a month, but those values were even larger in a number of high-cost markets—more than $1,400 in San Francisco ($119/month) and $1,334 in Los Angeles ($111/month).

In short, even without any new initiatives to further expand the EITC, local efforts to increase filing rates among those already eligible for benefits could help moderate severe cost burdens for a significant number of working families. As we will discuss further, campaigns focused on families with two or more children (these families are generally eligible for higher benefits) could make an even greater difference.

Other studies have estimated overall EITC participation rates of similar magnitude, but without the same levels of geographic specificity. For

Table 6. **Estimated Number of EITC-Eligible Individuals, Nonfilers, and the Nonfiler Rate, Top 12 Metropolitan Areas, 1996**

Metropolitan Area (CMSA)	Eligible	Nonfilers	Nonfiling Rate (%)
Los Angeles–Riverside–Orange County, CA	1,058,798	295,679	27.9
New York City–Long Island, NY, and NJ	981,344	220,677	22.5
Houston–Galveston–Brazoria, TX	325,363	97,673	30.0
Chicago–Kenosha, IL, and Gary, IN	480,415	93,617	19.5
Philadelphia, PA, Wilmington, DE, and Atlantic City, NJ	402,276	87,292	21.7
Washington, DC, and Baltimore, MD	330,760	71,675	21.7
Dallas–Fort Worth, TX	261,349	66,640	25.5
San Francisco–Oakland–San Jose, CA	354,597	59,257	16.7
Detroit–Ann Arbor–Flint, MI	317,993	54,879	17.3
Miami–Fort Lauderdale, FL	279,601	50,482	18.1
Seattle–Tacoma–Bremerton, WA	172,917	45,969	26.6
Boston–Worcester–Lawrence, MA, and NH	234,133	39,716	17.0
Total—Top 12 metropolitan areas	5,199,546	1,183,556	22.8

Source: Internal Revenue Service 2002.
CMSA = consolidated metropolitan statistical area.

instance, using the U.S. Bureau of the Census's CPS database to estimate EITC eligibility and matching eligibles against IRS filing data, the U.S. General Accounting Office (GAO) estimated an overall participation rate of about 75 percent for households that qualified in 1999 (12.9 million out of 17.2 million) (2001). Though not without its critics for using "two potentially inconsistent data sets" (Burman and Kobes 2002, 1), the GAO study found participation rates to be highest for families with one or two children (93 to 96 percent) and considerably lower for others. According to the GAO, only 45 percent of qualifying childless workers and 63 percent of qualifying families with three or more children claimed the credit (2001).

Liebman (cited in IRS 2002) used CPS and IRS data to analyze EITC participation rates for the 1991 tax year and found that participation rose with reported earnings—from 70 percent in the phase-in range to 83 percent in the plateau range and 88 percent in the phase-out range.

Considering the EITC in needs assessments

The income subsidy that the EITC provides may ameliorate some of the more severe housing cost burdens that families face. In this section, we estimate receipt of the EITC among households in the AHS in 1999 and ask to what extent the tax credit reduces the incidence of severe housing costs and other indicators of excessive spending on housing. We assess the impact of the EITC on housing cost burdens for three populations:

1. All EITC-eligible households

2. Households with HUD-defined worst-case needs

3. Households with critical housing needs as defined in the National Housing Conference series (Lipman 2002; Stegman, Quercia, and McCarthy 2000)

To be sure, there is considerable overlap among these populations. EITC-eligible households include many with severe housing cost burdens and vice versa. Households with worst-case needs and critical housing needs are defined quite similarly, although there are subtle differences. Our aim in describing the impact of the credit on each of them is not to belabor the point, but to establish new baselines for how we calculate and understand the housing burdens borne by low-income workers and their families.

We conclude the section by considering the combined impact of federal income and payroll taxes—including the EITC—on the affordability of housing for households with and without children.

Before proceeding, it is important to note that our analyses pertain to EITC-*eligible* families and households, not to *recipients*. While we have used IRS data on EITC filers to calibrate our model, we have no way of determining whether each qualifying household in our AHS data actually received the EITC. Since there is no best way to adjust our empirical models to account for actual rather than full participation, our assessments of how a modified EITC could affect housing cost burdens consider full participation only. To give a sense of how current participation in the EITC alters its impact on housing cost burdens, we use the GAO's reported participation rates to quantify those effects by family size. Thus, the tables in this section portray the estimated *actual* impact of the EITC on severe housing cost burdens in 1999, as well as the estimated *hypothetical* impact on severe housing costs if all eligible earners had claimed the EITC that year.

The impact on EITC-eligible workers and families[14]

About 3.9 million low- and moderate-income working families—one in four EITC-eligible families—lived in households with severe housing cost burdens in 1999 (table 7). When we factor the EITC into their household incomes, assuming the GAO's less than full participation rates, the overall incidence of severe housing costs declines by 15 percent—or nearly 600,000 families. The overall incidence of these burdens drops from 25 percent to 21 percent of EITC-eligible families.

Our model shows that, because of differing benefit levels and participation rates, the EITC has a very different impact on the incidence of severe housing costs across family types. For childless families, the combination of low income limits and low benefit levels largely negates the EITC's reduction of severe housing cost burdens—only 14,000 of these families overcome severe housing costs with the EITC. At the same time, significantly larger credits and participation rates for

[14] As indicated earlier, throughout this article, we use the term "family" when we discuss how the EITC works because the unit of analysis for the credit is the tax unit, which consists of an income-eligible worker and his or her qualifying children. Because the unit of analysis for most housing data is the household, which may contain more than one tax unit or family, we use the term "working household" when discussing housing cost burdens.

Table 7. **Impact of the EITC on the Incidence of Severe Housing Costs, by Number of Children: EITC-Eligible Families Living in Households with Severe Housing Costs, 1999**

	Before EITC		After EITC		After EITC, Full Participation	
	SHC[a]	Rate	SHC[a]	Rate	SHC[a]	Rate
No children	1,408	28.3	1,394	28.0	1,380	27.7
One child	975	21.9	769	17.2	758	17.0
Two children	888	23.7	614	16.4	593	15.8
Three or more children	605	25.2	512	21.3	445	18.6
Grand total[b]	3,876	24.9	3,289	21.1	3,176	20.4
Reduction			–587		–700	
Percent Reduction			–15.1		–18.1	

Source: U.S. Department of Commerce and HUD 2002a and the authors' calculations.
[a] In thousands.
[b] An additional 7,000 ineligible families without children no longer had severe housing costs because they were living with an EITC-eligible family.

families with children reduce the incidence of severe housing costs among EITC-eligible families with one child by 206,000 families (21 percent) and among EITC-eligible families with two children by 274,000 families (31 percent). Because of a lower participation rate among families with three or more children, the credit removes severe housing cost burdens for only 15 percent of these families—less than half the impact it has for two-child families. Nevertheless, our model estimates that the EITC reduces the incidence of severe housing costs for all eligible families with children by an impressive 15 percent or 587,000 families.

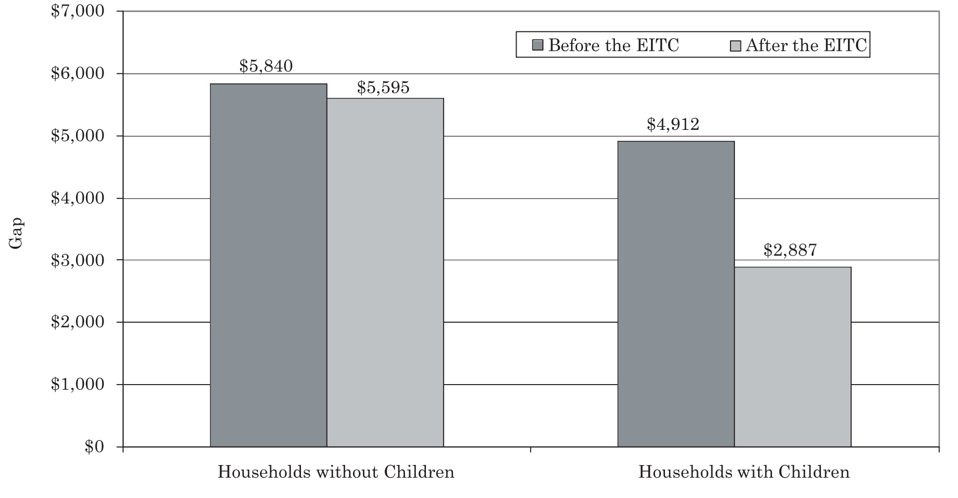
The EITC's impact on severe housing costs would be heightened if all eligible working families claimed the extra income due to them (full participation). Because of the low participation rates among larger families, boosting participation to 100 percent for qualifying families with more than two children would have the single greatest incremental impact, reducing the incidence of severe housing costs by an additional 67,000 families. We estimate that full participation across all family types would remove almost 700,000 families from the ranks of those who are severely cost burdened.

Of course, focusing solely on whether a household does or does not have severe housing costs may serve to understate the impact of the EITC. Another way to assess its efficacy is to calculate the degree to which the tax credit reduces the median housing gap for working households. We define the median housing gap as the amount of additional household income that a typical severely cost burdened household would need to reduce the percentage of its income spent on housing to 50 percent.[15]

In 1999, the median housing gap for EITC-eligible households with severe housing cost burdens was more than $5,800 for childless workers and over $4,900 for households with children (figure 2). The differences due to the presence of children in the household are stark. The EITC had a minimal impact on the housing costs of childless households, reducing the median housing gap by just over 4 percent; for households with children, it reduced the gap by 41 percent—10 times as much.

While they do not appear on the radar screen, households with gross housing costs between 40 and 49 percent of income also carry a heavy burden that the EITC reduces significantly. If all eligible families were

Figure 2. **Median Housing Cost Gap* before and after the EITC, EITC-Eligible Households with Severe Housing Costs, 1999**



Source: U.S. Department of Commerce and HUD 2002a and the authors' calculations.
*Housing cost gap equals twice the annual housing costs minus total household gross income: that is, the increase in income required to reduce the housing cost ratio to 50 percent. Applied only to EITC-eligible households with severe housing costs.

[15] For example, we can consider a family that has two children, earns $12,000 a year, and pays $8,000 a year in housing costs. To reduce its housing cost ratio to 50 percent, this family's income must be increased by $4,000, which is the "housing cost gap." This family would be eligible for $3,816 in EITC (see table 1), so the EITC would cover roughly 95 percent of the gap.

to claim the EITC, the number of working households that have children and pay this much of their income for housing would decrease by nearly 60 percent, or 761,000 households (table 8).

Table 8. **Impact of the EITC on Housing Cost Ratios, EITC-Eligible Households Only, Full Participation**

		After EITC		
Housing Cost Ratio Category	Before EITC Households*	Households*	Reduction	Percent Reduction
Households without children				
30–39%	513	499	–14	–2.7
40–49%	272	251	–21	–7.7
Households with children				
30–39%	1,969	1,229	–740	–37.6
40–49%	1,273	512	–761	–59.8

Source: U.S. Department of Commerce and HUD 2002a and the authors' calculations.
*In thousands.

The impact on worst-case needs. As discussed earlier, HUD defines worst-case needs households as unassisted renters whose total household income is less than 50 percent of the local area median and who spend more than half their income on rent and/or live in substandard housing. Here we assign estimated EITC benefits to worst-case needs households to determine the extent to which the wage supplement reduces severe housing cost burdens among this population.

According to HUD (2001), there were about 9.7 million unassisted very low income renter households in 1999, and roughly half of them had worst-case needs (table 9). Because 36 percent of all such households have no wage earners and another 34 percent are childless workers whose EITC benefits are very small, the EITC has the potential to significantly help only the 30 percent that both work and have children. For this reason, the EITC as currently configured can have at best only a modest impact on worst-case needs.

Next, we apply the GAO's estimated participation rates by family size and find that the EITC reduces the overall incidence of worst-case needs by about 350,000 households, or just 7 percent—8 percent at full participation (figure 3). Nearly all of this reduction comes among working households that have children and are eligible for the largest credits. For that subpopulation, the credit removes severe housing costs for 25 percent of the households. At full participation, the impact of the EITC rises to 29 percent of working households with children.

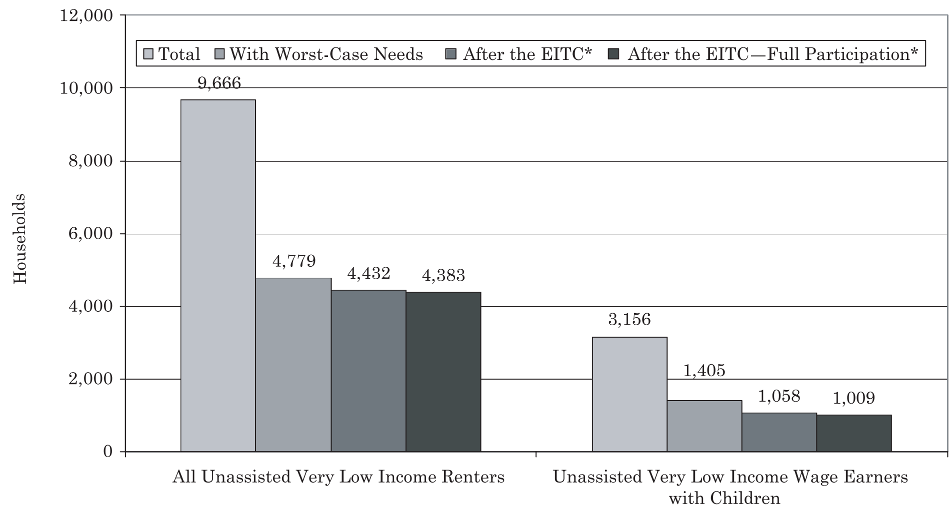
The impact on critical housing needs. Stegman, Quercia, and McCarthy (2000) introduced into the housing needs assessment literature the concept of critical housing needs, which applies to a broader range of

Table 9. **Worst-Case Needs Households, by Earner Status and Presence of Children, 1999**

	Total[a]	With Worst-Case Needs[a]	Percentage with Worst-Case Needs
Unassisted very low income renters	9,666	4,779	49.4
Non-wage earners	3,432	1,744	50.8
Wage earners[b]	6,234	3,035	48.7
Without children	3,078	1,630	53.0
With children	3,156	1,405	44.5

Source: U.S. Department of Commerce and HUD 2002a and the authors' calculations.
[a] In thousands.
[b] Wage-earning households are defined as those containing at least one family with earned income.

Figure 3. **Impact of the EITC on Worst-Case Needs, 1999 (in Thousands)**



Source: U. S. Department of Commerce and HUD 2000a and the authors' calculations.
*The EITC reduces the number of unassisted very low income renter households with severe housing costs by 371,000 under current participation and 422,000 under full participation, but some of those households also had severely inadequate housing and therefore still qualify as having worst-case needs.

working households than HUD's worst-case needs.[16] Their universe encompasses all homeowners and renters, including those who receive HUD subsidies and those who do not, whose earned incomes range from a low of $10,700 (the equivalent of one full-time worker earning the federal minimum wage) to 120 percent of the local area median income. Like worst-case needs, critical housing needs measures the proportion of this universe that pays more than half of its income for rent or a mortgage or lives in substandard housing.

We would not expect the EITC to have an impact on the incidence of critical housing needs among childless workers, because the lower end of the income threshold for this group—$10,700—is above the maximum income limit for childless workers under the EITC, which was $10,200 in 1999. For working households with children, however, the impact is notable. Overall, there were about 17 million low- and moderate-income renter households in the United States in 1999. If EITC benefits are excluded, about 12 percent of these households had critical housing needs (table 10). Current participation in the EITC reduces

Table 10. **Impact of the EITC on Critical Housing Needs, 1999**

	Before EITC		After EITC		After EITC, Full Participation	
	Critical Housing Needs[a]	Rate (%)	Critical Housing Needs[a]	Rate (%)	Critical Housing Needs[a]	Rate (%)
Low- to moderate-income working renter households (N = 16,580)[a]	1,936	11.5	1,706	10.1	1,681	10.0
Reduction (compared with HUD)	NA	NA	230[b]	NA	255[b]	NA
Percent reduction	NA	NA	11.9	NA	13.2	NA
Low- to moderate-income working homeowner households (N = 17,740)[a]	1,812	10.2	1,734	9.8	1,725	9.7
Reduction (compared with HUD)	NA	NA	78[c]	NA	87[c]	NA
Percent reduction	NA	NA	4.3	NA	4.8	NA

Source: U.S. Department of Commerce and HUD 2002a and authors' calculations.
[a] In thousands.
[b] Current EITC participation levels reduce the number of households with severe housing costs by 243,000, but 13,000 of those also had severely inadequate housing, leaving the total reduction at 230,000. At full participation, the number with severe housing costs is reduced by 268,000.
[c] Current EITC participation levels reduce the number of households with severe housing costs by 78,000, the entire decrease in critical housing needs. At full participation, the number with severe housing costs is reduced by 87,000.
NA = not applicable.

[16] Like Stegman, Quercia, and McCarthy (2000); Harkness, Newman, and Lipman (2002); and Lipman (2002), we use the phrase "working families" and households interchangeably when discussing critical housing needs.

critical housing needs among renter households by 230,000, or about 12 percent; at full participation, the incidence among this population is reduced by 13 percent.

For low- and moderate-income working homeowners, the EITC had a smaller impact. About 10 percent of these homeowners had critical housing needs in 1999, and the EITC eliminated this burden by 4 percent at current participation and 5 percent at full participation. Overall then, ignoring EITC benefits overstates the incidence of critical housing needs among lower-income working households by between 310,000 and 340,000 households.[17]

The impact of combined federal taxes on severe housing cost burdens

Consistent with most housing policy research, we have calculated our measures of housing affordability and the associated impact of the EITC on a pretax basis. Because the EITC boosts after-tax income, however, it is also useful to examine how all federal taxes—including credits like the EITC—affect housing cost burdens for low-income working households.

As we explain more fully in the appendix, our model of after-tax housing costs is designed to capture the relevant federal tax provisions that affect lower-income families, such as federal income taxes, including the EITC, as well as the employee's share of federal payroll taxes.[18] The model also includes two relevant post-1999 changes in individual income taxes: (a) a refundable credit of up to $600 per child and (b) a modest expansion in the EITC for married couples with children. To compute after-tax income, then, we deduct 7.5 percent of earnings (the employee share of federal payroll taxes), along with any federal income taxes due, from gross income. We then add, where applicable, the EITC and refundable Child Tax Credit to arrive at after-tax income and recalculate the percentage of income paid for housing.

[17] As is true with our worst-case needs analysis, the reduction is almost entirely among families with children. The EITC reduces the incidence of critical housing needs among working renters with children by between 31 percent and 35 percent, and among homeowners with children by a more modest 10 percent to 15 percent.

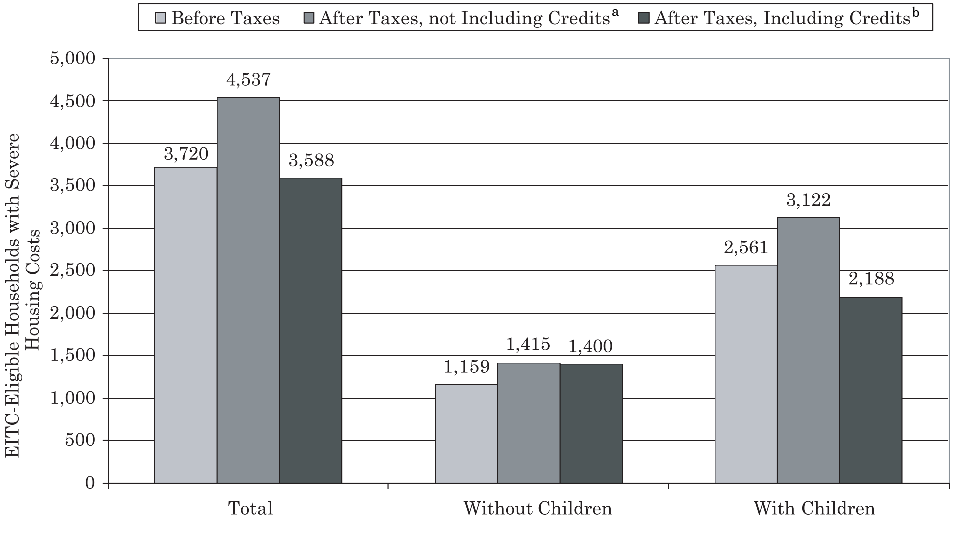
[18] For the purposes of this analysis, we assume that all EITC-eligible filers take the standard deduction. According to the IRS, 90 percent of all tax returns from filers with incomes of less than $30,000 and 94 percent of those from filers with incomes of less than $15,000 took the standard deduction in 1999 (2000). Note that our analysis does not take into account state taxes, which for many low-income families consume a greater share of income than federal taxes.

The most important finding that emerges from this analysis is that the established practice of assessing housing costs on the basis of pretax income seriously understates cost burdens among low-income workers without children. For EITC-eligible childless households, federal taxes increase the incidence of severe housing costs from 31 to 38 percent or about 250,000 households (figure 4). Because only a small EITC is available to these workers, the credit offsets their after-tax burden only minimally, eliminating severe housing costs for just 15,000 households.

By contrast, for households with children, we find that the EITC and child credit more than compensate for the income and payroll taxes paid and that after-tax housing cost burdens are less severe than before-tax burdens. After taxes, 373,000 fewer low-income working households with children bear severe housing costs than before taxes. The net effect of federal taxes and tax credits on all working households is a modest reduction in the incidence of severe housing cost burdens. About 3.7 million EITC-eligible households spend more than 50 percent of their before-tax income on housing, compared with 3.6 million that spend more than 50 percent of their after-tax income.

These findings confirm that, in the absence of the EITC and the refundable child credit, several hundred thousand low-income working

Figure 4. **Effect of Federal Taxes on Severe Housing Cost Burdens, EITC-Eligible Households (in Thousands), 1999**



Source: U.S. Department of Commerce and HUD 2002a and the authors' calculations.
[a] Includes federal income and payroll taxes.
[b] Includes the EITC with the marriage plateau extension, and refundable tax credit of up to $600 per child.

households would spend more than half of their after-tax income on housing. These findings also suggest that policy makers might more actively use the tax code to relieve housing cost burdens—for childless workers, in particular—a topic we examine in greater detail next.

Expanding the EITC to reduce severe housing costs

Our analysis confirms that the EITC serves as a powerful tool for reducing the housing-cost burden among low-income working households with children. Among families with children, the EITC eliminates severe housing costs for one-fourth to one-third of those eligible. It substantially reduces the incidence of worst-case needs among very low income unassisted renters with children. The impact of the credit on housing cost burdens extends beyond those households with the most severe burdens, reducing by more than half the number of low-income working households that spend between 40 percent and 50 percent of their income on housing.

We argue that the EITC could go further than it does now to help erase severe housing cost burdens for a broader group of workers and families. Even after receiving the EITC, nearly 2 million low-income working households with children still spend more than half of their income on housing. In addition, low-income childless workers, in particular, make up more than half of all households with severe housing costs, but benefit only marginally from the current EITC.

In this section, we explore how three options for expanding the EITC affect the incidence of severe housing cost burdens for lower-income workers and their families:

1. The first proposal, embodied in legislation (H.R. 3574) introduced in the U.S. House of Representatives by former Congressman William J. Coyne (D–PA) in December 2001, would increase the EITC both for childless workers and for families with three or more children (U.S. House Committee on Ways and Means 2001d). While the proposal is not explicitly designed to ameliorate housing cost burdens, the groups targeted for an expanded credit are among those most likely to face such burdens.

2. The second proposal derives from a suggestion by housing policy expert Cushing Dolbeare that the EITC could be designed to plug the gap between half of a family's income and the rent (2001).

3. We designed the third proposal to help eligible families afford median-priced housing in the bulk of housing markets in the United States. We consider the distribution of housing costs across the country and set parameters for the EITC accordingly.

Before explaining how each proposal works and how each affects EITC eligibility and benefit levels, it is important to keep in mind the bright line that distinguishes most housing assistance programs from initiatives like the EITC, which are designed to reward work and help elevate low-paid workers and their families above the poverty line. Basically, for otherwise identical families, housing subsidies vary directly with local housing costs, while wage-based subsidies like the EITC do not.

The importance of geography in housing prices and the spatial variation in housing subsidies cannot be overstated. Take, for example, North Carolina and California. The average HUD FMR for a 2-bedroom apartment in metropolitan North Carolina in 2003 was $603. In metropolitan Rocky Mount in the lower-cost eastern part of the state, the comparable FMR was $464, while in the Raleigh-Durham metropolitan Research Triangle area, it was 72 percent higher at $799. The lowest-cost 2-bedroom FMR in metropolitan California was $592 in Visalia–Tulare–Porterville, while the FMR in San Francisco for a similar unit was three times greater ($1,775).

While housing subsidy payments are sensitive to spatial variations in housing costs, EITC benefits are not. Thus, any proposal to modify this credit to relieve severe housing cost burdens for working households must address this issue. At the same time, because it is designed to reward work, the EITC is not only tied to wages and the number of children, but it also increases as earnings rise, before leveling off and declining with further increases in income. Any proposal to make the EITC more responsive to regional variations in housing cost would have to respect the integrity of the program's current design, which gives the benefit levels the inverted U shape seen in figure 1. We will return to these various design issues after describing our proposals and comparing them on four measures: their cost; their impact on severe housing costs among eligible families and households; their impact on poverty; and their targeting efficiency—the proportion of increased spending that reduces severe housing cost burdens. As noted earlier, our models assume full participation among eligible workers.[19]

[19] Our comparisons also incorporate a small expansion of the EITC for married couples with children. Although this was not actually added by Congress until 2001, we felt that our baseline and proposals should mirror current EITC policy as closely as possible. See the appendix for more details.

Legislative proposals to modify the EITC for one reason or another are quite common, with some aimed at expanding benefits and others at curtailing them. In the past two sessions of Congress alone, members have introduced measures that would do the following:

1. Protect low-income taxpayers from unscrupulous tax preparers who entice EITC filers with instant refunds through high-cost refund anticipation loans (U.S. Senate Committee on Finance 2001, 2003)

2. Expand (U.S. House Committee on Ways and Means 2001b, 2002) or eliminate (U.S. House Committee on Ways and Means 2001c) benefits for childless workers

3. Increase the credit for welfare families that work for their benefits (U.S. House Committee on Ways and Means 2001a)

4. Reduce benefits across the board (U.S. House Committee on Ways and Means 2001c)

5. Prohibit the IRS from implementing certain precertification requirements on EITC filers without explicit authorization by Congress (U.S. House Committee on Ways and Means 2003a)

6. Direct the IRS to establish a national public awareness campaign to educate Americans on the availability of the credit (U.S. House Committee on Ways and Means 2003b)

Because a significant segment of worst-case needs households consists of single individuals and because low-income families with three or more children are more likely than others to have severe housing costs, the first measure we evaluate is a proposal, introduced in the 107th Congress by former Democratic Congressman William Coyne, that would increase EITC benefits for childless workers and large families (U.S. House Committee on Ways and Means 2001d).

The Coyne proposal: Expanding the EITC for childless workers and large families

The EITC was initially designed to relieve tax burdens for families with children. Only in 1993 was a small version of the credit enacted for childless workers, providing them with an effective rebate on the employee share of payroll taxes for the first few thousand dollars of earned income. In 1999, $700 million, or 2 percent of the total EITC, went to low-income workers without children (Greenstein 2000b). That year, the maximum credit for a childless family was less than $300, and eligibility ended at $10,000 of earned income.

Greenstein (2000b) has argued that no group of workers needs a tax cut more than low-income workers without children. He notes that, in addition to paying federal payroll and excise taxes, these workers begin paying federal income tax before their earnings reach poverty level. In addition, he observes that childless workers are eligible for few, if any, other government benefits, such as cash, housing, or medical assistance.

Another argument in favor of increasing the EITC for this group is that it might encourage young fathers, especially minority fathers, who have been largely ignored by welfare reform efforts, to join the work force. As Offner and Holzer note, "[P]rogress in encouraging marriage and family formation among welfare families will depend, in part, on the ability of young men to find jobs" (2002, 1). Yet today, Offner and Holzer (2002) calculate that only about half of the nation's 1 million black 16- to 24-year-old high school dropouts are employed, compared with more than 60 percent 20 years ago. Raising the return on low-wage labor by increasing the EITC for childless workers could induce more young men without dependent children to join the labor force.

As indicated earlier, a bill sponsored by former Congressman William Coyne in the 107th Congress (U.S. House Committee on Ways and Means 2001d) would increase EITC benefits for all families, particularly those with no children and those with three or more children. The proposal makes four major changes to the structure of the EITC. First, for families with children, the bill raises the maximum used to calculate the credit to $10,710, the annual earnings of a full-time worker being paid the minimum wage.[20] Second, it extends the phase-in range for childless workers through the first $6,000 in wages and extends the plateau for these workers through $10,710. Third, it would double the credit's phase-in rate for childless workers to 15.3 percent, offsetting both the employer and employee share of the payroll tax.[21]

The fourth major change that the Coyne proposal would make recognizes that the poverty rate is "a stunning 29 percent for children in

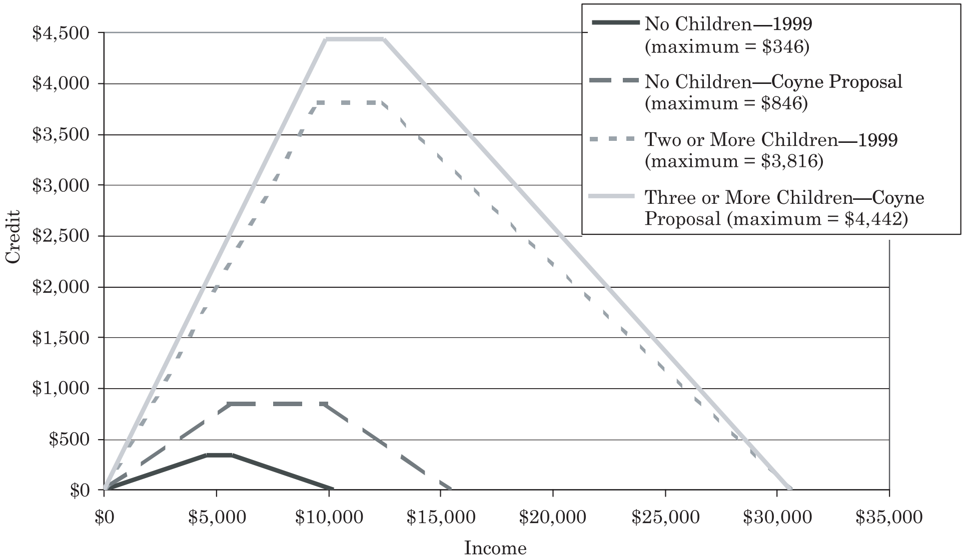
[20] In tax year 2002, the maximum earnings used to calculate the credit were $7,370 for one-child families and $10,350 for families with two or more children.

[21] Most economists believe that, in the long run, the full burden of the payroll tax—including the employer share—is borne by workers in the form of lower wages (Greenstein 2000a).

families with three or more children, which is more than double the poverty rate among children in smaller families" (Greenstein 2000a, 1). The bill would "create a new EITC benefit level for families with three or more children, including a credit percentage of 45 percent, which is higher than the 40 percent credit rate that currently applies under the existing 'two or more children' category" (Statement of The Honorable William J. Coyne 2001, 1). Figure 5 shows how the Coyne proposal would expand eligibility and credit amounts over current law for both childless workers and families with three or more children.

We estimate that this proposal would nearly double the number of EITC-eligible workers without children—to 9.7 million (table 11).[22] It would also more than double both the maximum credit (to $846) and the average credit (to $527) for these workers. Only about 15 percent of all EITC-eligible families with children have three or more. But for these families, the maximum benefit would rise by more than $600 and average benefits would rise by nearly $400, to $2,549.

Figure 5. **Structure of the EITC in 1999 and under the Coyne Proposal**



Source: U.S. Department of Commerce and HUD 2002a, U.S. House Committee on Ways and Means 2001d, and the authors' calculations.

[22] To properly compare Coyne's proposal, which was introduced in 2001, with the 1999 tax year EITC, the plateau and maximum earned income limits in the bill were adjusted for inflation.

Table 11. **Eligible Families and the Average EITC under 1999 Law and the Coyne Proposal**

	Eligible Families, 1999*	Average EITC, 1999*	Eligible Families, Coyne Proposal*	Average EITC, Coyne Proposal
No children	4,980	$193	9,666	$527
One child	4,465	$1,438	4,553	$1,936
Two children	3,741	$2,167	3,851	$2,257
Three or more children	2,401	$2,151	2,450	$2,549

Source: U.S. House Committee on Ways and Means 2001d and the authors' calculations.
*In thousands.

The Dolbeare proposal: Targeting individual families with high housing costs

Housing policy expert Cushing Dolbeare (2001) has suggested a broader change to the EITC, one that is explicitly designed to reduce severe housing cost burdens among lower-income families. We note from the outset that we do not favor this approach because it would break the direct link between earnings and benefits and convert the EITC into a more traditional type of social welfare program while adding substantial administrative complexity. Nonetheless, an evaluation of this proposal may provide a best-case look at the degree to which an EITC-like credit could lower housing cost burdens for working households.

Dolbeare proposes an add-on to the EITC designed to ensure that no eligible family faces severe housing costs for a reasonably priced unit. Under her proposal, recipients who pay more than 50 percent of their income for rent would be eligible for an earnings-based supplement to the EITC that would equal the difference between 50 percent of the family's earned income plus its current EITC benefit and actual rent payment. The proposal would cap the benefit at the difference between 50 percent of the family income and the applicable local FMR.[23]

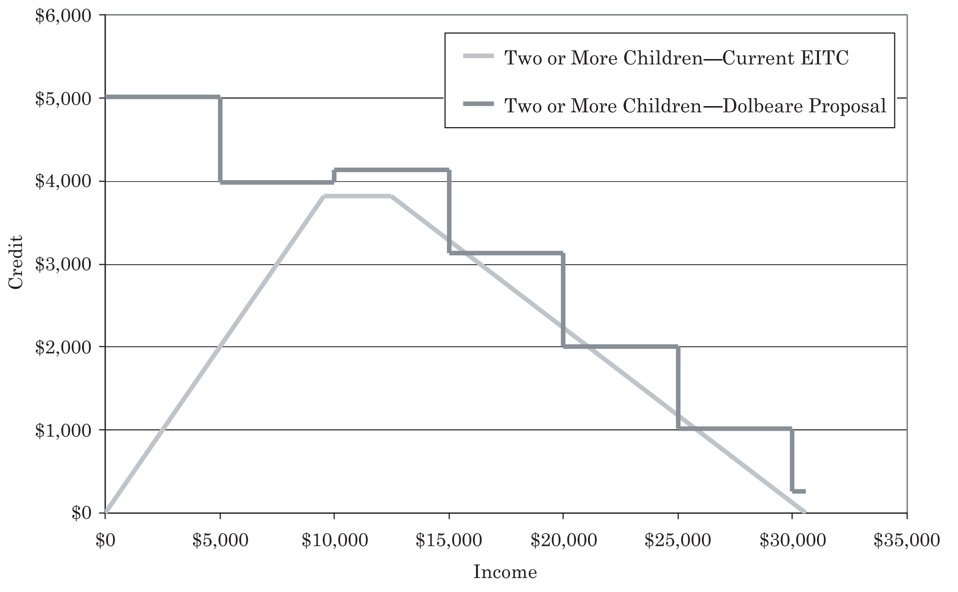
For example, a family with two children and $12,000 in earnings would have qualified for an EITC of $3,800 in 1999. If the family paid $700 a month for rent (assuming that this amount did not exceed the local FMR), under Dolbeare's proposal it would have been eligible for an EITC supplement of $8,400 (12 months' rent) minus $7,900 (50 percent of earnings including current EITC), or $500. The $500 supplement

[23] In her article, Dolbeare proposes a more generous subsidy equal to the difference between 30 percent of earned income including the EITC and actual rent. We reduce the subsidy for cost considerations.

effectively makes up the gap between 50 percent of the family's income and its total rent payment.

How would this proposal change the structure and distribution of EITC benefits? It would tie EITC benefits not just to a family's earned income, but also to its housing costs. Therefore, a family with a given level of earned income but without severe housing costs would receive its regular EITC benefit, while another family that had the same earned income but also had severe housing costs would receive a larger benefit, possibly thousands of dollars larger (see the appendix for details). Because a given level of earned income would qualify a family for a range of EITC benefits, it is impossible to show exactly how the distribution of the EITC would change from current law. However, using our model, we can calculate average benefits from the Dolbeare proposal for families in various earned income ranges. This method produces the jagged-line effect shown in figure 6.[24]

Figure 6. **Current EITC versus the Dolbeare Proposal, Family with Two or More Children, 1999**



Source: U.S. Department of Commerce and HUD 2002a and the authors' calculations.

[24] Note that using this average benefit method to display the structure of the Dolbeare proposal results in a line that dips below the current EITC at certain levels. In reality, because the proposal contemplates a supplement to the EITC, the proposed credit at a given income level always exceeds the amount under current law.

Because cost-burdened families with the lowest earned incomes would receive the largest supplements, Dolbeare's proposal would effectively convert the EITC into a traditional housing subsidy program. In addition to eroding work incentives in the phase-in range, the proposal could give rise to perverse housing incentives. For example, between two families with identical earnings living in the same local housing market, the one with the higher housing costs would receive a larger supplemental credit (up to the local FMR). This could encourage families to move into more expensive housing to increase their subsidy.

By requiring IRS verification of a family's actual housing costs, Dolbeare's proposal would raise EITC administrative costs significantly. Moreover, because the maximum allowable supplement would be tied to local FMRs, the proposal also introduces local variations into federal benefits. One further complexity arises from the fact that the EITC is family based, while housing cost burdens are measured at the household level. The proposal would necessitate some way of determining each family's share of housing costs in the multi-tax-unit households in which over 40 percent of all EITC-eligible families live.

Overall, our model shows that the Dolbeare proposal would boost EITC benefits for childless workers by the largest amounts (table 12). This is not surprising, since these workers are the most likely to have severe housing cost burdens. The magnitude by which their average credit would increase—more than $1,600, or eight times the current average credit—is striking. The average projected benefit increase for families with children, about $650, is modest by comparison. However, only families with severe housing costs would receive an increase in EITC; the amounts cited here are averaged over all families, and those with severe housing costs would in fact receive much larger amounts.

Table 12. **Average EITC under 1999 Law and the Dolbeare Proposal***

	Average EITC, 1999	Average EITC, Dolbeare Proposal
No children	$193	$1,820
One child	$1,438	$2,092
Two or more children	$2,198	$2,844

Source: Dolbeare 2001, U.S. Department of Commerce and HUD 2002a, and the authors' calculations.
*The eligibility standards of the Dolbeare proposal match those of the current EITC. There is no increase in coverage, only in benefits for families with severe housing costs.

Our proposal: Tying the EITC to median housing costs

We share Dolbeare's goal of using tax policy to make housing more affordable for lower-income working households. We have developed a proposal, administratively simple compared with Dolbeare's, to expand the EITC for this purpose. Our goal is to ensure that significantly fewer working households pay more than 50 percent of their gross incomes to live in decent but modest housing.

Our proposal features an implicit EITC housing supplement. Instead of tying it to the actual housing costs of each eligible family (as well as local housing market conditions) as the Dolbeare proposal does, we base ours on a median housing cost standard. In addition to reducing complexity, this design retains the work incentive in the current EITC.

Why, it might be asked, do we base our proposal on median housing costs, rather than on an FMR standard? The short answer is cost and administrative complexity. Our rough estimate is that benchmarking the tax credit against actual FMRs would increase incremental costs by about 50 percent over the costs of our proposal. Administrative complexity and compliance issues arise because for the first time, EITC benefits would vary by geography for similarly situated workers, and tax filers would have to know what local FMR jurisdiction they live in as they consult a new IRS schedule that matches credit percentages with local FMRs.

Our standard is based on a *national* distribution of local median housing costs. We set the standard such that most EITC-eligible families could afford a median-priced unit of the appropriate size in 25 to 75 percent of all local housing markets in the country. Under our proposal, benefits for working families with earnings at the low end of the EITC plateau are pegged to the median housing cost at the 25th percentile of the national distribution, while benefits for families with earnings at the high end of the EITC plateau are pegged to median housing cost at the 75th percentile.

We also note that the incidence of severe housing costs by income (table 5) reveals that, in each category by child, families with severe housing costs tended to have incomes between $5,000 and $15,000. Given this empirical reality, we incorporate a steep phase-in rate and relatively slow phase-out rate into our design so that families across this income range would qualify for the largest benefits.

To illustrate how the proposal works, here is the proposed structure of the EITC for a family with one child:

1. In 1999, the median housing cost of a two-bedroom apartment located at the 25th percentile along the national distribution (i.e., the price point that exceeds exactly one-fourth of all local median housing costs nationwide) was $485 a month, or $5,820 a year.

2. For a family to spend no more than 50 percent of its income on that rent, it would need to earn twice that amount, or $11,640.

3. Therefore, we set the phase-in rate (the amount of additional credit per dollar earned) and plateau starting point for families with one child such that the sum of earned income plus EITC benefits roughly equals the target income of $11,640.

4. To achieve this, we raise the phase-in rate from 34 cents per dollar of earnings to 60 cents and push out the starting point of the plateau from the 1999 level of $6,800 to $7,000. Thus, a family at the beginning of the plateau would receive $4,200, raising total income to $11,200, including the EITC. This is just a bit shy of our target income of $11,640.

5. At the upper end of the plateau, we aim to make a two-bedroom unit at the 75th percentile price affordable. In 1999, that price was about $690 a month, or $8,280 a year.

6. To meet the earnings target of double that amount ($16,560) at the end of the plateau, we select the end point such that family income plus the EITC roughly equals the target income. Moving the maximum income on the plateau *back* from $12,460 to $12,200, coupled with the $4,200 maximum EITC, results in total family income of $16,400, which is just shy of the target.

We set parameters for the zero-child and two-or-more-children credits in the same way, using median housing cost for three-bedroom apartments for the latter, and half of the median housing cost of a two-bedroom apartment for the former.

In contrast to the Dolbeare proposal, the higher credit levels built into our proposal give families an added measure of affordability regardless of whether they have severe housing costs (and whether they choose to spend their additional EITC money on housing). Table 13 displays parameters for the median housing cost–based credit for families of different size, and figure 7 compares this proposal with the existing EITC (current credit in dashed lines, proposed credit in solid lines).

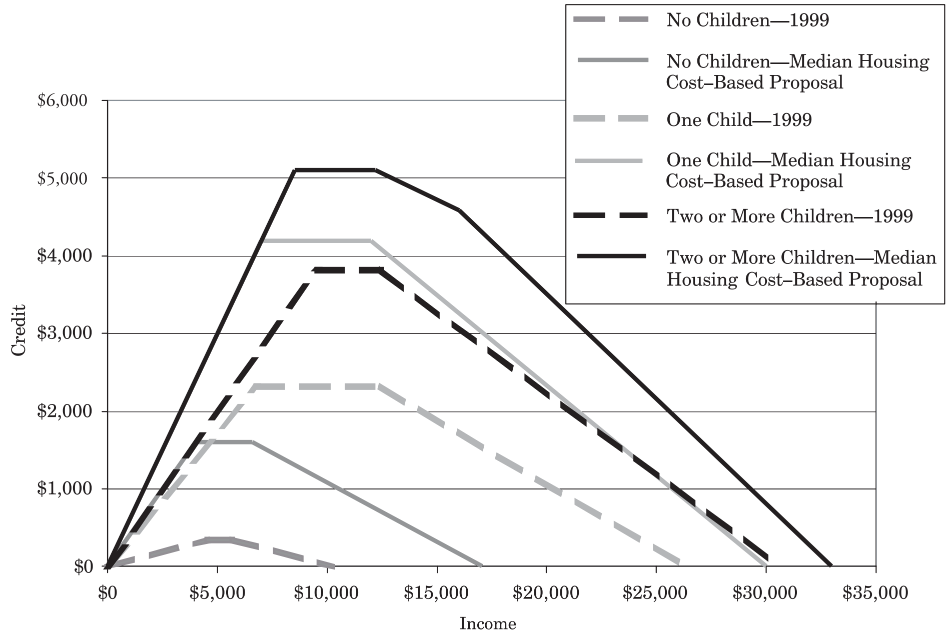
For families with two or more children, we include a graduated phase-out rate. In addition to helping control costs, this feature would also help many families with below-poverty incomes avoid the high marginal tax rate implicit in the EITC phase-out. (See the appendix for more detail.)

Table 13. **Parameters for the EITC Based on Median Monthly Housing Costs**

	No Children	One Child	Two or More Children
Phase-in rate	0.40	0.60	0.60
Plateau begins	$4,000	$7,000	$8,500
Plateau ends	$6,600	$12,000	$12,200
Phase-out rate	0.1530	0.233	0.135/0.270[a]
Maximum earned income	$17,058	$30,026	$32,989
Maximum credit	$1,600	$4,200	$5,100
Number of eligible families[b]	10,860	5,299	6,878
Average credit	$917	$2,467	$3,104

[a] Declines at the rate of 0.135 from $12,201 to $16,000; declines at rate of 0.27 after that.
[b] In thousands.

Figure 7. **Structure of the EITC in 1999 and under the Median Housing Cost–Based Proposal**



Source: U.S. Department of Commerce and HUD 2002a and the authors' calculations.

How would a credit tied to local median housing costs be administered? Each year, the IRS publishes new inflation-adjusted parameters for the EITC. As part of that process, HUD would supply the IRS with information on the distribution of local housing costs so that the agency could set the corresponding EITC plateaus. Relative to the Dolbeare proposal, the administrative costs are quite low.

Though both the Dolbeare proposal and ours target families with high housing costs, they produce different distributions of dollars. Because the Dolbeare proposal directs additional money only to workers and families with severe housing costs and because there are more childless workers with very high housing costs, it would increase average credits for these workers by a factor of eight. Families with two or more children, meanwhile, would see their average benefits rise by 29 percent. By contrast, our alternative would result in a somewhat more modest increase in the childless worker credit (quadrupled, on average, to $917) and a more significant increase for families with two or more children (44 percent on average, to $3,104).

Comparing the impact and efficiency of the three proposals

Cost. The costs of the proposals vary widely. The Coyne proposal would add about $7.7 billion to the cost of the EITC (table 14). Dolbeare's proposal would cost $15.5 billion, and our proposal would cost $25 billion, nearly doubling the total value of all EITC benefits. None of these estimates include any additional administrative costs, which would likely be substantial in the case of the Dolbeare proposal.

Targeting efficiency. Because Dolbeare's proposal explicitly links EITC supplements to families with extremely high housing costs, it has much higher targeting efficiency than either of the others. Her plan would direct about 62 percent of new EITC dollars to families with severe housing costs, compared with less than 25 percent for the other proposals.[25]

[25] Some readers may wonder why the Dolbeare proposal does not achieve 100 percent targeting efficiency if all supplemental credits are directed at those with severe housing costs. The lower figure of 62 percent represents the percentage of new dollars going to *families* with severe housing costs, while the proposal explicitly targets *households* with severe housing costs. Since such a significant share of households contain more than one family (but most often only one EITC-eligible family), many of the families that would receive supplemental credits under this proposal do not in fact face severe housing costs at the *family* level. This calculation makes clear that the IRS would face significant problems administering a credit based on actual household-level housing costs. For more details, see the appendix.

Table 14. **Measures of the Impact and Efficiency of the Three EITC Proposals**

	Coyne	Dolbeare	Median Housing Cost–Based
Revenue cost (in billions of dollars)	+ 7.7	+ 15.9	+ 25.0
Targeting efficiency: Percentage of new EITC spending on families with severe housing costs	21.6	61.5	23.3
Reduction in families with severe housing costs			
No children	–93,000	–160,000	–234,000
One child	–37,000	–83,000	–132,000
Two children	–2,000	–71,000	–87,000
Three or more children	–21,000	–58,000	–58,000
Total	–153,000	–372,000	–511,000
Reduction in median housing cost gap ($)	–383	–1,053	–2,683
Reduction in households by housing cost ratio			
Currently eligible households without children			
30–39%	–79,000	–99,000	–154,000
40–49%	–46,000	–91,000	–98,000
Currently eligible households with children			
30–39%	–157,000	–97,000	–406,000
40–49%	–86,000	–99,000	–244,000
Newly eligible households without children			
30–39%	–39,000	*	–106,000
40–49%	–29,000	*	–66,000
50% and above	–36,000	*	–81,000
Reduction in worst-case needs			
Households without children	–50,000	–41,000	–100,000
Households with children	–30,000	–108,000	–154,000
Total	–80,000	–149,000	–254,000
Reduction in severe housing costs for low-income working households			
Low- to medium-income working households	–76,000	–114,000	–224,000
Low- to medium-income homeowners only	–46,000	–105,000	–169,000
Reduction in the poverty level			
Households without children	–132,000	–273,000	–281,000
Households with children	–96,000	–275,000	–447,000
Total	–228,000	–547,000	–728,000
Reduction in the poverty level by race/ethnicity (EITC-eligible households only) (%)			
White non-Hispanic households	–6.8	–18.1	–21.0
Black households	–5.1	–10.7	–15.7
Hispanic households	–6.9	–11.2	–23.1
Other households	–5.4	–23.8	–19.2
Total	–6.2	–14.9	–19.8

Source: U.S. Department of Commerce and HUD 2002a and the authors' calculations.
*Both the Coyne and the median housing cost–based proposals greatly expand eligibility for childless workers; these figures represent reductions in housing-cost ratios among childless households that would become eligible for the credit under these proposals. Because the Dolbeare proposal does not change eligibility rules for the EITC, no additional reductions are projected.

The impact on severe housing costs. The table shows five measures of the proposals' impact on housing cost burdens: (1) total reduction in severe housing costs among families by number of children; (2) reductions in the median housing-cost gap among those who are severely burdened; (3) reductions in housing cost ratios; (4) impact on worst-case needs; (5) impact on severe housing costs among low- and moderate-income working households; and (6) reduction in the poverty level.

Our proposal would reduce the number of families that face severe housing cost burdens by 511,000, nearly as many as the other two proposals combined. It would reduce the median housing cost gap by nearly $2,700. Although under our proposal, less of the money would be directed to families with severe housing costs than under the Dolbeare proposal, ours would significantly reduce the number of households that, while not severely burdened, pay between 30 and 50 percent of their income for housing. To be sure, our proposal achieves this effect at a cost considerably higher than that of the other two proposals.

It is important to note that last year, HUD declared as a goal reducing the number of worst-case needs households with children by about 6 percent, or 103,000 households, between 2001 and 2003 (ICF Consulting 2002). If implemented, our proposal, as well as Dolbeare's, would achieve this goal.

As discussed earlier, one area of particular policy concern is the high and growing concentration of severe cost burdens among low- and moderate-income working households, a group we define as earning between the full-time minimum wage ($10,700) and 120 percent of the area median. This group has historically been overlooked by federal housing assistance programs. The proposals reduce the number of working households with severe housing costs by amounts roughly in line with their costs, with our proposal having the largest impact (224,000 households). Additionally, unlike housing vouchers that target only renters, all three measures would help homeowners who face severe housing costs; our proposal would reduce the incidence among homeowners by 169,000.

The impact on poverty. The number of households lifted out of poverty by these three proposals also tracks their relative costs. Our proposal would raise an additional 20 percent of working poor EITC-eligible households out of poverty, compared with 6 percent for the Coyne proposal and 15 percent for the Dolbeare proposal.

The effect of the three measures on poverty varies by race and ethnicity because of differences in the demographic and economic composition of working households. In general, the Coyne proposal's focus on childless workers and large families would serve to reduce poverty more among non-Hispanic whites and Hispanics. Dolbeare's measure would reduce poverty most among "other" households, a group composed primarily of ethnic Asians. Our proposal would have the greatest impact on EITC-eligible Hispanic households, nearly a quarter of which would be lifted above the poverty line by the expansion in the EITC.

Conclusion

For the better part of the past 20 years, students of national housing policy of all political persuasions have come to recognize that America's "core housing problem stemmed, predominantly, not from deficits in supply but from deficits in income" (Winnick 1995, 97).

Our experience during the 1990s—an almost decade-long period of unprecedented economic prosperity during which income inequality grew and housing affordability deteriorated—underscores this reality (Elliott, Grote, and Levin-Waldman 2001). Between 1997 and 2001, while the number of nonworking or marginally employed, nonelderly households with critical housing needs fell by 15 percent, the number of full-time working households with such needs grew by 60 percent, to 4 million (Lipman 2002). While a significant portion of this growth is represented by previously nonworking households that are now working, their wages are too low to significantly lower their relative housing costs. With affordability problems no longer concentrated among the nonworking poor, advocates and policy makers alike are searching for new strategies to help raise the income of working households.

At the local level, tax credits that supplement the federal EITC and living wage ordinances are emerging to address the income deficit facing low-wage workers and their families. Seventeen states and two localities—Montgomery County, MD, and Denver—have adopted their own earned income credits that piggyback on the federal EITC (Center for Budget and Policy Priorities 2003; Johnson, Llobrera, and Zahradnik 2003). Living wage laws are generally enacted at the municipal level and require certain classes of employers—in most cases, those with municipal contracts—to pay minimum wages ranging from 150 percent to 300 percent of the federal minimum wage (Turner and Barnow 2003). In researching this article, we reviewed more than 75 living-wage ordinances—with mandatory wage rates for covered workers ranging from $6.25 an hour in Milwaukee to $12 an hour in Santa Cruz, CA—and found few with the potential to close the housing affordability gap for large numbers of families (Ewell 2002).

We are inclined to prefer tax credits over living-wage laws because they do not raise employer costs directly and are less likely to discourage employers from hiring applicants with low skills (Employment Policies Institute 2002). Because tax credits can also be better targeted to families with children, we believe that expanding the federal EITC is an effective way of improving housing affordability for millions of working poor families. Our results indicate that, as currently structured, the EITC substantially reduces severe housing cost burdens for millions of lower-income working households, especially those with children. At existing participation rates, the reduction encompasses an estimated 587,000 families and, at full participation, 700,000 families. It also substantially reduces the incidence of HUD-defined worst-case needs, as well as critical housing needs, among low- and moderate-income working households.

Because the purpose of this article is to start a conversation among housing interests and those working on a broader working families agenda, rather than to analyze a single tax-credit strategy, we explored three ways that the EITC could be expanded to address growing housing costs among America's working families. Above and beyond the impact of the existing credit, each proposal would alleviate severe housing costs for hundreds of thousands of working households and lift an even larger number of families above the poverty line, independent of their existing housing cost burden. Our proposal, for instance, would reduce the number of households with severe housing costs by an additional 511,000 over the current EITC, while raising an additional 728,000 working poor households out of poverty.

We have analyzed the EITC's impact on only the most severe housing cost burdens. A family spending 45 percent of its income on rent after receiving the EITC is better off than if it had not received the credit and spent 55 percent of its income on rent, but surely still struggles to secure shelter and the other necessities of life. Yet with critical housing needs growing so rapidly in recent years, we believe it appropriate to focus first on how tax policy can alleviate the most acute housing problems for low-income families. As our analysis has shown, the EITC provides significant benefits to families with more moderate housing cost burdens (30 to 50 percent of income) as well.

In examining the potential of the EITC as an instrument of housing policy, we do not seek to diminish the role of dedicated housing and community development programs. Indeed, we cannot hope to eliminate severe housing cost burdens through tax policy alone. Like Dolbeare (2001), we seek ways to "remove from HUD's back some of the impossible burden of adequately addressing the Nation's most critical housing affordability needs…[while leaving room]…for imaginative and creative use of vouchers and other measures" (128). An expanded EITC would not, and should not, sound the death knell for housing assistance programs.

The Section 8 voucher program, in particular, should serve as a critical complement to income-based strategies like an expanded EITC. The congressionally appointed Millennial Housing Commission, for instance, recommended the Section 8 voucher program for additional funding "in substantial annual increments" (2002, 6). Because a demand-side strategy based only on the EITC would leave too many households with worst-case needs untouched—either because they are elderly and do not work (4.1 million) or because they are only marginally employed (2.5 million)—it makes sense to use expanded Section 8 rental assistance largely for those individuals and families that would not benefit from an expanded EITC. In fact, according to HUD, almost two-thirds of current voucher holders have primary sources of income other than wages (HUD 2003a). The commission also found merit in local programs that "match voucher holders with services that complement efforts to embrace employment and other opportunities" (Millennial Housing Commission 2002, 6). At recent incremental funding levels that average about 35,000 new housing vouchers a year, it would take nearly 200 years to meet the urgent needs of the two cohorts, which is why the argument that an expanded EITC would eliminate the need for housing assistance programs has little merit.

In addition, we agree with the commission that housing supply constraints at the bottom of the income scale oblige Congress to resume capital subsidies for the production of units for extremely low income households.

We envision an important role for the tax code in helping families pay for housing because the affordability problem is so great that our nation cannot deal with it through traditional housing programs alone (Turnham and Khadduri 2001). For the reasons we discussed earlier, a significantly expanded voucher program may lack the capacity to meet the housing needs of severely burdened working households. The EITC provides a potential mechanism for increasing our commitment to affordable housing at a level commensurate with the growing needs of this population. Whether implemented at the federal, state, or local levels, an expanded EITC could go far toward helping lower-income workers meet the rising costs of safe, decent, affordable housing for themselves and their children.

Appendix

The EITC is designed to reward work by lowering the tax burden of lower-income working families. It initially increases with income, then levels off, before decreasing as income increases (see figure 1 and table 1). The EITC is a refundable credit, which means that if it exceeds the amount of federal income tax owed, the family receives a refund of that amount.

For a family to qualify for the EITC, its earned income and adjusted gross income (AGI) must be less than the maximum allowed for its category, which is determined by number of children. AGI equals earned income plus income from interest, dividends, and other sources. The credit is based solely on earned income, but a family must also meet the AGI limit to qualify (IRS 1999b).

The amount of EITC for which a tax filer is eligible depends on the number of qualifying children in the tax unit. The largest credits are available for families with two or more children, while families that have very low incomes but no children are eligible for only a small credit. Qualifying children must be unmarried, have resided with the parent(s) for at least half the year, and be 18 or younger (or 19 to 24 and enrolled in school full-time). Some foster children, children being raised by their grandparents, and older children with disabilities also qualify (IRS 1999b).

Modeling the impact of the EITC on housing costs presents several challenges. First, a set of data with detailed information on income, household composition, and housing costs for a large national sample is needed. The 1999 national file of the AHS has a large sample size (67,000 units, approximately 47,000 occupied units), extensive information on housing costs and quality, and sufficient information on income to estimate the EITC with reasonable precision (U.S. Department of Commerce and HUD 2002a).

Once we selected a data set, estimating EITC receipt and the impact on housing costs required four steps:

1. Identifying separate tax units within a household and the potentially EITC-qualified children associated with each unit

2. Determining the EITC eligibility of each unit

3. Calculating the EITC for eligible units

4. Recalculating household income, including the EITC, for eligible units and determining their new housing-cost burden

Identifying tax units and qualifying children. Generally, the IRS treats the family—related individuals living together—as the tax unit. Related individuals living together may, however, constitute more than one unit, depending on age, income, and other considerations. We used several variables available for each person in an AHS-sampled household to determine the number and nature of families present: relationship to the respondent, identification of a parent or spouse in the household, age, and highest level of education completed.

A household may, of course, contain numerous tax units, and the EITC eligibility of each must be assessed. The first step we take is to determine the tax unit's "head" and "spouse," with an eye toward the EITC regulations on qualified children. The following are treated as independent tax units:

1. A married couple, even in cases where the spouses' parent(s) were present in the household

2. All unmarried individuals 18 and older without a parent present in the household

3. All unmarried individuals 22 and older with a parent in the household

Identifying children 18 and under who resided with a parent at the time of the survey is straightforward. The AHS does not, however, ask about school enrollment, so there is no way to identify children aged 19 to 24 who were enrolled in school (and who constitute qualifying children for purposes of the EITC and, in most cases, the dependent exemption).[26] However, the AHS does collect the highest level of education completed for each person in the household. Therefore, we treat children 19 to 21 with a parent in the household and "some college" as children for purposes of the parent or parents' tax return. Persons aged 22 or older and persons aged 19 to 21 whose highest level of education completed was either high school or less or college were treated as separate tax units.

[26] Nor does the AHS provide information on how long a child has resided in the household, so we are unable to discount children who do not pass the EITC residency test (living at least 6 months with a parent).

Special cases of qualifying children—foster children, children raised by their grandparents, and older children with disabilities—cannot be identified in the AHS. This causes us to underestimate the number of families with children and overestimate childless families.

Determining EITC eligibility. After identifying tax units and their qualifying children, we determine whether each unit is eligible for the EITC. The AHS collects information on the earned income of every member of the household, so calculating the earned income for each unit within a household is fairly straightforward.

Although the EITC is based on a family's earned income, the AGI must also fall within the eligible income range. Determining the AGI for multiple tax units in the same household is not so straightforward, because the AHS collects information about other sources of income only for the household as a whole, rather than for each person separately. However, ignoring other income entirely would cause us to overestimate the number of EITC-eligible families, including many living in high-income households. We instead approximate each tax unit's AGI by dividing up other nonwage household income equally among the adult taxpayers in the household and adding those amounts to each tax unit's earned income.

For example, a household whose members are an unmarried mother of one living with her parents consists of two tax units—the first is the mother and child, and the second is her parents. The earned income for the first tax unit is that of the mother, and the earned income for the second is the sum of her parents' earned incomes. If the household has other income of $3,000, it would be divided by the number of adults (three) and assigned to each tax unit according to the number of adults it has. The first unit (mother and child) has one adult and so would be assigned $1,000 of other income. The second unit (her parents) would be assigned $2,000 of other income. After adding other income to arrive at an AGI, we determine the EITC eligibility of each unit. Eligibility for the mother-and-child unit is based on the one-child criterion, while eligibility for the other is based on the no-child criterion.

Calculating the EITC. The credit for an eligible tax unit follows from its earned income, number of qualifying children, and the parameters in table 1.

Recalculating household income. After calculating the EITC for each tax unit within a household, we sum these estimates to get the household's total EITC. This amount is then added to household income and a new value of the housing-cost ratio (total housing costs divided by household income) is calculated. We can then assess the impact of the EITC on housing costs by comparing the housing-cost ratio with and without the credit.

This four-step process was repeated for each of the proposals.

Eligibility estimates. In 2001, the GAO estimated the number of EITC-eligible families in 1999 using CPS data (2001). Table A.2 compares our estimates of the number of EITC-eligible families with the GAO estimates and our estimates of the average credit per child category with the IRS data on actual returns. We slightly overestimate the number of

Table A.1. **Number of Tax Units per EITC-Eligible Household[a] by Number of Children per Tax Unit, 1999**

Tax Units per Household	Eligible Households[b]	Eligible Families[b]	No Children[b]	One Child[b]	Two Children[b]	Three or More Children[b]	Average ETIC
One	8,620	8,620	1,205	2,727	2,799	1,889	$1,649
Two	4,598	5,099	2,602	1,334	743	420	$1,060
Three or more	1,379	1,866	1,173	404	201	89	$1,090
Total	14,597	15,585	4,980	4,465	3,742	2,398	$1,411

Source: U.S. Department of Commerce and HUD 2002a and the authors' calculations.
[a] An eligible household is defined as a household with at least one EITC-eligible tax unit. Differences between child columns and total column are due to rounding.
[b] In thousands.

Table A.2. **Comparison of EITC-Eligible Families in the AHS with GAO/IRS Estimates, 1999**

	GAO/IRS 1999	AHS 1999	Percent Difference
Number of tax units*			
No children	4,700	4,979	+5.9
One child	5,000	4,461	–10.8
Two children	4,300	3,742	–13.0
Three or more children	3,200	2,398	–25.0
Total	17,200	15,580	–9.4
Average credit			
No children	$196	$193	–1.5
One child	$1,515	$1,427	–5.8
Two or more children	$2,284	$2,159	–5.5

Source: GAO 2001, IRS 2001, U.S. Department of Commerce and HUD 2002a, and the authors' calculations.
*In thousands.

EITC-eligible childless families, but underestimate the number of EITC-eligible families with children. Our estimate of the number of families with three or more children is particularly low, something for which we have no explanation. However, the fact that our estimates of average credits are quite close to the IRS data gives us confidence in our methods. Overall, our estimates of the impact of the EITC on housing costs are likely to be conservative.

The GAO (2001) also estimated EITC participation rates within each of the child categories—45 percent for no children, 96 percent for one child, 93 percent for two children, and 63 percent for three or more children. To compare the impact of the EITC at current and full participation, we randomly assign the EITC to tax units based on the number of qualifying children and the participation rates estimated by the GAO.

Multifamily households. Overall, our AHS estimates reflect the fact that households with more than one family constitute 22.5 percent of all U.S. households (table A.3) and nearly 41 percent of all EITC-eligible households (table A.1). There is a notable distinction in household structure between low-income workers with and without children: Nearly 70 percent of EITC-eligible families with children live in single-family households, but 76 percent of childless EITC-eligible filers live in multifamily households. As such, multifamily households typically receive smaller EITC amounts than single-family households.

Table A.3. **Number of Tax Units per Household, All Households, 1999**

Tax Units per Household	Households*	Percentage of Households	Average Number of Children per Household
One	79,718	77.5	0.70
Two	18,665	18.2	0.57
Three or more	4,420	4.3	0.51
Total	102,803	100	0.67

Source: U.S. Department of Commerce and HUD 2002a and the authors' calculations.
*In thousands.

A recent change to the EITC. Congress, in the 2001 Economic Growth and Tax Relief Reconciliation Act (P.L. 107–16), added a benefit in the EITC for married couples with children, extending the phase-out range by $1,000 for tax years 2002 through 2004, by $2,000 for 2005 through 2008, and by $3,000 for 2008 and beyond.

We estimated that the impact on housing cost burdens had a $1,000 extended phase-out range for married couples in tax year 1999. This change would have increased eligibility for the EITC by approximately 87,000 families with one child, and 160,000 families with two or more children. However, the average credit increased by just $39 for families with one child and $87 for families with two or more children. As a result, this change would have had almost no impact on severe housing cost burdens and would have reduced the number of families with severe housing costs by a little over 5,000.

In the first part of the article, we focus primarily on the EITC's impact on severe housing costs as they existed in 1999, before the 2001 change became law. However, we use the modified version of the EITC with an added marriage benefit as the baseline against which to measure the impact of other proposals. Table A.4 summarizes the incidence of severe housing costs under the extended phase-out EITC.

Table A.4. **Incidence of Severe Housing Costs for EITC-Eligible Families by Number of Children and Tenure: The EITC with Extended Phase-Out for Married Couples, 1999**

	Eligible Families or Households*	Number with Severe Housing Costs*	Rate (%)
Families			
No children	4,979	1,380	27.7
One child	4,555	758	16.6
Two children	3,851	597	15.5
Three or more children	2,450	457	18.7
Total	15,835	3,192	20.2
Households			
Renters	8,531	1,909	22.4
Owners	6,307	1,122	17.8
Total	14,838	3,031	20.4

Source: U.S. Department of Commerce and HUD 2002a and the authors' calculations.
*In thousands.

EITC proposals. We investigate three different EITC proposals: H.R. 3574, introduced by former Congressman William J. Coyne (D–PA) in 2001, a rent-based proposal (Dolbeare), and a proposal based on median housing costs that we developed. In modeling their effects, we followed the same steps outlined earlier, applying different eligibility requirements where necessary.

The Coyne proposal. Representative Coyne's proposal makes three major changes to the existing EITC. First, it greatly expands coverage and the benefit for workers without children. It increases the phase-in rate to match the sum of the employee and employer portions of the payroll tax and raises the initial amount of earnings for the credit by $1,000 (table A.5). Second, H.R. 3574 would increase benefits for workers with one child by increasing the maximum income in the phase-in range to $9,870, thereby increasing the maximum benefit by over $1,000 to $3,356. Third, the proposal would add a third tier for families with three or more children, increasing the phase-in rate from 0.40 to 0.45 and boosting the maximum credit by $626.

Table A.5. **Comparison of the Current EITC with the Coyne Proposal, 1999**

	No Children		One Child		Three or More Children	
	Current EITC	Coyne	Current EITC	Coyne	Current EITC	Coyne
Phase-in rate	0.0765	0.1530	0.34	0.34	0.40	0.45
Plateau begins	$4,530	$5,530	$6,800	$9,870	$9,540	$9,870
Plateau ends	$5,670	$9,870	$12,460	$12,460	$12,460	$12,460
Phase-out rate	0.0765	0.1530	0.1598	0.2322	0.2106	0.2452
Maximum earned income	$10,200	$15,400	$26,928	$26,910	$30,580	$30,580
Maximum benefit	$347	$846	$2,312	$3,356	$3,816	$4,442
Number of eligible families	4,979	9,666	4,555	4,553	2,450	2,450
Average credit	$193	$527	$1,438	$1,936	$2,204	$2,549

Source: U.S. House Committee on Ways and Means 2001d and the authors' calculations.
*In thousands.

The Dolbeare proposal. Cushing Dolbeare (2001) raised the idea of using the EITC and other existing federal programs to help alleviate housing cost burdens. She briefly outlined a proposal to target an added EITC benefit to eligible families with severe housing cost burdens and suggested giving such families an EITC supplement equal to the difference between their actual housing costs and 50 percent of their earned income plus their current EITC benefit. If a family paid more than the appropriate FMR, her proposal would cap the supplemental benefit at the difference between FMR and 50 percent of earned income plus the current EITC benefit (Dolbeare 2001).

One difficulty in modeling this proposal arises from the differences between households and families. The housing-cost ratio is generally calculated as total housing costs divided by total household income. For multifamily households, there is no clear way to determine the housing cost borne by each family.[27] We approach this complication by dividing the total housing cost by the number of people in the household and then assigning each family its per capita share of housing costs. This leads to having some families receive the additional benefit even though they do not live in a household with severe housing costs. But we feel that this is a valid choice since (1) it reflects a real-life difficulty the IRS would have in administering the program, and (2) the goal of the program is to allow families to afford decent housing. As modeled, the benefit might allow families that currently double-up to rent their own unit.

Dolbeare's (2001) proposed added benefit simply piggybacks onto the current EITC, so the eligibility criteria and coverage are the same. However, the average benefit does change and, as we have noted, it greatly changes the shape of the EITC and the direct relationship between earnings and the credit received.

Our median housing cost–based proposal. Our goal was to design a proposal that would have a substantial impact on housing cost burdens while remaining true to the nature of the EITC and requiring little or no additional cost to administer. While there are obvious advantages to limiting the benefit to those with severe housing cost burdens, our proposal is intended to enable working households to spend no more than half their income on housing in a broad range of markets. Consequently, we examined the weighted distribution of median housing costs for differently sized units across the metropolitan areas included in the AHS. We then set phase-in rates and plateau points such that

1. Earned income plus EITC for a family at the beginning of the plateau would be twice the median housing cost of an appropriately sized unit in approximately 25 percent of housing markets

2. Earned income plus EITC for a family at the end of the plateau would be roughly twice the median housing cost of an appropriately sized unit in approximately 75 percent of housing markets

See table 13 for the full set of parameters.

Thus, under our proposal, a working family with one child and about $7,000 in earned income would pay half of its income (including the

[27] This is a problem the IRS would face in administering the proposal.

EITC) for a median-priced two-bedroom unit in approximately 25 percent of housing markets. A similar family making about $12,000 could, with half its income, rent a median-priced two-bedroom unit in approximately 75 percent of housing markets. Somewhat coincidentally, a similar family earning the full-time minimum wage ($10,700) would pay half of its income for a median-priced two-bedroom unit in approximately half of all housing markets.

We apply a similar logic in setting credit levels for childless families and families with two or more children. In the case of the former, the plateau points were set such that families at the beginning and end of the plateau could afford half of a two-bedroom unit in approximately 25 percent and 75 percent of all local housing markets, respectively. For families with two or more children, we used the distribution of median housing costs for three-bedroom units.

One wrinkle seemed necessary for families with two or more children. Extending the plateau all the way to the point where the target income would cover the 75th percentile median housing costs would have been extremely costly and required a very high phase-out rate. Instead, we designed a graduated decline rate to ease families down from the plateau. The first decline rate is 13.5 percent and covers families with earned income between $12,200 and $16,000. The rate then doubles to 27 percent.

Estimating tax burdens and after-tax incomes. To our knowledge, no previous research has looked at the housing cost burdens of working households using after-tax income. In this article, we attempt to quantify the impact of federal income and payroll taxes on the incidence of severe housing cost burdens among lower-income families. To do so, we adjust family income for numerous factors—deductions, exemptions, income tax, payroll tax, the EITC, and the Child Tax Credit. Numerous simplifying assumptions were necessary, so these numbers should be treated as indicative, not definitive.

Deductions and exemptions. The AHS collects no information on whether the members of the household itemize deductions. However, given the low incomes earned by our population of interest, we assumed that all families took the standard deduction. We further assumed that all unmarried parents living with their children filed as heads of household and that those who were unmarried and not parents filed as singles. (In reality, the latter can qualify as heads of household in limited circumstances.) Finally, we assumed that all married couples filed jointly. Table A.6 displays our resulting assumptions as to families' deductions and exemptions.

Table A.6. **Deductible and Exempted Income by Marital Status and Number of Children, 1999**

Children	Single	Married
None	$7,050	$12,700
One	$11,850	$15,450
Two	$14,600	$18,200
Three*	$17,350	$20,950

Source: IRS 1999b.
*Add $2,750 per additional child.

Income tax. In 1999, individual income tax rates were as follows: 15 percent of taxable income up to $25,750 for singles, $34,550 for heads of household, and $43,050 for married couples filing jointly; then 28 percent up to taxable income of $62,450, $89,150, and $104,050, respectively.[28]

Child Tax Credit. In 1999, families could receive a tax credit of up to $500 per child. However, it was not a refundable credit, which means that it could only be used to pay taxes owed. By implication, most EITC-eligible families owe no income tax and so did not benefit from the child credit.

The 2001 tax act increased the credit to $600 per child and made it partially refundable. First, the available credit is used to pay any income tax owed. If there is any credit remaining, the refund is the lesser of the remaining credit or 10 percent of earned income above $10,000. For example, a single mother who has one child and whose gross income (all earned) is $11,850 owes no income tax, but would receive a Child Tax Credit refund of $185.

After-tax income. The total tax burden is estimated as the sum of the income tax owed plus the payroll tax (7.65 percent of earned income) minus the EITC and the Child Tax Credit. For this article, we use 2002 IRS regulations (adjusted to 1999 dollars) to assess the impact of the refundability of the Child Tax Credit. It is important to note that due to refundable credits like the EITC and the Child Tax Credit, this tax "burden" may be negative.

[28] In 2001, a 10 percent bracket was added for taxable incomes below $5,550 for single filers, $9,200 for heads of household, and $11,100 for married couples filing jointly (all figures are adjusted to 1999 dollars).

Once taxes are calculated, they are subtracted from family gross income to arrive at after-tax income. For the household-level measures presented in this article, we sum after-tax incomes across all families in a household.

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