The United States' Earned Income Tax Credit and Canada's Child Tax Benefit: Have they proven to be effective anti-child poverty tools?

Nathalie J. Côté

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The United States’ Earned Income Tax Credit and Canada’s Child Tax Benefit: Have they proven to be effective anti-child poverty tools?

by

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B.Ed. University of Ottawa, 1999

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Approved by:

Chairperson

Dean, Graduate School

Date 12-18-02
In the mid-1990s, the United States and Canada reformed their public policy, eliminating entitlement to cash assistance. Poor families were no longer entitled to social assistance. The only cash-transfer programs that remained a guarantee to low-income families were the Earned Income Tax Credit (EITC) and the Canada Child Tax Benefit (CCTB). However, these programs had only in the 1990s become major players in the fight against child poverty. The EITC was substantially increased by OBRA 1990 and OBRA 1993, while the CCTB was fully implemented in 1998. With conventional welfare programs losing ground, these “new” tax transfer programs were expected to pick up some of the slack.

While the EITC’s and the CCTB’s budgets have seen increases in recent years, unlike most of the other safety net programs, their effectiveness in combating child poverty remains largely hypothetical. The programs are popular because they encourage work and smaller families. In theory, they appear the ideal programs as they remedy many of the disincentives that have accompanied traditional welfare programs. In addition, they have low administrative costs; overall, the intended recipients are being targeted; preliminary studies link them to increases in employment, particularly for female-headed households, and decreases in the welfare caseload; the poverty rate and poverty gap have been reduced in the United States and Canada, due to these programs. However encouraging these findings appear, they do not reflect the magnitude of these achievements. The increases in employment, decreases in welfare caseload, as well as decreases in child poverty rate and gap, have all been minor.

Research reveals that the potential for large impact is present within these programs; however, they must be restructured before they can effectively combat child poverty. The credit rates must be increased and adjusted for family size. Furthermore, welfare recipients should benefit from the EITC and the CCTB. The credits should not be counted as income for welfare recipients, but rather viewed as an incentive for them to make the transition between welfare and work. Only once these reforms have taken place will the EITC and the CCTB be able to call themselves child poverty tools.
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Introduction

Ever since the existence of governments, nations have struggled with poverty and its eradication. While most countries provide some form of economic security to their citizens, the question of how much, how long and who should benefit from the safety net, is a key policy issue for all governments.

Countries must first identify what basis of need should be tackled by their programs. Most nations agree that income security for the elderly and the disabled is a necessary and legitimate program. However, they differ over the methods used to secure income for the groups, even if there is no debate about their existence.

Poverty due to unemployment or inadequate income is a more controversial issue. Both the United States and Canada have programs to supplement or substitute earnings for the unemployed, and the working poor. Over the years, these programs have been a point of contention for all governments. Canada and the United States have struggled with the extending of income to the unemployed. In recent years, both countries have severally reduced the last-resort welfare programs or modified them in order to eliminate dependency and encourage work. States and provinces have introduced “workfare” programs and the federal governments have increased substantially the amount of benefits bestowed upon the working poor.

Public opinion has favored programs such as the United States’ Earned Income Tax Credit (EITC) and the Canada Child Tax Benefit (CCTB) in the last decade. Americans and Canadians support national programs that aim to break the “welfare cycle” and compel individuals to take responsibility for their circumstances and those of their
families. Both countries have made these programs the largest cash transfers to working families in an attempt to diminish the role of the welfare system. Welfare is easily the most controversial of all income security programs, and the least popular from the perspective of public support. While the EITC and the CCTB may be well liked by the public, their anti-child poverty effectiveness has yet to be established.

This thesis will attempt to ascertain, through existing literature and studies carried out by government and non-government organizations, whether the federal governments of the United States and Canada are on the right track by utilizing the EITC and the CCTB to fight child poverty. The first chapter will look at the United States' and Canada's current poverty rates, the methods used to calculate child poverty, the causes of poverty, and the programs currently in existence to fight poverty, and more specifically child poverty. The second chapter will review the history of the EITC and the CCTB, as well as how they work, and how they compare to each other. The third chapter will look at each program's characteristics: costs, recipients, employment rate and welfare caseload effect, poverty rates and gap, as well as compliance, in an attempt to determine their effectiveness in combating child poverty. The last chapter will review the findings to determine whether the EITC and the CCTB are effective means of fighting child poverty. Furthermore, the chapter will make recommendations in terms of the future of each program. Are changes required, if so what should be done and should the programs remain in existence? In conclusion, this paper will look at whether welfare policy is headed in the right direction or whether changes need to be made for the United States.

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and Canada to effectively ensure that today’s children will be able to successfully become tomorrow’s citizens.
The first chapter of this thesis will look at the concept of child poverty in the United States and in Canada. First, it will outline the current statistics in comparison to the last two decades. Second, it will describe how poverty is calculated in each country. Third, it will explain the causes of child poverty. Last, it will review the programs that are currently in place to combat child poverty.

Child poverty in the United States and in Canada is among the highest in all industrialized countries. The United States ranks at the bottom, while Canada is only ahead of Italy, Australia, and the United States. Historically, Canada has tended to be more receptive to welfare spending, however, since Brian Mulroney took power in 1984, Canada’s social spending has been radically reduced. Canada has begun to emulate its neighbor to the south.

**Child poverty in the United States**

The poverty rate in 2001 in the United States was 11.7 percent, which is up from 11.3 in 2000. The number of people below the poverty thresholds was 32.9 million, 1.3 million higher than the 31.6 million poor in 2000. The poverty rate for children did not fluctuate between 2000 and 2001. It remained at 16.3 percent, which is the highest of any age group. In 2001, 11.7 million children were poor. At 35.7 percent, children represent a disproportionate share of the poor, as they represent only one-fourth (25.6

---

percent) of the total population. Children under the age of six were at an even greater risk of being poor. The poverty rate for children under the age of six was 18.2 percent in 2001. The poverty rate for individuals between the ages of 18 and 64 and those 65 and over was at 10.1 percent in 2001, up slightly from 2000. Finally, the number of families in poverty in 2001 was 6.8 million, up from 6.4 million in 2000.

While the percentage of children in poverty has not increased since 2000, child poverty rates have remained consistently higher than any other age group. Figure 1.1 demonstrates the poverty rates since 1959 in all three age groups. The 65 and over group has seen a large decline in poverty since the expansion of the social security program. In the past, this group endured greater poverty rates than any other group; however, once the government committed to targeting them through social security, their poverty rates declined to rates analogous to adults between the ages of 18 and 64. As of 1996, 75.6 percent of the elderly were moved out of poverty by social insurance benefits.3 Undoubtedly, the government could reduce the child poverty rate if a program was enacted to specifically target children.

---

Child poverty in Canada

Poverty in Canada has followed similar trends to that of the United States (it is important to note at this point that their measures of poverty are different and will be explained in the next section). In 2000, the poverty rate in Canada for children was 12.5 percent, down from the 1999 rate of 13.5 percent. An estimated 868,000 children under age 18 were living in low-income families. An estimated 666,000 families of two or more people had low-incomes in 2000, down from 714,000 in 1999. The low-income rate declined also declined from 10.7 percent in 1996 to 7.9 percent in 2000. The poverty rate for those 18 to 64 was 11 percent, down from 11.8 in 1999, while the poverty rate for those 65 and over was 7.3 percent, down from 7.6 percent in 1999.

Figure 1.2 shows the time lines of all three age groups in Canada. The trends are similar to those of the United States. The 65 years and over data reflect the importance the Canadian government has attached to targeting elderly poverty in the last 20 years.
According to the Luxembourg Income Studies,\textsuperscript{4} Canada is a leader in combating elderly poverty, ranking only behind Norway, Finland and Sweden, three of the most generous countries in terms of social spending. Figure 1.2 demonstrates the ability of governments to have an impact on poverty if the political will is present.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{Figure12.png}
\caption{Persons in Low Income (After Tax).}
\end{figure}

\textit{Source: Income Statistics Division, Statistics Canada}

**Measures of poverty**

As noted earlier in this chapter, there is no universal measure of poverty. To compare poverty among different countries, one can refer to the Luxembourg Income studies. However, taking data from two different countries and comparing them is dangerous. One must keep in mind the different measures used by each country when comparing the data.

The United States calculates its official poverty population figures through the poverty thresholds. The Census Bureau uses a set of money income thresholds that vary by family size and composition to determine who is poor. If a family's total income is less than that family's threshold, than that family, and every individual in it, is considered poor. The poverty thresholds do not vary geographically (Alaska and Hawaii excluded),

\textsuperscript{4} Ibid.
but they are updated annually for inflation using the Consumer Price Index (CPI-U). The official poverty definition counts money income from all sources (even social security and public assistance benefits) before taxes and does not include capital gains and noncash benefits (such as public housing, Medicaid, and Food Stamps). After tax government transfers, such as the Earned Income Tax Credit or the Child Tax Credit, are not included in the income calculations. Individuals in military barracks, institutional group quarters, or unrelated individuals under age fifteen (such as foster children) are not included in the poverty definition. The Census Bureau updates the thresholds on a yearly basis. Table 1.1 illustrates the poverty thresholds for the year 2000. For example, a family with two children's poverty threshold would be $17,463. Therefore, if the family earned $21,000, its income would be greater than its' threshold, and it would not be considered poor.5

The United States has a second measure of poverty called the poverty guidelines. They are issued each year in the Federal Register by the Department of Health and Human Services (HHS). The guidelines are a simplification of the poverty thresholds for administrative purposes, such as determining financial eligibility for certain federal programs. The poverty guidelines do not distinguish between aged and non-aged units. Programs using the guidelines (or percentage multiples of the guidelines — for instance, 125 percent or 185 percent of the guidelines) in determining eligibility include Head Start, the Food Stamp Program, the National School Lunch Program, the Low-Income Home Energy Assistance Program, and the Children's Health Insurance Program. In general, cash public assistance programs (Aid to Families with Dependent Children and

Table 1.1 Poverty Thresholds in 2000, by size of family and number of related children under 18 years (Dollars).

<table>
<thead>
<tr>
<th>Size of Family Unit</th>
<th>Weighted average thresholds</th>
<th>Related Children Under 18 Years</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>None</td>
</tr>
<tr>
<td>One person (unrelated individual)</td>
<td>8,794</td>
<td></td>
</tr>
<tr>
<td>• Under 65 years</td>
<td>8,959</td>
<td>8,959</td>
</tr>
<tr>
<td>• 65 years and over</td>
<td>8,259</td>
<td>8,259</td>
</tr>
<tr>
<td>Two persons</td>
<td>11,239</td>
<td></td>
</tr>
<tr>
<td>• Householder under 65 years</td>
<td>11,590</td>
<td>11,531</td>
</tr>
<tr>
<td>• Householder 65 years and over</td>
<td>10,419</td>
<td>10,409</td>
</tr>
<tr>
<td>Three persons</td>
<td>13,738</td>
<td>13,470</td>
</tr>
<tr>
<td>Four persons</td>
<td>17,603</td>
<td>17,761</td>
</tr>
<tr>
<td>Five persons</td>
<td>20,819</td>
<td>21,419</td>
</tr>
<tr>
<td>Six persons</td>
<td>23,528</td>
<td>24,636</td>
</tr>
<tr>
<td>Seven persons</td>
<td>26,764</td>
<td>28,347</td>
</tr>
<tr>
<td>Eight persons</td>
<td>29,701</td>
<td>31,704</td>
</tr>
<tr>
<td>Nine persons or more</td>
<td>35,060</td>
<td>38,138</td>
</tr>
</tbody>
</table>


its block grant successor Temporary Assistance for Needy Families, and Supplemental Security Income) do not use the poverty guidelines in determining eligibility. The Earned Income Tax Credit program uses its own income ranges to determine eligibility.6

Unlike the United States, Canada does not have an official poverty line. While several measures of low income are used in Canada, the two most widely applied indicators of low income are Statistics Canada’s Low-Income Cut-Offs (LICOs) and the Low-Income Measure (LIM). Both are relative measures that establish a dollar figure below which a family is considered to be living on low income. They can be reported measures, pre-tax (income including government transfers such as the Canada Child Tax Benefit, before the deduction of income taxes) and after-tax (total income after the

6 Ibid.
deduction of income taxes). Both pre- and post-tax LICOs are set according to the proportion of annual income spent on basic needs (food, shelter and clothing). If a family spends 70 percent or more of its income on these basic necessities, then it falls beneath the LICO line. The size of the family and the community is taken into account, but geographic differences in the cost of living are not. This paper, like Statistics Canada, focuses on the after-tax LICOs, unless otherwise specified.7

The LIM was developed as an alternative to the LICOs. It considers a family to be living on low income if its income, adjusted for family size (number of adults and children), is less than half of the median income (the income level at which the incomes of half of all families are higher and half are lower). The post-tax-and-transfer LIM is similar to measures used in international comparisons, but it does not reflect geographic differences in living across Canada.8

---

8 Ibid.
Table 1.2 Low Income Cut-offs for Economic Families and Unattached Individuals, 2000.

<table>
<thead>
<tr>
<th>Family size</th>
<th>500,000 or more</th>
<th>100,000 to 499,999</th>
<th>30,000 to 99,999</th>
<th>Small urban regions</th>
<th>Rural (farm and non-farm)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>18,371</td>
<td>15,757</td>
<td>15,648</td>
<td>14,561</td>
<td>12,696</td>
</tr>
<tr>
<td>2</td>
<td>22,964</td>
<td>19,697</td>
<td>19,561</td>
<td>18,201</td>
<td>15,870</td>
</tr>
<tr>
<td>3</td>
<td>28,560</td>
<td>24,497</td>
<td>24,326</td>
<td>22,635</td>
<td>19,738</td>
</tr>
<tr>
<td>4</td>
<td>34,572</td>
<td>29,653</td>
<td>29,448</td>
<td>27,401</td>
<td>23,892</td>
</tr>
<tr>
<td>5</td>
<td>38,646</td>
<td>33,148</td>
<td>32,917</td>
<td>30,629</td>
<td>26,708</td>
</tr>
<tr>
<td>6</td>
<td>42,719</td>
<td>36,642</td>
<td>36,387</td>
<td>33,857</td>
<td>29,524</td>
</tr>
<tr>
<td>7+</td>
<td>46,793</td>
<td>40,137</td>
<td>39,857</td>
<td>37,085</td>
<td>32,340</td>
</tr>
</tbody>
</table>


Causes of child poverty

The previous section reveals that poverty is not a concrete concept. Most countries have difficulty agreeing on one measure of poverty, and therefore one meaning of poverty. Without an income line to determine when an individual’s or a family’s income is insufficient, one cannot determine poverty. Not surprisingly, there is also no consensus about the causes of poverty or child poverty.

Three groups of factors are understood to play a role in child poverty. First, there are the economic causes. Included in this group are high unemployment rates, recessions, a low minimum wage, and the decline in the earning capacity of adults, particularly men, with limited education. While periods of economic recovery usually lead to decreases in poverty rates, in recent years, while the number of people in poverty declined, the poverty gap (the amount by which the incomes of all poor people fell below the poverty line) has not been decreasing significantly. The poverty gap reflects both the number of

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people who are poor and the depth of poverty. Because the poverty gap is based in part on the number of people who are poor, it should shrink as the number of poor people declines. This has happened, however, only to a limited degree in recent years because those who are poor have become poorer. For example, in the United States, the poverty gap in 2000 ($66.5 billion) was only one percent smaller than the $67.1 billion poverty gap in 1995, despite the fact that the number of people in poverty was 13 percent lower in 2000 than in 1995.  

Various studies have been performed on the link between unemployment rates and child poverty rates. Employment alone is less likely today than in the past to promote economic self-sufficiency. Nearly one in three poor family heads today are in the labor force, a figure higher than that observed in 1980. Indeed the poverty rate among working family heads is higher than those observed in the 80s. An analysis of data from 41,996 children under the age of 18, living with at least one parent, from the 1990 annual demographic supplement of the Current Population Survey, undertook to study the relationship between parental employment and child poverty. The investigators surmised that since most men work, the population of non-working fathers who could make the transition from unemployment to employment was small. Therefore, they concluded that paternal employment would have a modest effect on child poverty: If 10 percent of unemployed fathers became employed, the overall child poverty rate would decline from 9.7 percent to 9.5 percent, a decrease of 2 percent; if 50 percent and 90

12 D. Hollander, “Plausible Increase in Parental Employment Likely to Produce Only a Slight Decline in Child Poverty”, Family Planning Perspectives 27 no. 2 (March-April) : 88.
percent began working, poverty rates would fall to 8.5 percent and 7.5 percent, drops of 12 percent and 23 percent respectively.\textsuperscript{13}

On the other hand, when nonworking mothers in a two-parent household make the transition to employment, the effect is roughly doubled. For example, if 10 percent of such mothers became employed, child poverty rates would decline by 4 percent; likewise, if 50 percent or 90 percent of unemployed mothers entered the labor force, child poverty would drop by 23 percent and 41 percent, respectively. In households headed by a nonworking mother, if 10 percent became employed, child poverty fell by 5 percent; if 50 percent became employed, the child poverty rate would drop by 23 percent, and if 90 percent entered the labor force, the poverty would decline by 42 percent.\textsuperscript{14} Evidently, maternal employment has a greater effect on child poverty rates.

Researchers have concluded that only a substantial increase in maternal employment would have an important effect on child poverty. However, it may not be realistic to think that unemployed mothers will be able to find jobs that pay adequately in their skill levels, and child care they can afford. Therefore, welfare policies that aim to “get people working” will not eliminate child poverty unless the pay is sufficient to provide for basic material needs of families and children.\textsuperscript{15}

The minimum wage debate is still hotly contested. Many opponents claim that raising the minimum wage reduces employment and generates involuntary unemployment.\textsuperscript{16} Furthermore, those that would benefit from the minimum wage

\textsuperscript{13} Ibid.
\textsuperscript{14} Ibid., 89.
\textsuperscript{15} Ibid.
increase would be teenagers living with their parents. Other critics argue that raising the minimum wage causes price increases, which in return increases inflation. Proponents disagree with these arguments, pointing to the last increase in the minimum wage in 1996-1997, where unemployment actually decreased, especially among groups most affected by the minimum wage. In addition, wages have risen since the minimum wage increase, but there has been no evidence of price pressures coming from those recent wage gains. Therefore, proponents believe that modest increases in the minimum wage will not generate job losses or price pressures.

The causes of poverty also double as solutions to the problem. However, economic causes tend to be seen as a result of a free market and the government does not want to interfere in this sphere. Yet, looking to economic recovery to cure poverty has yet to be proven as a successful measure of poverty reduction. The jobs created are often not for low-skilled workers.

The second group of factors that cause child poverty are family (and individual) causes. Included in this category are erosion of family values, with high divorce rates and high premarital birth rates, along with laziness, and lack of responsibility on the part of the poor. In 1993, one-quarter of all children and two-thirds of black children were born out of wedlock. Not surprisingly, the number of children living in single parent households has increased significantly. Single-parent families, with the mother as the head of the household, are much more likely to be poor than two-parent families because

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single mothers' earning power tends to be low, the absent father often fails to contribute child support, and public benefits are in short supply. Even for those who are working, average real earnings have not grown rapidly for many years and the distribution of earnings has become more unequal than ever. Public policy in both the United States and Canada has begun to reflect conservative assumptions. Programs such as AFDC (Aid to Families with Dependent Children) in the United States and Social Assistance in Canada were seen as establishing perverse incentives for beneficiaries to have babies outside of marriage and not work. The belief was that welfare was so generous that it made sense to stay on welfare and have more babies, rather than go to work. Both governments have moved away from these programs, toward courses of action that "encourage" work and family values.

Progressives point to the minimal amounts collected by beneficiaries of programs such as AFDC and Social Assistance. The average monthly AFDC payment in its last year of existence, accounting for inflation, had withered by almost 50 percent since 1970, yet the birth rate for unmarried mothers soared during this period. Furthermore, states with low welfare benefits had higher illegitimacy rates than states with high welfare benefits; in fact, New Jersey's 1993 law that ended the practice of increasing a welfare check when a recipient had another baby did not drive down birth rates among women on

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welfare. Finally, much more generous welfare states in Western Europe and Scandinavia have much lower out-of-wedlock birth rates than the United States.24

The third group of factors is government causes. Included in this category are lack of social spending, poor targeting, inefficiency in program administration, and prejudicial public policy. Lack of social spending is seen as playing a large role in child poverty. Children may be poor because their parents do not earn enough, however, there are no adequate substitute sources of cash or services to meet the needs of children. Programs such as AFDC, and now TANF (Temporary Assistance for Needy Families) or Social Assistance do not meet the needs of the recipients. The amount of financial assistance given to families is well below the poverty line. Additionally, government cutbacks, user fees, minimum wage laws, and de-indexing of various benefits will continue to exacerbate the rates of child poverty.25 While in an ideal world, a healthy economy and good jobs for parents would eliminate child poverty, in a world where there is unjust, unequal, and discriminatory distribution of resources, the government must step in to balance the needs and resources of various groups of people. Such compromise requires economic and social policies, including redistribution of resources and opportunities, which provide “a fair chance for all children” regardless of birth or luck.26

Comparing the poverty statistics of those over 65 and of children, it is evident that proper targeting of poverty groups by the government can have a large effect on the poverty rate of the group. Both the United States and Canada have well-developed and

23 Ibid.
24 Ibid.
26 Ibid.
generous social security programs which lift 75 percent of the elderly out of poverty.
While children may not be as easy to target as the elderly, more could be done by the
governments to reduce child poverty, whether it be through cash or in-kind transfers
(Food Stamps, Headstart, or Medicaid).

**Antipoverty programs in the United States**

The United States’ antipoverty programs are of two types: social insurance and
means-tested transfers. Among each category are both cash and in-kind transfers. Social
Insurance programs have two distinguishing characteristics. They are universal and they
have dedicated funding mechanisms. All individuals and their employers make
contributions that finance the programs. All individuals can receive benefits when
specific eligibility requirements are met. Social Insurance taxes are disbursed to trust
funds from which benefits are paid. In the United States, the main social insurance
programs are Social Security, Medicare, Unemployment Insurance, Workers’
Compensation, and Disability Insurance. The largest social insurance program is Social
Security, which was established in 1935 to meet the needs of older workers. Over half of
Social Security benefits go to families whose pretax and pretransfer incomes identify
them as poor. In 1998, average benefits (including survivors’ benefits) were about
$9,600, while the poverty threshold for the elderly in 1998 was $7,818 for a single person
and $9,862 for a couple, the program has had a major effect in reducing poverty among
the elderly.27

The next largest program, Medicare, began in 1967. It covers most individuals over
65 and most people under 65 who are receiving Social Security Disability benefits. In

27 John Karl Scholz and Kara Levine, "The evolution of income support policy in recent decades", *Focus*
21 No. 2 (Fall 2000): 11.
1998, per capita expenditure was $5,810. Over half of Medicare benefits go to families whose pretransfer incomes are below the poverty line. The effect of Medicare on poverty is more difficult to ascertain because it provides an in-kind benefit (medical care) and insurance, rather than cash.

The elderly receive between 85 and 90 percent of all payments for Social Security and Medicare. Three smaller programs target workers between the ages of 18 and 64: Unemployment Insurance, Workers’ Compensation, and Disability Insurance. Unemployment Insurance (UI) is given to workers who become involuntarily unemployed. It covers only one-third of job separations for less-skilled men and fewer than 16 percent for less-skilled women. Therefore, it has a relatively minor effect on poverty.

Workers’ Compensation and Disability Insurance (DI) are overshadowed by Social Security; however, they are still large programs. In 1998, Workers’ Compensation payments were $42.6 billion, and in 1999 DI payments were over 50 billion. Little is known about their antipoverty effect.

While welfare programs have had declining budgets in the last decade, social insurance programs have been growing. These programs are in harmony with societal norms and values, unlike welfare programs, which are seen as creating dependence on the system and eroding the family unit. Furthermore, social insurance programs do not have explicit antipoverty objectives, rather it is an indirect result. While most individuals in society would agree that the poor need some help, the extent to which they should be helped is another matter.

\[28 \text{Ibid.}\]
\[29 \text{Ibid.}\]
Means-tested programs, on the other hand, have clear antipoverty intentions. The largest means-tested program is Medicaid, which funds medical assistance to low-income elderly, blind, and disabled individuals, to members of poor families with children under age 18, and to some pregnant women and other children. More than 70 percent of all Medicaid recipients had incomes below the poverty line in 1997. Fewer than ten percent were 65 and older in 1995.\(^{30}\) Medicaid, just like Medicare, is difficult to assess as an antipoverty program, as it is difficult to assign a value to a benefit that a person may not use.

The other means-tested health related program is Supplemental Security Income (SSI), a federally administered cash transfer program for elderly, blind, and disabled individuals (the last group makes up 80 percent of all recipients). Between 1990 and 1994, the program’s costs rose 55 percent, making SSI one of the nation’s fastest growing entitlement programs.\(^{31}\)

The Aid to Families with Dependent Children (AFDC) was the largest cash transfer means-tested program for non-working or working families. It was in existence from 1936 to 1996, at which time it was replaced by TANF (Temporary Assistance to Needy Families). AFDC was a means-tested entitlement program. All applicants whose income and assets were below state-stipulated levels could receive benefits. The federal government provided matching funds. On the contrary, TANF is a set of block grants given to states by the federal government, with few restrictions imposed upon them. The three main “conditions” of receipt are that states have to spend at least 75 percent of their “historic” level of AFDC spending, a five-year limit is imposed on the receipt of

\(^{30}\) Ibid.

\(^{31}\) Ibid., 12.
federally supported assistance, and states have to meet certain targets in moving portions of their TANF recipients into work activities. Most states use the two-year requirement, expecting recipients to participate in work activities within 24 months of initial benefit receipt. States can exempt single mothers with children under the age of one from such requirements. States can also give exemptions to the time limit to 20 percent of their caseload, and are permitted to make payments beyond five years, using their own funds.

The welfare caseload peaked in 1994 with a total of 14.2 million recipients (5 1/2 percent of the population). However, the numbers have been declining since 1994, and in March 1999, there were 7.3 million recipients of TANF, a 48 percent decline in the number of recipients of cash assistance since the peak in 1994. The sharp reduction in welfare spending has been roughly proportional to the decline in welfare caseloads. Under AFDC, states were required to disregard a portion of earned income, however, the amount was limited and had a steep phase-out period. In the pre-TANF era, working AFDC clients often lost one dollar in benefits for every dollar earned, effectively facing a 100 percent tax rate. Under TANF, many states have altered their earnings disregards to encourage work. Connecticut disregards all earnings below poverty and California disregards $225 of earnings and 50 percent of the remainder for an unlimited number of months. These changes reflect state priorities to make work pay, as well as one of the main goals of PRWORA (Personal Responsibility and Work Opportunity Act): to end the

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32 Ibid.
34 Ibid., 161.
35 Ibid., 166.
dependence of needy parents on government benefits by promoting job preparation, work, and marriage.\textsuperscript{36}

The other cash transfer program to able-bodied families is the Earned Income Tax Credit (EITC). It is a refundable tax credit that began in 1975 to offset payroll taxes. It encourages low-skilled workers to enter the labor market, since payments are linked to earnings. Families who have no earnings receive nothing. Spending for the EITC has increased dramatically over the last decade. In 1999, 19.5 million taxpayers benefited from the EITC. Federal spending on the program exceeded spending on TANF and Food Stamps combined by several billion dollars in 1999.

Two other tax-linked benefits exist to aid families. The personal exemption is deducted from income, and is of use only to those who have earned enough to pay taxes, that is, more than $7,000 in the year. Since the tax rate is higher for those with higher incomes, the exemption is also worth more to those with higher incomes. Its maximum cash value is about $1,000 per person. The Child Tax Credit is a federal benefit worth up to $600 in 2001 for each dependent under age 17. In 2001, even families that earned too little to pay income tax could get the credit. The credit is refundable and is in addition to the Earned Income Tax Credit for anyone with a dependent under age 17 who earns more than $10,000.\textsuperscript{37}

The last category of means-tested antipoverty programs are the in-kind transfers. The largest of these programs are Food Stamps, housing assistance, Head Start, and two nutritional programs: school nutrition programs and the special supplemental program for

\textsuperscript{36}Ibid., 158.

Women, Infants, and Children (WIC). The United States’ single, almost-universal program for people with low income and assets is Food Stamps. Since 1994, real Food Stamp expenditures fell 38.3 percent, a decline far steeper than the declines in overall poverty rates or in child poverty.\(^{38}\)

Housing assistance has never been an entitlement. Eligibility is based on family characteristics and income. Space is generally allotted on a first-come, first-served basis, although preference is given to families that are homeless, living in substandard housing, involuntarily displaced, or paying more than 50 percent in rent.

The other four programs are much smaller, and they have decreased slightly in the last decade. The school programs are entitlement programs, while WIC and Head Start are not.

**Antipoverty programs in Canada**

Antipoverty programs in Canada are very similar to that of the United States. They are also divided in two categories: social insurance and means tested transfers. Social insurance programs include Old Age Security, the Canada Pension Plan, Guaranteed Income Supplement, Employment Insurance (formerly known as Unemployment Insurance), and Workers’ Compensation (run by the provincial governments). Income Security Programs for the elderly are divided in two levels.

The first level is Old Age Security. It is the cornerstone of Canada’s retirement income system. It includes a basic monthly pension that is received by almost all people 65 or older who have lived in Canada for at least 10 years. An applicant’s employment history is not a factor in determining eligibility, nor does the applicant need to be retired.

Old Age Security pensioners pay federal and provincial income tax. Higher income pensioners also repay part or all of their benefits through the tax system. For those receiving Old Age Security who have little or no other income, there is the Guaranteed Income Supplement. It is determined through the filing of an income statement on a yearly basis; unlike Old Age Security, it is not subject to income tax. Allowances are also available for surviving spouses.

The second level of income security, the Canada Pension Plan (CPP), is a monthly retirement pension to people who have worked and contributed to the CPP. It also acts as an insurance plan, supplying disability and survivor benefits for those who qualify. It provides a monthly income to individuals and their families who have been severely disabled during their working years. It also offers a monthly income to surviving spouses, or children.

Employment Insurance and health care are the two remaining social insurance programs. Canada provides universal coverage without any point-of-service charges for essential medical services through its national health care system, commonly known as medicare. Provincial governments administer and fund the system, with the federal government providing some financing to the provinces. However, the medicare system is not comprehensive. Prescription drugs, dental care, and eyeglasses, are not covered under Canada’s health care plan. Employment Insurance is also available, yet, its’ role as an antipoverty program is limited.\footnote{Ken Battle, Michael Mendelson, Daniel Meyer, Jane Millar, and Peter Whiteford, \textit{Benefits for Children: A Four Country Study}, (Ottawa: Renouf Publishing Company Limited, 2001), 111.} The number of workers eligible for EI has dropped
dramatically in the past ten years. Only one-third of unemployed workers in Canada currently receive benefits under the program.40

In Canada, federal and provincial governments share equal power over most means-tested antipoverty programs. The largest anti-child poverty program is the Canada Child Tax Benefit introduced in 1993, but reconfigured in 1998. It has a two-tier structure: the Child Tax Benefit (CTB) and the National Child Benefit Supplement (NCBS). The CTB is broadly targeted, encompassing 80 percent of families, while the NCBS is for low-income families only.41 It is in addition to the basic benefit. Under the 1998 National Child Benefit reforms, provincial and territorial governments are expected (though not required) to reduce their existing social assistance expenditures on behalf of children to take into account these increasing federal expenditures. If they do, they must reinvest such savings in other programs and services for low-income families with children. Previous provincial social assistance benefits for children were essentially programs of last resort, available only to those who had exhausted all other sources of income, in other words, "welfare" as understood in the United States. All provinces and territories, except Prince Edward Island, now offer income-tested child benefit programs and/or earnings supplements for families with children, most created under the National Child Benefit reform. The fully integrated child benefit program has replaced most social assistance payments on behalf of children.42

The federal government had established the Canada Assistance Plan (CAP) in 1966. It was an entitlement program for adults who had exhausted all other sources of income.

42 Ibid., 105.
Under CAP, provinces were required to pay financial aid to applicants who qualified on the basis of need. This meant that their liquid assets (cash, bonds) had to fall below certain levels. In certain provinces, the value of their fixed assets (house, car) could not exceed designated levels, and their available income had to be insufficient to meet their basic and/or special needs (health or disability-related conditions). However, two federal actions in the 1990s put an end to CAP. In 1990, the federal government announced a cap on CAP, and the 1995 federal budget introduced the Canada Health and Social Transfer (CHST), which completely replaced CAP and the Established Programs Financing arrangement for health and postsecondary education, with a single block fund for health, post-secondary education, welfare and social services. With the new funding system, there is no guarantee that the funds will be spent on welfare and social services objectives, as there is no cost-sharing intended explicitly for welfare and social services. The death of CAP means that the protections inherent in the legislation will be lost. Welfare is no longer an entitlement program in Canada. The loss of CAP invariably implies that provinces will be free to provide financial assistance to whichever “deserving” applicants they choose.

Adults who have exhausted all other means of income may still qualify for social assistance (welfare) by undergoing income and assets test, through monthly monitoring of their situation; however, most provinces are actively seeking ways to keep individuals off welfare or to move them out quickly once they are in the system. Most provinces

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44 Ibid., 4.
have "workfare" programs, which require individuals to participate in a planning process to discuss their training and employment options.

In-kind means-tested transfers are limited in Canada. Only about ten percent of children aged zero to twelve occupy a provincial government-regulated child care space, and of these, only 31 percent receive a targeted-to-the-poor government subsidy.\(^45\) However, there is a child care expense deduction, but it only partly compensates for families' outlays on child care. Social housing is also available to the poor, but there are long waiting lists and the supply is shrinking. Canada has no US-style Food Stamp program.

Looking at the direction which both countries seem to have taken in the last decade, it appears that tax-linked benefits seem to be the preferred method to fight child poverty. Both the United States and Canada have expanded and funded more generously their tax-linked benefits for families and their children. Both countries are attempting to retreat from traditional forms of welfare entitlement programs and progress toward programs that reward work and promote independence and responsibility in recipients.

Chapter 2

The United States’ Earned Income Tax Credit and the Canada Child Tax Benefit

The history of the Earned Income Tax Credit

The United States became preoccupied with poverty in the early 1960s. President Lyndon Johnson’s Great Society singled out poverty as the social crisis of the 1960s. While some argued for entitlement-oriented guaranteed annual incomes (GAIs), the loudest voices called for work-oriented programs. An anti-welfare, pro-work attitude pervaded the national culture. It emphasized work over dependency, distinguishing between poverty (which was seen as a temporary condition of the working poor and a permanent condition of the disabled and aged) and welfare dependency (which was seen as a pathological and voluntary condition of the indolent). The development of this national sentiment was not recent. In 1937, for instance, with the nation immersed in a protracted depression and with millions of Americans without jobs, public opinion favored “work relief” over “cash relief” by a nine-to-one margin. Even during the Depression, Americans supported work-relief over cash-relief programs.

The Johnson administration set out to eliminate barriers that precluded individuals from becoming self-sufficient. The tax system was perceived as an obstacle to low-income earners. Policymakers realized that traditional means of tax reforms (reducing positive tax rates or raising personal exemptions) would not help low-income individuals who did not owe federal income tax. Reformers recognized that tax laws had to be

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modified in order to pay benefits directly to the needy. They put together a plan for a negative income tax (NIT).

The NIT would apply negative rates per capita credit. The NIT would reduce administrative cost by displacing social workers and would encourage individuals once out of poverty to earn their way toward self-sufficiency by using fractional marginal tax rates (50 percent), rather than 100 percent marginal tax rates on earnings such as done by traditional welfare programs. However, the NIT had one crucial flaw. It paid out the maximum credit to nonworking households and was likely to act as a work disincentive. Even Johnson opposed the NIT.48

In 1969, Nixon promoted the NIT in his Family Assistance Plan (FAP). The plan proposed to replace the AFDC program with a standardized national payment, which states could supplement if they desired. Through the use of an income disregard, fractional phase-outs, and a requirement that all recipients either maintain employment or seek work, FAP would reverse the rising welfare rolls. By 1970, nine million people received AFDC.49 However, opponents to Nixon's FAP program were quick to surface. Most liberals felt that the FAP was inadequate to aid those in need. Conservatives, on the other hand, deemed it lacking in work requirements and compared it to a cash giveaway. Furthermore, FAP costs would exceed those of existing public assistance programs by two billion dollars.50 While FAP was eventually defeated, the proposal for a work bonus gained popularity among the public.

The first work supplement was introduced by President Ford in the Tax Reduction Act of 1975.51 The credit was called the Earned Income Credit (EITC). Section 32 of the

48 Ibid., 5.
49 Ibid., 8.
50 Ibid., 9.
51 Ibid., 17.
Internal Revenue Code established (for one year) a refundable credit for taxpayers with incomes below $8,000. The EITC equaled ten percent of the first $4,000 of earned income, or $400. It also phased out at ten percent, and disappeared entirely at $8,000.

The goals of the EITC were to encourage people to obtain employment, reduce the unemployment rate and the welfare rolls, and to offset payroll tax burdens for low-income families. The benefits were awarded only to working poor families with children. The EITC cost only $1.25 billion. While the credit might play a role in reducing welfare dependency, it was unlikely to reduce poverty.

In 1978, the EITC became a permanent provision of the Internal Revenue Code. While the EITC still phased in at 10 percent, it now increased until $5,000 and conferred a maximum benefit of $500 between $5,000-$6,000. The phase-out rate was 12.5 percent, which zeroed out at $10,000. The expansion of the credit restored its original value, which had eroded due to inflation.

In 1984, the Deficit Reduction Act raised the maximum benefit to $550, as well as the length of the stationary range by $500, and the maximum income to $11,000. Despite the growth in benefits, inflation persisted in eroding the real value of the EITC. These changes may seem unimpressive to liberals, but during a period known for its cutbacks, any program expansion is remarkable. The 1981 OBRA cut federal and state welfare expenditures by four billion dollars, reducing funding by 17.4 percent.

Between 1975 and 1984, the EITC’s maximum credit decreased by 35 percent in real terms. The Tax Reform Act of 1986 offset this erosion and raised the maximum benefit

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52 Ibid.
53 Ibid., 18.
54 Ibid.
55 Ibid., 26.
to $1,174. TRA 86 increased the phase-out point to $21,287. Furthermore, TRA 86 guaranteed future indexing for inflation.\textsuperscript{56}

Both OBRA 1990 and 1993 expanded the EITC’s maximum benefit and phase-out rates, while OBRA 93 also raised the breakeven point. OBRA (Omnibus Budget Reconciliation Act) 1990 introduced different credit rates to reflect family size (one and two or more qualifying children) and enacted auxiliary credits for children under age one (the so-called “wee tots” credit) and for health insurance paid on behalf of a qualifying child. These auxiliary credits were retracted by OBRA 1993. However, the 1993 law provided substantial increases in the credit rate and the maximum credit for families with children. In particular, the 1993 OBRA increased the credit rate for families with two or more children and extended the benefits to childless taxpayers between the ages of 25 and 64.\textsuperscript{57} The changes produced by the 1990 and 1993 bills caused the EITC to triple in size, jumping from $7.5 billion in 1990 to $21.1 billion in 1994. As a result of the changes in 1990 and 1993, the EITC became the largest cash-benefit program provided to low-income families with children. Between 1986 and 1996, EITC expenditures grew by 1,191 percent. In 2001, beneficiaries of the EITC were four times as great as the number of those receiving TANF at a cost of $26 billion.\textsuperscript{58}

What is the Earned Income Tax Credit and how does it work?

The EITC is an income-transfer program that operates through the tax system to provide an income grant to low-income working households with children. If the amount of the credit exceeds the taxpayer’s federal income liability, the excess is refundable to

\textsuperscript{56} Ibid., 27.
\textsuperscript{58} Ibid., 2.
the taxpayer as a direct transfer payment. For example, if a household’s tax would have been $450 but their EITC credit is $300, then the household pays only $150 in tax. Furthermore, if the household owes $450 in tax, but their EITC credit is $800, then the household receives a tax refund of $350 from the IRS. The credit has several important purposes: to reduce the tax burden of low- and moderate-income workers, to supplement wages, and to make work more attractive than welfare.

Single or married people who work full-time or part-time can qualify for the EITC, depending on their income. Both families and childless workers are eligible for the EITC. Qualifying children must be under age 19, or under 24 if they are full-time students. Totally and permanently disabled children of any age may also be “qualifying children”. The relationship test requires that the child be the child, adopted child, stepchild, grandchild, or foster child of the taxpayer. The residency test requires that the child live with the taxpayer for more than half of the taxable year. Workers without children between the ages of 25 and 64, and who had earnings below $10,710 were eligible for the credit in 2001. The EITC is based on the household’s total income, not the individual’s. The credit is restricted to households with labor earnings. Income from programs such as TANF do not count toward EITC Earnings.

The EITC is available to low-income working taxpayers with three separate schedules based on the level of income. The credit amount generally equals a specified percentage of the earned income up to a certain income level, called the “phase-in range.” The maximum credit applies to a certain income range “stationary range” and then gradually decreases to zero over a specified “phase-out range.”
Figure 2.1 shows the actual EITC schedule for 1997 for households with one qualifying child. If the household’s earnings were zero, its credit was zero. When the household earns its first $100, it receives a credit of $34; it continues to receive $34 for each additional $100 of earnings until earnings reach $6,500 and the credit reaches $2,210 (34 percent of $6,500). There is a stationary range from $6,500 to $11,930 where the credit remains $2,210. The phase-out begins at $11,930. The phase-out rate is 15.98 percent; for each additional $100 of earnings, the credit is reduced by $15.98. Since the maximum credit is $2,210, it takes $13,820 of additional earnings to completely phase-out the credit. This occurs at $E = $25,750 (11,930 + 13,820 = 25,750).

![Figure 2.1 EITC schedule for households with one qualifying child.](image)


* Author has changed the calculations to 1997 rather than 1990.

Figure 2.2 shows the actual EITC schedule for 1997 for households with two qualifying children. If the household’s earnings were zero, its credit was zero. When the household earns its first $100, it receives a credit of $40; it continues to receive $40 for each additional $100 of earnings until earnings reach $9,140 and the credit reaches $2,740 (30 percent of $9,140). There is a stationary range from $9,140 to $13,580 where the credit remains $2,740. The phase-out begins at $13,580. The phase-out rate is 14.02 percent; for each additional $100 of earnings, the credit is reduced by $14.02. Since the maximum credit is $2,740, it takes $15,840 of additional earnings to completely phase-out the credit. This occurs at $E = $39,420 (13,580 + 15,840 = 39,420).

![Figure 2.2 EITC schedule for households with two qualifying children.](image)
$3,656 (40 percent of $9,140). There is a stationary range from $9,140 to $11,930 where the credit remains $3,656. The phase-out begins at $11,930. The phase-out rate is 21.06 percent; for each additional $100 of earnings, the credit is reduced by $21.06. Since the maximum credit is $3,656, it takes $17,360 of additional earnings to completely phase-out the credit. This occurs at $E=29,290 (11,930 + 17,360=29,290).


* Author has changed the calculations to 1997 rather than 1990.

The phase-in EITC depends on a family’s earned income, while the phase-out depends on either earned income or adjusted gross income (whichever is greater). Adjusted gross income (AGI), as defined by the U.S. tax code, equals labor income plus capital income (property income such as interest, dividends, capital gains, or rental income) plus several items such as unemployment compensation, minus several items such as individual retirement account deductions. Although a households’ AGI is usually larger than its labor income, it is possible for it to be smaller due to the items that are
Table 2.1 Earned Income Tax Credit Parameters, 1975-97 [Dollar amounts unadjusted for Inflation].

<table>
<thead>
<tr>
<th>Calendar Year</th>
<th>Credit Rate (percent)</th>
<th>Minimum Income for Maximum Credit</th>
<th>Maximum Credit</th>
<th>Phase-out Rate (percent)</th>
<th>Phase-out Range</th>
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</tr>
<tr>
<td>• One Child</td>
<td>18.50</td>
<td>$7,750</td>
<td>$1,434</td>
<td>13.21</td>
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<td>19.50</td>
<td>$7,750</td>
<td>$1,511</td>
<td>13.93</td>
<td>$12,200</td>
<td>$23,050</td>
</tr>
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<tr>
<td>• No Children</td>
<td>7.65</td>
<td>$4,000</td>
<td>$306</td>
<td>7.65</td>
<td>$5,000</td>
<td>$9,000</td>
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<td>26.30</td>
<td>$7,750</td>
<td>$2,038</td>
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<td>$25,078</td>
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<td>$11,610</td>
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<tr>
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<td>7.65</td>
<td>$4,340</td>
<td>$332</td>
<td>7.65</td>
<td>$5,430</td>
<td>$9,770</td>
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<td>$9,140</td>
<td>$3,656</td>
<td>21.06</td>
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<td>$29,290</td>
</tr>
<tr>
<td>1999*</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>• No Children</td>
<td>7.65</td>
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<td>7.65</td>
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<td>$2,312</td>
<td>15.98</td>
<td>$12,460</td>
<td>$26,928</td>
</tr>
<tr>
<td>• Two Children</td>
<td>40.00</td>
<td>$9,540</td>
<td>$3,816</td>
<td>21.06</td>
<td>$12,460</td>
<td>$30,580</td>
</tr>
</tbody>
</table>

Source: U.S. Congress (1998), Green Book (p. 867)

*Data for the year 1999 collected from the Internal Revenue Service 1999.
subtracted in computing AGI. An increase in other income can render a family ineligible for the EITC even if the level of earned income falls within the phase-out range. The reason for the phase-in by labor earnings and phase-out by adjusted gross income or labor earnings is simply that the EITC's purpose is to encourage work and reward work effort. The phase-in must therefore be based on labor earnings.

Households must file a tax return to receive their EITC credit. Many eligible households do not file an income tax return because households with low-incomes are not legally required to file a federal income tax return. For example, in 2002, a single individual under 65 did not have to file if her gross income was less than $7,700, a head of household under 65 did not have to file if she earned less than $9,900, a married couple (both spouses under 65) filing jointly did not have to file if they earned less than $13,850. Undoubtedly, there are households who are eligible for the EITC that do not receive the credit to which they are entitled. In theory, the household does not need to wait until its 1040 return is processed to receive its credit. An advance payment option is available through employers for workers with at least one qualifying child. Childless workers are not eligible for the advance payment option. The credit can be received with each paycheck. In practice, only a small amount of households receive the credit through advance payment.

The history of the Canada Child Tax Benefit

In Canada, the major reforms to federal child benefits can be divided into four phases: regressive targeting, untargeted universality, progressive universality, and

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60 Ibid., 15.
progressive targeting. The long-term trend has been toward greater “targeting,”
signifying focusing child benefits on need as measured by family income. Child benefit
programs in Canada have tried to meet two broad objectives: horizontal equity and anti-
poverty. Horizontal equity acknowledges that parents have a heavier financial burden
than childless couples and single individuals with similar incomes. This objective also
appreciates the contribution that parents make to society by raising future citizens,
workers and taxpayers. The anti-poverty objective is founded on the moral principle that
societies should aid those in need. Since the late 1970s, the anti-poverty objective has
become more important than the horizontal equity objective.

The first tax-transfer benefit introduced was the children’s tax exemption
(temporarily changed to a non-refundable credit from 1942 to 1946). It delivered its
benefits through regressive methods (regressive targeting). The higher the income tax
bracket, the larger the income tax saving, as children’s tax exemptions reduce taxable
income. Families which did not owe income tax (the majority, in those days) did not
benefit from the children’s tax exemption.

In 1945, the Family Allowances was introduced. It was a non-taxable monthly cash
payment to all mothers on behalf of their children. Family Allowances was the first
universal child benefit program in Canada. It allowed poor families to finally benefit
from the federal child benefit system. However, low-income families ineligible for the
children’s tax exemption received smaller total child benefits than did non-poor families.

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62 Ken Battle and Michael Mendelson, Child Benefit Reform in Canada: an evaluative framework and
63 Ibid.
While all families gained from the new universal system, benefits were still non-responsive to need as measured by income,\textsuperscript{64} in the untargeted universality phase.

In the 1970s, child benefits were increased extensively. In 1973, Family Allowances were tripled and fully indexed to the cost of living. Furthermore, they became taxable, which made them "progressive" since their value decreased as incomes increased. The system began to respond more positively to income. Nevertheless, the taxability of Family Allowances was offset by the children's tax exemption. However, in 1978, the federal government established a new child benefit program, the refundable Child Tax Credit, which bestowed its maximum benefit upon low-income families. The refundable Child Tax Credit was also indexed to the cost of living. For the first time, the income tax system was used to deliver benefits to families too poor to owe income tax.\textsuperscript{65}

Even with the changes in the Family Allowance and the launching of the refundable Child Tax Credit, which substantially increased benefits to lower-income families, the distribution of child benefits remained skewed, the well-off families receiving larger credits. Families earning $50,000 received more child benefits than families earning $15,000 or less. In 1984, the final year of the progressive universality phase of federal child benefits, a two-earner family, earning $100,000, with two children, received $1,515 worth of child benefits, while a family earning $10,000 received $2,197 in child benefits – only $682 more than the family with ten times as much earned income.\textsuperscript{66}

The fourth phase, progressive targeting, was launched in the 1980s. In 1988, the children’s tax exemption was converted into a non-refundable Child Tax Credit. While

\textsuperscript{64} Ibid.
\textsuperscript{65} Ibid.
\textsuperscript{66} Ibid.
the children's tax exemption had been a regressive social program, providing higher benefits to those with higher incomes, the non-refundable Child Credit provided taxpayers with identical income tax savings. However, the non-refundable Child Tax Credit had two major flaws: it did not provide benefits to those who had no income tax liability and those who had income tax liability lower than the value of the credit could not receive the maximum amount. The equivalent-to-married exemption (a benefit paid on behalf of the first child in single-parent families) was also converted to a non-refundable credit. In 1985, the federal child benefit system, which had been fully indexed since 1973, was partially deindexed.\textsuperscript{67}

In 1991, universal child benefits were eliminated. Upper-income families were required to repay all of their Family Allowances by means of a clawback administered through the income tax system. The measure was phased in over a three-year period, between 1989 and 1991, one-third each year. As of 1991, well-off families received what amounted to temporary Family Allowances since they had to pay the allowance back through the clawback at income tax time.\textsuperscript{68}

In 1993, the three major federal child benefits program (Family Allowances, the refundable Child Tax Credit and the non-refundable Child Tax Credit) were replaced by a single income-tested Child Tax Benefit. The new benefit increased payments to working poor families with children (by paying a Working Income Supplement), maintained the level of benefits to other low-income families, reduced benefits for middle-income families and removed benefits from upper-income families. In 1998, the Child Tax Benefit was restructured under the National Child Benefit (NCB) reform into the Canada

\textsuperscript{67} Ibid.

\textsuperscript{68} Ibid.
Child Tax Benefit, which provided equal federal payments to all low-income families with children. The NCB reform allowed provinces to reinvest their savings from reduced provincial welfare expenditures on behalf of children (resulting from increased federal child benefits) in other provincial income programs or social services for low-income families with children.69

What is the Canada Child Tax Benefit and how does it work?
The Canada Child Tax Benefit (CCTB) is a direct non-taxable payment by the Canada Customs and Revenue Agency to households with children. The CCTB was introduced in 1998 under the National Child Benefit (NCB) reform. Through the National Child Benefit, the federal government redesigned and enriched the Child Tax Benefit (renamed the Canada Child Tax Benefit) by adding the National Child Benefit Supplement (NCBS).

The Canada Child Tax Benefit has a two-tiered structure. The first tier of the CCTB, the "basic Child Tax Benefit" (CTB), is an income-tested benefit payable to low to upper middle-income families. In contrast, the National Child Benefit Supplement is paid exclusively to low-income families. In addition, under the NCB, provinces are allowed to reduce their welfare-provided child benefits by the amount of the federal child benefit increase, provided they reinvest the resulting savings in other programs and services for low-income families with children. The programs and services can be income-tested child benefits, earnings supplements, child care, employment programs, and extension of in-kind benefits to the other low-income families. The amount of the federal child benefit increase is the amount that the federal government spends on the National Child Benefit.

69 Ibid.
Benefit Supplement. The objective of the National Child Benefit reform is to raise the Canada Child Tax Benefit to the point where it displaces welfare-delivered child benefits.

To be eligible for the CCTB and the NCBS, the child must live with the claimant and the latter must be the person who is primarily responsible for the care and upbringing of the child. Individuals must file income tax returns to be entitled to the Canada Child Tax Benefit and the National Child Benefit Supplement, even if they have no income to report, as well as a one-time CCTB application.

*Figure 2.3 How does the National Child Benefit Work?*

![Diagram showing the National Child Benefit Initiative](image)

*Source: The National Child Benefit Website.*

The benefits described below are for the 12-month payment period July 2001- June 2002 (the payment year is from July 1 of one year to June 30 the next year). The first tier of the Canada Child Tax Benefit, the basic child tax benefit, paid a maximum $1,117 per child under age 18 per year from July 2001 through June 2002, delivered on a monthly basis. In addition, there was a small ($77 per year) supplement for larger families (for the
Table 2.2 Canada Child Tax Benefit (CCTB) payment amounts.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Benefit</td>
<td>$1,020</td>
<td>$1,020</td>
<td>$1,104</td>
<td>$1,117</td>
<td>$1,151</td>
</tr>
<tr>
<td>Supplement for 3rd and following child</td>
<td>$75</td>
<td>$75</td>
<td>$77</td>
<td>$78</td>
<td>$80</td>
</tr>
<tr>
<td>Supplement for children under age seven</td>
<td>$213</td>
<td>$213</td>
<td>$219</td>
<td>$221</td>
<td>$228</td>
</tr>
<tr>
<td>Base Threshold</td>
<td>$25,921</td>
<td>$25,921</td>
<td>$30,004</td>
<td>$32,000</td>
<td>$32,960</td>
</tr>
<tr>
<td>Benefit Reduction Rates</td>
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<td></td>
</tr>
<tr>
<td>- one child</td>
<td>2.5%</td>
<td>2.5%</td>
<td>2.5%</td>
<td>2.5%</td>
<td>2.5%</td>
</tr>
<tr>
<td>- two or more children</td>
<td>5.0%</td>
<td>5.0%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>(NCBS) amount for</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- first child</td>
<td>$605</td>
<td>$785</td>
<td>$977</td>
<td>$1,255</td>
<td>$1,293</td>
</tr>
<tr>
<td>- second child</td>
<td>$405</td>
<td>$585</td>
<td>$771</td>
<td>$1,055</td>
<td>$1,087</td>
</tr>
<tr>
<td>- each additional child</td>
<td>$30</td>
<td>$510</td>
<td>$694</td>
<td>$980</td>
<td>$1,009</td>
</tr>
<tr>
<td>NCBS Threshold</td>
<td>$20,921</td>
<td>$20,921</td>
<td>$21,214</td>
<td>$21,744</td>
<td>$22,397</td>
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<td>NCBS Phase-Out Rate</td>
<td></td>
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<td></td>
<td></td>
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</tr>
<tr>
<td>- one child</td>
<td>12.1%</td>
<td>11.5%</td>
<td>11.1%</td>
<td>12.2%</td>
<td>12.2%</td>
</tr>
<tr>
<td>- two children</td>
<td>20.2%</td>
<td>20%</td>
<td>19.9%</td>
<td>22.5%</td>
<td>22.5%</td>
</tr>
<tr>
<td>- three or more children</td>
<td>26.8%</td>
<td>27.5%</td>
<td>27.8%</td>
<td>32.1%</td>
<td>32.1%</td>
</tr>
</tbody>
</table>

Source: Canada Customs and Revenue Agency

third and each additional child) and up to $220 per year for each child under age seven for whom the child care expenses deduction (a tax benefit for families with receipted child care) were not claimed. Provinces can vary the rates according to the age and/or number of children.  

Maximum payments went to families with net incomes under $32,000 and were reduced gradually above this level at the rate of 2.5 percent for families with one child and five percent for those with two or more children. Eligibility for benefits ended at relatively high incomes - $76,680 in net income for families with one or two children. Because the Canada Child Tax Benefit calculates its payment on the basis of net family income, a definition that allows substantial deductions (child care expenses, private pension savings), families with gross incomes thousands of dollars above $76,680 net family income level, where eligibility for benefits ends, still qualified for some payment.

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70 Battle, "Benefits for Children", 100.
Thus, the Canada Child Tax Benefit is a broad based social program that serves eight in ten families with children, excluding only the well off.\textsuperscript{71}

The second tier is called the National Child Benefit Supplement (NCBS). It is received by low-income families only. For the 12-month period July 2001-June 2002, the National Child Benefit Supplement paid a maximum $1,255 for the first child, $1,055 for the second child and $980 for each additional child, phasing out above net family income of $21,744 at the rate of 11.1 percent for one child, 19.9 percent for two children and 27.8 percent for larger families, to end once net family income reached $32,000 for families with one, two or three children (not coincidentally, the same level where the basic Child Tax Benefit begins to reduce its payments). Together, the basic Child Tax Benefit and the National Child Benefit Supplement amounted to a maximum annual Canada Child Tax Benefit of $2,372 for one child, $2,172 for the second child and $2,175 for each additional child.\textsuperscript{72}

For children in institutional care, a Children’s Special Allowance is paid to the federal or provincial government department, child care agency or institution supporting that child. The payment also may be made to foster parents. The Children’s Special Allowance paid the same amount as the maximum Canada Child Tax Benefit for one child – for July 2001-June 2002, $2,372 per year.\textsuperscript{73}

Families with net incomes between $21,744 and $32,000 in 2000 qualified for the maximum basic CCTB and part of the NCBS. However, families with net incomes between $32,000 and $76,000 in 2000 only qualified for part of the basic CCTB.

\textsuperscript{71} Ibid., 101.
\textsuperscript{72} Ibid., 101.
\textsuperscript{73} Ibid., 102.
Furthermore, there was an additional supplement of $221 per year ($18.41 per month) provided for each child less than seven years of age for whom no child care expenses were claimed. The Alberta government is the only provincial government which has chosen to vary the amount of basic benefit its residents receive. The basic benefit for Albertans in 2002 was $1025 for children under seven, $1095 for children seven to eleven, $1225 for children twelve to fifteen, and $1297 for children sixteen and seventeen, plus an additional supplement of $78 per year for the third and each additional child.

Table 2.3 Annual Maximum CCTB (including the NCBS) for the July 2001 to June 2002 benefit year for families with net incomes below $21,744 in 2000.

<table>
<thead>
<tr>
<th>Number of Children</th>
<th>Basic CCTB</th>
<th>NCBS</th>
<th>Total</th>
<th>Monthly Benefit</th>
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</thead>
<tbody>
<tr>
<td>1(^{st}) Child</td>
<td>$1117</td>
<td>$1255</td>
<td>$2372</td>
<td>$197.66</td>
</tr>
<tr>
<td>2(^{nd}) Child</td>
<td>$1117</td>
<td>$1055</td>
<td>$2172</td>
<td>$181.00</td>
</tr>
<tr>
<td>3(^{rd}) and each additional child</td>
<td>$1195</td>
<td>$980</td>
<td>$2175</td>
<td>$181.25</td>
</tr>
</tbody>
</table>

Source: National Child Benefit Website.

Figure 2.4 Canada Child Tax Benefit, family with two children, 2001.

Source: The Caledon Institute of Social Policy.
The 2000 budget announced several significant changes to the CCTB. Foremost, among them was the restoration of full indexation of the CCTB and the personal income tax system’s tax brackets and credits to the 2000 cost of living. This is a significant change for both child benefits and the income tax system (including its various child-related benefits) as both systems had been eroded steadily for a decade and a half by partial deindexation. The Canada Child Tax Benefit’s rates and income thresholds were adjusted by the amount of inflation over three percent a year, which in real terms meant that they fell by three percent if inflation ran over three percent or by the amount of inflation if the latter was under three percent. The same held for the personal income tax system’s tax brackets and credits.\textsuperscript{74}

The 2000 budget also announced increases to the CCTB’s rates and income thresholds (for both the Basic Child Tax Benefit and the National Child Benefit Supplement). Moreover, the reduction rate on the BCTB would be lowered in the future (from two and a half percent to two percent for one child and from five to four percent for two or more children by 2004). By July 2004, the maximum annual Canada Child Tax Benefit was slated to reach $2,520 for the first child, $2,308 for the second child, and $2,311 for each additional child.\textsuperscript{75}

A comparison of the Earned Income Tax Credit and the Canada Child Tax Benefit

After having reviewed the Earned Income Tax Credit and the Canada Child Tax Benefit individually, a comparison of their similarities and differences is required before moving on to the study of their anti-child poverty effectiveness. Each country’s culture

\textsuperscript{74} Ibid., 102.
\textsuperscript{75} Ibid., 103.
has favored the implementation of programs which reward work and family values. Canada's European ties had made it a more socially generous country in the past, however, the current poverty rates of both countries, viewed in a cross-national perspective, reveal that Canada is headed in the same direction as the United States. Both countries have significantly reduced their spending on welfare programs, in an effort to establish programs which encourage work and keep the family unit intact. Neither the United States nor Canada possesses entitlement cash-assistance programs. While the elderly and the disable still benefit from generous income security programs, because they are societies' "deserving" poor, the unemployed poor is not as lucky. Children benefit from more programs than adults; however, significant increases in spending must be recorded in each country before child poverty rates are lowered to an "acceptable" level. Yet, targeting children through anti-poverty programs is problematic, as parents do not necessarily have the child's best interest at heart. Cash transfers may not be spent on the needs of the child, and even in-kind transfers do not always get used adequately.

The EITC and the CCTB have become vital cash-transfer programs for children in need. While the EITC has three phases (phase-in range, stationary range, and phase-out range), the CCTB has only two phases (stationary range and phase-out range). In the United States, the EITC is only available to those with labor earnings, unlike in Canada, where "welfare" recipients can count their social assistance payments as income. Moreover, the EITC is received by recipients on a yearly basis, and therefore is not as responsive to the monthly needs of households. The CCTB, however, is received on a monthly basis, and consequently is more reactive to the needs of low-income families. Both programs calculate their benefits on a yearly basis, making their program
unresponsive to the changes of families in need. However, in Canada, when parents separate or a spouse dies, the credit may be amended within a few weeks, but changes in income can take up to eighteen months to be reflected in the credit. In the United States, amendments are not made until the following tax year. While advance payment is available in the United States, less than ten percent of EITC recipients take advantage of this delivery method, as claimants have to refund any excess EITC that they receive since it is merely an estimate and not the actual credit amount.

Both programs manifest signs of predicaments inherent to tax-transfer benefits. Recipients must file an income tax return to be eligible for the EITC and the CCTB. In both countries, personal exemptions exist for individuals who do not earn enough income. They do not have to file taxes if they earn less than a certain amount. In addition, each program requires separate forms to be filed along with the income tax return. The process is somewhat confusing and could be simplified.

The CCTB is a more expansive program as it is claimed by eighty percent of families in Canada. The EITC is not as far-reaching as the CCTB. Canada’s child benefit system attempts to fight not only child poverty, but also to achieve horizontal equity. While the second-tier of the CCTB, the NCBS, targets exclusively low-income families, the first-tier, the CTB, targets 80 percent of families, even some families earning above $80,000. Since the CCTB aims to remedy horizontal equity, the phase out rates for the basic tier are fairly low (two and a half percent and five percent). However, the second tier has higher phase-out rates, similar to that of the EITC, as the second level is comparable to the EITC.
The CCTB is also more responsive to the needs of larger families, supplementing the benefits of families with more than two children, unlike the EITC, which only differentiates between families with one and two or more children. Adjusting credits by family size is a controversial issue, as the government does not want to be perceived as creating incentives for poor families to have more children. Furthermore, both the EITC and the CCTB could be expanded in terms of credit amounts to have a more significant effect upon low-income families.
The anti-child poverty effectiveness of the Earned Income Tax Credit and the Canada Child Tax Benefit

The costs of the Earned Income Tax Credit and the Canada Child Tax Benefit

One of the advantages of the EITC and the CCTB is that they have relatively low administrative costs compared to other anti-poverty programs of the same stature. Using the tax system, rather than the welfare system to transfer income has the potential to greatly reduce administrative costs because caseworkers are not required to administer the program. The administrative costs of AFDC in 1995 were 16 percent of benefits paid, in large part because of the need to pay for caseworkers.\(^\text{76}\) By relying on taxpayers to self-report on their tax returns, the EITC avoids this cost. Furthermore, tax-transfer programs are usually based on income tax returns, which would have to be processed regardless of the extra benefit program, therefore they do not usually add much work or costs. The majority of EITC recipients would have to file a tax return even in the absence of the credit; consequently, the marginal costs of the EITC are simply the small costs of filling out Schedule EIC and the additional time necessary for the taxpayer or paid preparer to fill out schedule EIC. TANF recipients, on the other hand, had costs such as repeated visits to the welfare office, the assembling of documents such as school attendance records and letters from employers. This cost is likely to be much greater than the marginal costs to a taxpayer of applying for the EITC.

The cost to the IRS is quite small. The entire IRS budget is roughly eight billion dollars, and the IRS serves roughly 120 million individual taxpayers and 15 million corporations. The incremental cost of administering the EITC is a very small fraction of this total. The U.S. General Accounting Office has estimated that the administrative costs of the EITC are less than one percent of dollars transferred. Recent IRS efforts to combat EITC noncompliance have probably raised these costs. In 2001, the IRS proposed to use 1.59 percent of its budget toward EITC activities including compliances services, filing and account services, pre-filing taxpayer assistance and education, and administration of the EITC. Of the 1.59 percent, only 2.75 percent was to be used for administration purposes.\footnote{Internal Revenue Service, \textit{Accountability Report,} 2001, available from<http://irs.ustreas.gov> Internet; accessed November 29 2002.} However, the entire IRS budget in 2001 was $8.8 billion. Even under the unlikely assumption that ten percent of IRS costs were due to the EITC, EITC administrative costs would be only three percent of benefits paid.\footnote{Liebman, “The Impact of the Earned Income Tax Credit”, 111.}

Table 3.1 reveals the annual costs of various anti-child poverty programs in the United States. While only Medicaid is larger in costs per year, the EITC has the advantage of being the only program with relatively low administrative costs. The estimate is between one and three percent of dollars transferred to recipients. The other large cash-transfer program to children, TANF (prior to 1996 AFDC), reported much higher administrative costs. By statute, states were required to keep their administrative costs below 15 percent. In 1997, the total of state administrative costs for TANF was $838 million while the total expenditures for all costs related to TANF was $9.9 billion, which would make administrative costs only eight and a half percent of total
expenditures. However, if we take into account other costs such as computer systems ($100 million), other expenditures such as Electronic Benefit Transfer development, fraud programs, quality control, emergency assessments, school readiness, teen pregnancy prevention, payments for TANF families in shelters, Emergency Assistance, and outreach advertising ($859 million), total costs to run the TANF program run closer to 18 percent.\textsuperscript{79} While a number of other expenditures are cash transfers to recipients, a large part of the costs are fraud and quality programs, which should be counted toward administrative costs of TANF as they are counted in the administrative costs of the EITC.

Under the new welfare law, the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) of 1996, Congress streamlined the several funding programs for child care into the Child Care and Development Block Grant. In fiscal year 1997, states spent $60 million to administer their child care programs. This amount consists of 2.4 percent of total federal and state funds. It is well below the maximum limit of five percent. However, administrative costs do not include expenditures such as computer systems, certificates to families, the improvement of quality child care services, and determination of families that can receive child care support and other related activities. States spent $9 million on child care computer systems, $83 million on costs to provide certificates to families, and $121 million on determining which families can receive child care support and other related activities, as well as $98 million on

improving the quality of child care services. If we take into account these expenditures, then the child care programs have administrative costs closer to 16 percent.\(^8\)

As for the Food Stamp program, in 1997, total expenditures were $21.5 billion, while administrative costs ranged around $2 billion, which is ten percent of all expenditures. In 2001, the administrative costs were closer to thirteen percent of all expenditures.\(^8\)

The Child Tax Credit is a cash-transfer through the tax system, and like the EITC has low administrative costs. Medicaid is in a different category all together as it is a health insurance for low-income children, and, as do all health related programs, has high administrative costs.

<table>
<thead>
<tr>
<th>Table 3.1 Cost of various government programs</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>EITC</td>
<td>29,700</td>
<td>30,600</td>
<td>31,200</td>
<td>31,200</td>
</tr>
<tr>
<td>Child Tax Credit</td>
<td>3,525</td>
<td>15,100</td>
<td>20,100</td>
<td>20,600</td>
</tr>
<tr>
<td>Medicaid</td>
<td>101,234</td>
<td>108,042</td>
<td>117,921</td>
<td>128,853*</td>
</tr>
<tr>
<td>TANF</td>
<td>13,286</td>
<td>14,161</td>
<td>15,464</td>
<td>17,080*</td>
</tr>
<tr>
<td>Social Services Block Grant</td>
<td>2,441</td>
<td>1,993</td>
<td>1,821</td>
<td>1,907*</td>
</tr>
<tr>
<td>Child Care</td>
<td>2,028</td>
<td>2,254</td>
<td>2,237</td>
<td>2,423*</td>
</tr>
<tr>
<td>Food Stamps</td>
<td>18,892</td>
<td>17,698</td>
<td>17,058</td>
<td>17,798</td>
</tr>
</tbody>
</table>

* Source: Data Collected from Four sources: Internal Revenue Service, General Accounting Office, Department of Agriculture and Department of Health and Human Services.
  * Data reflects the enacted budget rather than the actual budget.

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Looking at the administrative costs of the key anti-poverty programs, one can assume that the EITC and the Child Tax Benefit have an advantage over the other "welfare" programs, in terms of administrative costs. However, while they are successful in investing the funds directly to the recipients, whether the "poor" are being properly targeted is another issue that will be examined in the next section.

Programs in Canada follow the same pattern as far as administrative costs are concerned. The Canada Child Tax Benefit is a cash transfer through the tax system, and therefore, has relatively low administrative costs. Recipients qualify for the CCTB through their income tax returns, just as they do in the United States. Because the payments are made on a monthly basis, there are higher costs than in the United States due to postage, checks, and processing, however, it is still not as time consuming and workforce demanding as "welfare" programs which require caseworkers.

Revenue Canada administers a number of benefit programs. The two largest are the Canada Child Tax Benefit (CCTB) and the goods and services tax/harmonized sales tax (GST/HST) credit. There is also the Children’s Special Allowances (CSAs) paid to about 270 child care agencies and other institutions that are responsible for the care and maintenance of children, and the Disability Tax Credit (DTC), which provides a non-refundable tax credit for individuals who have a severe and prolonged impairment that markedly restricts a basic activity of daily living. Revenue Canada also administers a number of benefit programs on behalf of the provinces and territories, such as the Alberta Family Employment Tax Credit, The BC Family Bonus, the New Brunswick Child Tax Benefit, the Newfoundland Harmonized Sales Tax Credit, the Northwest Territories Child Benefit, the Nova Scotia Child Benefit, and the Saskatchewan Child Benefit.
Operating costs of all benefit programs administered through the federal tax system were $38 million in the 1998-1999 benefit year. The Canada Child Tax Benefit was a large percentage of this budget. However, even if the CCTB was the whole $38 million in operating costs, with a total transfer cost of $5.7 billion, the percentage in operating/administering costs is less than one percent. As this program is a benefit offered to 80 percent of Canadian families with children, plainly the CCTB ranks high in terms of cost-effectiveness.

Administrative costs for welfare programs are paid by the provinces through their share of the Canada Health and Social Transfer (CHST), funded by the federal government. For example, the province of Saskatchewan’s Social Services 1997-98 expenditure statement, which takes into account the expenditures of child care programs, family and youth services programs and all income security programs, estimates the administrative costs between four and thirteen percent, depending on the costs included in the estimate. Even using a narrow definition of administrative costs, welfare programs such as subsidized child care, social assistance and youth programs have higher administrative costs than tax-related benefit programs.

The recipients of the Earned Income Tax Credit and the Canada Child Tax Benefit

Both the EITC and the CCTB claim to target low-income families. However, the CCTB also has a basic tier which is received by 80 percent of families with children. Canada has a two-tiered child benefit program, which attempts not only to fight child

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poverty but also to remedy horizontal equity. To determine the targeting effectiveness of both programs, it is necessary to examine the recipients of the programs in terms of family size, family income, and sources of income.

In the United States, the EITC is only available to families with labor earnings, which excludes all families receiving solely social assistance under the TANF program. Consequently, these individuals who tend to fall much lower below the poverty line than the working poor, are not being targeted by this program. Since the EITC’s main objective is to encourage work by supplementing the incomes of the working poor, this is not surprising. However, if this type of program was determined to be an effective means of transferring funds to those in need, then the EITC’s income definition would have to be modified or/and the EITC’s structure would have to be changed.

Table 3.2 restricts the sample of EITC recipients to families with children under age 18. It shows the percent distribution of total recipient families, the share of total credits, and average credit amounts by selected family characteristics. Looking at the family type category, female-headed families with children received an average credit of $1,828, slightly higher than the average credit received by married-couple or male-headed families ($1,654 and $1,582, respectively). Since female-headed families with children are more likely to be poor, this trend is encouraging.

The number of children category in Table 3.2 reveals that families with two children received $1,983, on average, substantially more than the average credit of $1,349 received by one-child families. However, as the number of children increases from two to three children, and from three to four or more, the mean credit per child was $1,349 for families with one child, $992 for those with two children, $677 for those with three
children, and $467 for those with four or more children.\textsuperscript{84} The per child values reveal that the more children a family has, the less the credit received by the family is per child. These statistics reveal inequity in credit amounts received by families of different sizes. Some argue that the economy of scale justifies the payment range. Yet, these credits most likely reflect government policies that seek to establish disincentives for the poor to have more children.

Table 3.2 also points out that working parents still on TANF received relatively high credit amounts, on average $1,873 a year. Yet their share of the total credit was very small (ten percent).\textsuperscript{85} This data implies that the EITC could be a significant source of additional income once welfare recipients enter the workforce.

As far as poverty status and income class are concerned, 78.9 percent of EITC dollars went to the poor or near-poor families with income-to-needs ratios of less than 1.5. However, Table 3.2 indicates that very few dollars went to the extreme poor, with incomes below 50 percent of the poverty line (9.1 percent). The Table further indicates that most recipients were concentrated in the phase-out range (62.1 percent), receiving 54.7 percent of the total credits.\textsuperscript{86}

As Table 3.2 reveals, the EITC suffers from certain weaknesses in terms of target efficiency. More taxpayers with incomes above the poverty line benefit from EITC payments, receiving more than half the total credit amount. Table 3.3 reveals that OBRA 1993 further increased the credit payments going to taxpayers above the poverty line, as a consequence of having extended the break-even level of income. However, through the

\textsuperscript{84} Kim, "The Effects of the Earned Income Tax Credit", 14.
\textsuperscript{85} Ibid.
\textsuperscript{86} Ibid.
Table 3.2 Percentage Distributions of Total Credits and Total Recipient Families with Children by Family Characteristics: 1997.

<table>
<thead>
<tr>
<th>All EITC families with children under age 18</th>
<th>Percent of total caseload</th>
<th>Percent of total credits</th>
<th>Mean credit per year ($)¹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Family type</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Two parents</td>
<td>41.8</td>
<td>39.8</td>
<td>1,654</td>
</tr>
<tr>
<td>• Female-headed</td>
<td>49.9</td>
<td>52.5</td>
<td>1,828</td>
</tr>
<tr>
<td>• Male-headed</td>
<td>8.4</td>
<td>7.7</td>
<td>1,582</td>
</tr>
<tr>
<td>No. of Children</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• One</td>
<td>41.5</td>
<td>32.2</td>
<td>1,349</td>
</tr>
<tr>
<td>• Two</td>
<td>35.1</td>
<td>40.2</td>
<td>1,983</td>
</tr>
<tr>
<td>• Three</td>
<td>16.3</td>
<td>19.1</td>
<td>2,032</td>
</tr>
<tr>
<td>• Four of more</td>
<td>7.1</td>
<td>8.5</td>
<td>2,081</td>
</tr>
<tr>
<td>Age of household head</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• &lt; Age 25</td>
<td>14.9</td>
<td>14.5</td>
<td>1,685</td>
</tr>
<tr>
<td>• 25-34</td>
<td>37.7</td>
<td>38.8</td>
<td>1,785</td>
</tr>
<tr>
<td>• 35-44</td>
<td>34.1</td>
<td>35.2</td>
<td>1,794</td>
</tr>
<tr>
<td>• &gt; or = 45</td>
<td>13.3</td>
<td>11.5</td>
<td>1,498</td>
</tr>
<tr>
<td>TANF Participation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• On TANF</td>
<td>9.3</td>
<td>10.0</td>
<td>1,873</td>
</tr>
<tr>
<td>• Not on TANF</td>
<td>90.7</td>
<td>90.0</td>
<td>1,721</td>
</tr>
<tr>
<td>Poverty Status²</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Poor</td>
<td>37.1</td>
<td>46.8</td>
<td>2,191</td>
</tr>
<tr>
<td>• Non poor</td>
<td>62.9</td>
<td>53.2</td>
<td>1,466</td>
</tr>
<tr>
<td>Income-to-Needs Ratio³</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• &lt; 0.5</td>
<td>11.0</td>
<td>9.1</td>
<td>1,430</td>
</tr>
<tr>
<td>• 0.5-1</td>
<td>26.1</td>
<td>37.8</td>
<td>2,512</td>
</tr>
<tr>
<td>• 1-1.5</td>
<td>28.7</td>
<td>32.0</td>
<td>1,933</td>
</tr>
<tr>
<td>• 1.5-2</td>
<td>22.3</td>
<td>15.0</td>
<td>1,166</td>
</tr>
<tr>
<td>• &gt; or = 2</td>
<td>11.9</td>
<td>6.2</td>
<td>901</td>
</tr>
<tr>
<td>Race/Ethnicity</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Non-Hispanic</td>
<td>52.1</td>
<td>48.8</td>
<td>1,627</td>
</tr>
<tr>
<td>• White</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Non-Hispanic</td>
<td>22.5</td>
<td>23.7</td>
<td>1,825</td>
</tr>
<tr>
<td>• Black</td>
<td>21.7</td>
<td>23.6</td>
<td>1,886</td>
</tr>
<tr>
<td>• Hispanic</td>
<td>3.7</td>
<td>3.9</td>
<td>1,819</td>
</tr>
<tr>
<td>• Other</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>EITC Stage</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Phase-in</td>
<td>24.1</td>
<td>23.8</td>
<td>1,714</td>
</tr>
<tr>
<td>• Stationary</td>
<td>13.7</td>
<td>21.4</td>
<td>2,698</td>
</tr>
<tr>
<td>• Phase-out</td>
<td>62.1</td>
<td>54.7</td>
<td>1,537</td>
</tr>
<tr>
<td>Refundable Status</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Refundable</td>
<td>82.4</td>
<td>94.4</td>
<td>2,009</td>
</tr>
<tr>
<td>• Nonrefundable</td>
<td>17.6</td>
<td>5.6</td>
<td>524</td>
</tr>
</tbody>
</table>


Notes:

¹The Credit is the amount before subtracting a family’s federal income tax liability.

²Poverty status is determined by comparing a family’s pre-tax cash income against the poverty threshold.

³The income-to-needs ratio is a family’s pre-tax cash income divided by the poverty line.
Table 3.3 Antipoverty Effectiveness of the EITC under the Law prior to OBRA93 and under OBRA93 when fully phased in by 1996.

<table>
<thead>
<tr>
<th>EITC eligible taxpayers with incomes above the poverty line (millions)</th>
<th>Prior Law</th>
<th>OBRA 93</th>
</tr>
</thead>
<tbody>
<tr>
<td>EITC payments to these households (millions $)</td>
<td>6,224</td>
<td>8,994</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>EITC eligible taxpayers with incomes below the poverty line (millions)</th>
<th>Prior Law</th>
<th>OBRA 93</th>
</tr>
</thead>
<tbody>
<tr>
<td>EITC payments to these households (millions $)</td>
<td>5,820</td>
<td>9,020</td>
</tr>
<tr>
<td>Pre-EITC poverty gap (millions $)</td>
<td>20,156</td>
<td>23,982</td>
</tr>
<tr>
<td>Post-EITC poverty gap (millions $)</td>
<td>14,544</td>
<td>17,574</td>
</tr>
</tbody>
</table>

Number of households taken out of poverty by the EITC (millions) 0.909 1.380


Note: The poverty gap is defined as the difference between cash income (the sum of earnings, dividends, interest, social security, public assistance, SSI, veterans payments, pensions, unemployment, and alimony) and the poverty line.

extension of the EITC to childless workers between the ages of 25 and 64, the number of taxpayers eligible for the EITC below the poverty line has increased by approximately 33 percent. The relatively minor effect of the EITC on the poverty gap is a direct result of the program’s focus on the working poor. The current EITC parameters were chosen to ensure that families with a full-time minimum wage worker would not be poor. However, many poor children are in households that do not contain a full-time worker.

The EITC has been successful at helping the working poor near the poverty line, and the working poor female headed households. However, the 1993 OBRA extended the credit to more families with children above the poverty line, rather than under the poverty line. Unlike the CCTB, the EITC has a limited effect on the poverty gap, because it excludes the poor who do not have earned income, which is a greater percentage of the poor.

While the EITC’s targeting effectiveness could be improved, overall, its intended recipients are being reached. Scholz estimated in 1994, through data from tax returns and the SIPP, that 80-86 percent of taxpayers eligible for the EITC appeared to receive it in 1990.

The CCTB’s two-tier structure has enabled it to battle poverty more successfully. In addition, by making the basic credit available to 80 percent of Canadian families, it also ensures its popularity, as a large percentage of the population benefits from the credit. Table 3.4 illustrates the number of CCTB beneficiaries by family net income and type. Looking at the number of families receiving CCTB with one parent earning $15,000 or less, they consist of 71 percent of the overall number of families receiving CCTB, earning less than $15,000. Knowing that single-parent families are much more likely to be poor than two-parent families, it would appear that the CCTB is targeting this at-risk group. Digging further into these numbers, the overall number of one-parent families is only 32.5 percent of all families receiving CCTB benefits, while the two parent families are 67.5 percent of all beneficiaries. The largest group of beneficiaries is the two-parent group earning more than $30,000. They comprise 48 percent of all benefit recipients. They also receive the largest total amount of credit at 32 percent. However, considering that one-parent families earning under $15,000 comprise only 17 percent of CCTB recipients, they receive 25 percent of the total amount of the credit. The average credit per one parent family earning less than $15,000 is much higher. Without knowing the number of children per family, it is difficult to assess the average credit received by each child in each category, however, since the amounts for the first, second, and third child are almost identical, a rough estimate demonstrates that the lower income groups (under
$15,000 and $15,001 - $26,000) receive higher credits than the other two income groups. Yet, the average credit for the $15,000 or less group is not significantly higher than the average credit for the $15,001 - $26,000 group.

The NCBS data reflects what one would expect for the most part. By adding together the one and two parent groups earning less than $15,000, the percentage of the NCBS credit received by these families is 59 percent of the total NCBS credit. Since the NCBS is meant to aid low-income earners under $22,000, it would appear that it is achieving its goal. The $15,001 - $26,000 category is 37 percent of the total credit, indicating that 96 percent of those who receive the NCBS credit earn less than $26,000. This data seems to confirm that the NCBS is reaching its target.

The 1999 federal budget applied the previous years’ data to demonstrate the family type pattern that should be observed with the 2000 budget increases. It projected that over three-quarters of all CCTB benefits would go to one-earner families and single-parent families. The data displayed in Table 3.4 confirms the pattern projected by the 1999 federal budget in figure 3.1.

As the CCTB is not only attempting to combat child poverty, but also trying to create horizontal equity for all Canadian families, the data observed in Table 3.4 is not shocking. The basic tier of the CCTB is distributed to 80 percent of all Canadian families, as the break-even income level is close to $70,000, and therefore likely to be received by many in the above $30,000 category.

Comparing the target efficiency of the EITC and the CCTB, it would appear that the NCBS allows the CCTB to be more successful at targeting its intended recipients, as it exists solely to aid low-income families. Furthermore, since welfare recipients may
Table 3.4 Canada Child Tax Benefit Beneficiaries by Family Net Income, Family Type and CCTB/NCB Supplement (NCBS), July 2000–June 2001.

<table>
<thead>
<tr>
<th>Family Net Income</th>
<th>One Parent Families</th>
<th>Two Parent Families</th>
<th>All Families</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Children with CCTB</td>
<td>Families with CCTB</td>
<td>$ CCTB paid</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• $15,000 or less</td>
<td>905,984</td>
<td>543,940</td>
<td>1,786,462,741</td>
</tr>
<tr>
<td>• $15,001 – $26,000</td>
<td>398,034</td>
<td>245,317</td>
<td>740,565,334</td>
</tr>
<tr>
<td>• $26,000–$30,000</td>
<td>94,159</td>
<td>61,967</td>
<td>121,836,998</td>
</tr>
<tr>
<td>• More than $30,000</td>
<td>289,021</td>
<td>192,879</td>
<td>237,097,966</td>
</tr>
<tr>
<td>Total</td>
<td>1,687,198</td>
<td>1,044,103</td>
<td>2,885,963,038</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Family Net Income</th>
<th>Children with CCTB</th>
<th>Families with CCTB</th>
<th>$ CCTB paid</th>
<th>Children with NCBS</th>
<th>Families with NCBS</th>
<th>$NCBS paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>• $15,000 or less</td>
<td>444,478</td>
<td>220,505</td>
<td>878,656,946</td>
<td>444,478</td>
<td>220,505</td>
<td>358,102,504</td>
</tr>
<tr>
<td>• $15,001 – $26,000</td>
<td>553,647</td>
<td>279,847</td>
<td>1,047,357,390</td>
<td>553,647</td>
<td>279,847</td>
<td>401,704,850</td>
</tr>
<tr>
<td>• $26,000–$30,000</td>
<td>223,572</td>
<td>115,610</td>
<td>306,167,690</td>
<td>223,251</td>
<td>115,492</td>
<td>46,493,557</td>
</tr>
<tr>
<td>• More than $30,000</td>
<td>2,959,897</td>
<td>1,553,448</td>
<td>1,908,973,274</td>
<td>27,456</td>
<td>5,894</td>
<td>3,515,923</td>
</tr>
<tr>
<td>Total</td>
<td>4,181,594</td>
<td>2,169,410</td>
<td>4,141,155,301</td>
<td>1,248,832</td>
<td>621,738</td>
<td>809,816,835</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Family Net Income</th>
<th>Children with CCTB</th>
<th>Families with CCTB</th>
<th>$ CCTB paid</th>
<th>Children with NCBS</th>
<th>Families with NCBS</th>
<th>$NCBS paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>• $15,000 or less</td>
<td>1,350,462</td>
<td>764,445</td>
<td>2,665,119,687</td>
<td>1,349,625</td>
<td>764,002</td>
<td>1,103,651,223</td>
</tr>
<tr>
<td>• $15,001 – $26,000</td>
<td>951,681</td>
<td>525,164</td>
<td>1,787,922,724</td>
<td>951,325</td>
<td>524,974</td>
<td>702,296,831</td>
</tr>
<tr>
<td>• $26,000–$30,000</td>
<td>317,731</td>
<td>177,577</td>
<td>428,004,689</td>
<td>317,277</td>
<td>177,389</td>
<td>65,479,217</td>
</tr>
<tr>
<td>• More than $30,000</td>
<td>3,248,918</td>
<td>1,746,327</td>
<td>2,146,071,240</td>
<td>29,777</td>
<td>6,524</td>
<td>3,725,394</td>
</tr>
<tr>
<td>Total</td>
<td>5,868,792</td>
<td>3,213,513</td>
<td>7,027,118,339</td>
<td>2,648,004</td>
<td>1,472,889</td>
<td>1,875,152,665</td>
</tr>
</tbody>
</table>

Source: Canada Customs and Revenue Agency
Notes: The CCTB includes the NCBS.

Figure 3.1 CCTB Recipients: Percentage of total benefits by family type, 2000.

Source: Budget 1999
Note: The percentages are provisions for the year 2000.
receive the CCTB without penalty to their welfare income; it elevates more people out of poverty. In contrast, the NCBS is deducted from welfare benefits. This is not reflected in the data in Table 3.4, as the payments are made to welfare beneficiaries on a monthly basis, and then deducted from the amount of welfare they receive from their respective provinces, therefore, the impressive targeting seen by the under $15,000 group in Table 3.4 may not be quite as impressive in reality.

The effects of the Earned Income Tax Credit and the Canada Child Tax Benefit on welfare caseload and employment rates

The effects of the EITC and the CCTB on welfare caseload and employment rates are difficult to assess as these two indicators are influenced by many factors other than the two benefit programs. Several studies have been conducted on both programs to determine whether they have had an effect on welfare caseload and whether they have led to increases in employment rates.

With the reform of the welfare legislation in 1996, programs such as the EITC are more important than ever. As most states have five-year limits on welfare benefits and sanctions on benefits for recipients who do not regain in part or in full the labor force after 24 months, other programs must be in place to help in the welfare to work transition. As families move from welfare to full-time minimum wage work, a considerable portion of the increase in income is due to the EITC. Without federal and state EITC programs, a Mississippi family of three moving from no work to part-time work at minimum wage, would receive a 67 percent increase in income; however, when the EITC is included, the increase is 108 percent. If the same family of three lived in the state of New York, it
would benefit from an increase of 19 percent if it moved from no work to part-time
minimum wage work; however, when the EITC is included the increase is 45 percent.88

The EITC acts as a work incentive program by providing supplements to low-income
earners. Recent studies have concluded that the EITC increases employment, earnings,
and income, especially among single-parent families. These studies (Meyer and
Rosenbaum, 1998; Eissa and Liebman, 1996; Smeeding, Ross and O’Connor, 1999)
attribute much of the recent and dramatic rise in single-parent labor force participation
rates to the EITC. As the generosity of the EITC has increased over the years, so has
women’s participation in the labor force.

Eissa and Liebman examined the 1986 EITC expansion to estimate its effects on the
employment of single women and their hours of work. To isolate those affected by the
policy from those who were not, they treated single women with children as their
experimental group and single women without children as their control group. They
found that the 1986 EITC changes increased employment among all single women with
children by as much as 2.8 percentage points (from a base of 74.2 percent). They also
found that single women with children with less than a high school education’s
employment increased by six percent.89

In 1999, Meyer and Rosenbaum further reinforced these findings in their analysis of
the effects of the EITC and other policy changes on the employment of single women.
Their study takes into account, more than any other study in the literature of the EITC,

Market Participation of Families on Welfare”, Joint Center for Poverty Research, Working Paper 214
(January 2001) : 12.
changes that occurred over the last two decades. Furthermore, their study nets out the influence of changes in other policies, both over time and across place of residence in order to isolate the influence of the EITC. Meyer and Rosenbaum studied the employment statistics of single women from 1984-1996. They found that EITC changes accounted for 63 percent of the increase in the employment rate of single mothers from 1984 to 1996 and 37 percent of the increase from 1992 to 1996.\(^\text{90}\) The annual labor force participation rate among single women with children rose from 72.7 percent in 1984 to 82.1 percent in 1996.\(^\text{91}\) The increase in participation has been particularly significant among less-educated women. Between 1984 and 1996, the annual participation rate of single women with children and less than a high-school education rose from 46.8 to 58.8 percent.\(^\text{92}\) The increase in labor force participation among women with children reflects a decline in the number of people who receive welfare without working.

Table 3.5 demonstrates how the percentage of women who receive welfare and do not work during the year has decreased from 20.8 percent in 1984 to 10.8 percent in 1996. In return, this has resulted in a 9.5 percentage point increase in the share of single women with children that work at least part of the year, while only a 0.5 percentage point increase in the number of single women who do not work and do not receive public assistance.

While some may point to the market and economic growth to explain the increase in the labor-market activity of single women with children, a comparison of single women with children and without children demonstrates that the labor force participation of

\(^\text{90}\) Ibid.  
\(^\text{92}\) Ibid., 97.
Table 3.5 Labor Market and Welfare Participation of Single Women with Children, 1984-1996.

<table>
<thead>
<tr>
<th>Year</th>
<th>Work and receive no welfare during the year</th>
<th>Work and receive welfare during the year</th>
<th>Receive welfare and do not work during the year</th>
<th>Neither work nor receive welfare during the year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1984</td>
<td>62.9</td>
<td>9.7</td>
<td>20.8</td>
<td>6.6</td>
</tr>
<tr>
<td>1985</td>
<td>61.9</td>
<td>11.5</td>
<td>20.1</td>
<td>6.6</td>
</tr>
<tr>
<td>1986</td>
<td>61.0</td>
<td>11.8</td>
<td>20.4</td>
<td>6.9</td>
</tr>
<tr>
<td>1987</td>
<td>61.6</td>
<td>12.2</td>
<td>18.9</td>
<td>7.3</td>
</tr>
<tr>
<td>1988</td>
<td>62.7</td>
<td>11.6</td>
<td>19.4</td>
<td>6.4</td>
</tr>
<tr>
<td>1989</td>
<td>65.3</td>
<td>10.5</td>
<td>17.7</td>
<td>6.4</td>
</tr>
<tr>
<td>1990</td>
<td>62.8</td>
<td>13.1</td>
<td>17.9</td>
<td>6.3</td>
</tr>
<tr>
<td>1991</td>
<td>61.4</td>
<td>12.6</td>
<td>19.4</td>
<td>6.6</td>
</tr>
<tr>
<td>1992</td>
<td>60.9</td>
<td>12.8</td>
<td>19.3</td>
<td>6.9</td>
</tr>
<tr>
<td>1993</td>
<td>61.2</td>
<td>14.2</td>
<td>18.0</td>
<td>6.6</td>
</tr>
<tr>
<td>1994</td>
<td>64.5</td>
<td>14.6</td>
<td>14.3</td>
<td>6.6</td>
</tr>
<tr>
<td>1995</td>
<td>67.2</td>
<td>13.3</td>
<td>12.4</td>
<td>7.1</td>
</tr>
<tr>
<td>1996</td>
<td>68.6</td>
<td>13.5</td>
<td>10.8</td>
<td>7.1</td>
</tr>
</tbody>
</table>


Single women without children has actually decreased. Figure 3.2 reveals the labor participation trend of both women with and without children from 1984 to 1996. It demonstrates how the participation rate of women without children has fallen, while participation among women with children has risen dramatically. Indeed, among low-educated single women without children the participation rate has fallen from 78.3 to 72.3 percent since 1984.93

Further critics may argue that the EITC is not necessarily the culprit behind the rise in labor force participation by single mothers. However, the Eissa and Liebman study tested the effect of the Tax Reform Act of 1986 (TRA86) expansion of the EITC by

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93 Ibid., 98.
comparing the labor-force behavior of single women with children (who were eligible for the credit) with the labor-force behavior of single women without children (who were ineligible), before and after the expansion. The other aspects of TRA86, such as the increase in the value of dependent exemptions and of the standard deduction, simply reinforced the EITC expansion by increasing the return to work for single women with children more than it did for single women without children. The total size of the "natural experiment" was equivalent to a $1,331 (1996 dollars) increase in the maximum EITC. The study carefully controlled for other factors that might have caused the trends. It concludes that TRA86 increased labor-force participation among single women with children by 2.8 percentage points, from 73.0 to 75.8 percent. This implies that an extra 164,000 women entered the labor force.94

94 Ibid., 99.
Based on Liebman and Eissa's analysis, if it is assumed that there is a constant relationship between the dollar value of the maximum EITC and the percentage of single women with children who work at some point during the year, then in 1998 there would have been 405,000 taxpayers who were working because of the EITC, and would have been non-working welfare recipients in its absence. Furthermore, the study implied that the EITC was responsible for 59 percent of the increase in labor force participation that occurred between 1984 and 1996.\(^\text{95}\)

Meyer and Rosenbaum's 1997 study modeled state welfare policies and labor-market conditions, as well as the level of the EITC, in order to determine the relative importance of each factor. They found that state welfare policies and labor-market conditions accounted for only a slight share of the relative increase in labor force participation among single women with children, and that the timing of the increases in EITC corresponded closely with increases in labor force participation.\(^\text{96}\) However, it is unlikely that EITC recipients respond so quickly to the expansions in the credit. It would take a couple of years for them to realize the effect of the credit on their income.

Labor supply theory suggest that the EITC will cause some secondary earners in married couples to leave the labor force. However, so far there is little evidence to support these claims. Even if the EITC were causing a large decrease in participation by secondary earners, the decrease might not be a reason for concern. If families respond to the additional income from the EITC by deciding that the secondary earner should consume more leisure, then there is no deadweight loss from the reduction in participation. There would only be deadweight loss if the reduction in the net wage due

\(^{95}\) Ibid., 100.

\(^{96}\) Ibid., 101.
to the phase out of the credit caused the secondary earner to leave the labor force.\footnote{Ibid., 102.}

While the EITC encourages work for the most part, like other programs, it has a phase-out range. In the phase-in range, taxpayers are encouraged to work more in order to receive a larger credit. In the flat range, taxpayers do not earn a larger credit if they work more hours, still, the amount of the credit is not reduced if they work more hours (provided they stay in the flat range). However, once taxpayers earn enough to be in the phase-out range, the incentive to work more hours is no longer present. As sixty percent of EITC recipients are in the phase-out range since the OBRA93 expansion, many have expressed concerns over the work disincentives of the credit. Twenty three percent of EITC eligible taxpayers are in the phase-in range, while sixteen percent are in the flat range, therefore thirty nine percent of taxpayers have incentives to work more or at least not decrease their work hours.\footnote{Scholz, “Tax Policy and the Working Poor”, 8.}
While this schedule may not be ideal, it is nevertheless more likely to encourage work than other cash-transfer programs. Furthermore, this is under the assumption that taxpayers understand the EITC system; that they consciously calculate the credit amount that supplements their income level to ensure that they do not earn above a certain amount. This would require the taxpayer to receive the credit at least twice to compare with more work and less work and then adjust his behavior in the third year, assuming that the household wages and incomes remained fixed during the three years and all other factors stayed the same. In 1988, only thirty eight percent of EITC recipients had filed tax returns claiming the EITC in the previous two years. Thirty three percent of the recipients were receiving the credit for the first time. Therefore, the majority of recipients was receiving the credit for the first time and would not have had the opportunity to learn about its marginal incentives from previous experience with the credit. The lack of opportunity to learn about the EITC incentives is in sharp contrast to the frequent opportunities to learn of incentives in the welfare system and in the parts of the income-tax system that affect regular paychecks.

In terms of the EITC effect on welfare caseload, it is quite difficult to analyze due to several reasons. First, AFDC/TANF beneficiaries usually start to work for a number of reasons and not simply for one benefit. Second, the new welfare legislation (1996) has significantly changed the way the welfare system operates. Current welfare beneficiaries have a five-year lifetime benefit limit and in most states they need to regain the workforce in some capacity within two years. Therefore, the restructuring of the welfare program has drastically reduced the number of welfare recipients and the amount being

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spent on welfare by the governments. Between 1990 and 1994, the number of families receiving assistance from Aid to Families with Dependent Children (AFDC) exploded by 27 percent, while between 1994 and 1999 the number plunged by nearly 50 percent.\(^\text{100}\) Researchers have attributed the decline in welfare caseload to two sources: 1-the longest economic expansion in U.S. history; 2-the radical changes in social policy. Among the policy changes, two particularly stand out: expansions in the EITC, and welfare reform, implemented through state level waivers from federal rules in the early 1990s and through federal legislation in 1996. The problem, however, is determining the extent to which the economy and policy reforms have affected the rapid changes in welfare caseload.

Looking at the welfare caseload trends in the 1980s in comparison to the 1990s, one can look at the effect of the economy on caseload to determine why it had a greater effect in the 1990s than in the 1980s. The growth in labor productivity in the 1990s allowed employers to reach deep into the lower tail of the income distribution for workers and to reward them with higher real wages. In contrast, during the 1980s falling real wage rates for low-wage workers had resulted in falling real incomes and inevitably upward pressure on welfare caseload. Furthermore, the expansion in the 1990s was experienced in all regions across the United States. In contrast, in the late 1980s the auto and steel industries recovered, but the oil industry experienced a bust, which led to recessions in Texas and some Rocky Mountain States, and increases in AFDC and Food Stamp caseloads. The mid-to-late 1990s did not experience such regional shocks. This

undoubtedly led to decreases in welfare caseloads based more largely on the economy than on the welfare reforms.\textsuperscript{101}

However, once the effects of the welfare reform and the economy on welfare caseloads are taken into account, a sizeable amount of decline remains unexplained. There is no specific numbers on the effect of the EITC on welfare caseload decline because the studies use state-level panel data, and the EITC expansions affected all states at the same time. This implies that it is not possible to distinguish the effects of the EITC from the effects of the aggregate factors that might affect simultaneously state-level caseload movements such as national unemployment rates, oil price shocks, and even presidential elections. Indeed, there might even be a larger dimension to welfare reform that is entwined with the EITC and other national forces (national political pressure).\textsuperscript{102}

Table 3.2 (on page 56) looks at the characteristics of families with children who received EITC in 1997. It found that 9.3 percent of EITC recipients were on TANF. Furthermore, this 9.3 percent received 10 percent of the overall credit. Recipients receive a relatively high credit amount, on average $1,873 per year or $153 month. This monthly payment is quite large, especially in states such as Mississippi where TANF payments are quite low. However, the EITC payments depend on the income disregards of the states. If the disregards are too steep, than the TANF recipients will not benefit from the EITC. However, TANF recipients gained the least from the EITC in terms of its anti-poverty effects because most TANF recipients are well below the poverty line and need very large increases in annual income to be lifted out of poverty.

\textsuperscript{101} Ibid., 32.
\textsuperscript{102} Ibid.
The CCTB is somewhat different than the EITC as its basic tier is offered to 80 percent of families, regardless of their source of income. Welfare beneficiaries can receive the first-tier, the basic Child Tax Benefit. However, the second-tier, the NCBS, functions in a similar manner as the EITC, as it targets only low-income families by acting as a wage supplement. Therefore, the NCBS credit counts as income for welfare recipients and is subtracted from their benefits. Few studies have been conducted on the CCTB’s effect on employment due to its recent enactment, and because only one-tier of the benefit is meant to specifically act as a work incentive. One study that has been carried out, tracked where low-income families received their income from 1984 to 1999. Figure 3.5 demonstrates that government transfers continue to play an important role as a source of family income for low-income families. In keeping with the economic recovery in the 1990s, an increasing proportion of the income of low-income families

came from employment earnings. In 1992, low-income families earned on average $3,780. This amount represented approximately 23 percent of the total income of low-income families. In 1999, low-income families earned on average $4,825, which represented 26 percent of their total income.¹⁰³

![Figure 3.5 Sources of Family Income, Low-Income Families with Children, Pre-Tax LICOs (expressed in 1999 dollars).](image)

Furthermore, the proportion of low-income families, in which the parents had paid employment, increased in the late 1990s. As Figure 3.6 illustrates, the proportion of low-income families with children, in which at least one parent was employed for pay during the year, increased from 59.4 percent in 1994 to 67.2 percent in 1999. The proportion of one-parent families employed for pay rose from 42.5 percent to 53.4 percent over the same period.¹⁰⁴

¹⁰³ Federal, Provincial and Territorial Ministers, National Child Benefit Progress Report.
¹⁰⁴ Ibid.
Families on social assistance also declined in the 1990s. The number of one-parent families relying on social assistance declined from 472,500 households in March 1995 to 306,300 in March 2000. While the number of two-parent families with children decreased from 178,600 to 105,700 households over the same period. As a result, the number of children living in families relying on social assistance decreased by 440,400 between 1995 and 2000. Narrowing the period from March 1998 to March 2000, the number of two-parent families in receipt of social assistance decreased by 28.2 percent while the number of one-parent families receiving social assistance decreased by 23.8 percent. By comparing the reduction in caseloads of families with children to that of families without children over the same period, we can see that two-parent family welfare caseload numbers decreased by 28.2 percent while those of couples without children
decreased by only 7.0 percent.\textsuperscript{105} This reduction in welfare caseload is due to economic growth, welfare reform and other factors such as the CCTB.

While these indicators are encouraging, they do not reflect a direct link to the CCTB. Since the two-tier program has only been in existence for four years, no studies or data are available to link the CCTB to employment or welfare caseload changes. However, all economic indicators such as decreases in unemployment, welfare caseload, and poverty rate for children and their parents seem to indicate that the CCTB is having a positive effect, however, the extent of the effect is yet to be known.

\textbf{The effect of the Earned Income Tax Credit and the Canada Child Tax Benefit on poverty level and poverty gap}

The EITC and the CCTB both have a common goal of reducing poverty among families and, specifically, among children. Both programs serve as work incentives by attempting to reduce dependence upon the welfare system, and increasing the “permanent” attachment to the workforce by reducing marginal costs of reintegrating the

\textsuperscript{105} Ibid.
workforce. The belief is that if the programs are successful at doing this, then poverty caused by unemployment will be reduced.

Several studies have been performed on the EITC to determine its effect on poverty rates and poverty gap. In 1997, Rebecca Kim studied the effects of the EITC on poverty rate and poverty gap by measuring the effect of the EITC on the percentage increase in disposable income and the percentage reductions in poverty rate and poverty gap. She found that the EITC increased the disposable income of families with children under age 18 by only 1.2 percent. However, recipient families with children saw an increase of 9.9 percent in their disposable income. She also found that the poverty rate for all families with children under 18 in 1997 was 19.2 percent; 11.8 percent for those ineligible for the EITC and 37.1 percent for those eligible for the EITC. The EITC contributed to a modest decline in child poverty by decreasing the overall poverty rate from 19.2 percent to 16.2 percent (a 15.6 percent decrease) and the total poverty gap from $53.1 billion to $45.4 billion (a 14.6 percent decrease). The limited effect on the overall child poverty rate is due to the fact that EITC benefits are limited to working low-income families and that 63 percent of the recipient families were non-poor.

Table 3.6 indicates that the EITC reduced poverty to a larger degree for the recipient families (with children under age 18) by reducing their poverty rate by 27.2 percent and the poverty gap by 33.0 percent. Furthermore, the Table shows that as the number of children increased in a family, so did the poverty rate. In particular, families with four or more children showed a high poverty rate (67.2 percent), yet the EITC helps this poorest group the least by only reducing their poverty rate and poverty gap by 14.0 percent and 27.7 percent respectively. While the U.S. poverty thresholds take into account the
number of children in a family, the EITC does not adjust for families with more than two children.

Families on TANF were also among the poorest groups with a poverty rate of 71.6 percent. However, the EITC only reduces the rate by 16.3 percent and the poverty gap by 26.0 percent. The Table further indicates that families with incomes between 50 and 100 percent of the poverty line escaped poverty by receiving the EITC, however, no families with incomes below 50 percent of the poverty line were able to escape poverty through the EITC, and moreover, their poverty gap was only reduced by 14.2 percent. This would point to the fact that the EITC does not aid families without earned income, and that perhaps, the credit is not generous enough to reach those well below the poverty line. Scholz estimated in 1994 that only 36 percent of EITC payments go toward reducing the poverty gap, while the remaining 64 percent is received by taxpayers above the poverty line. Scholz further estimated that 17 percent of EITC-eligible taxpayers do not claim the credit, 35 percent of poor households have no earning, and the EITC raises some recipient households only part of the way to the poverty line, resulting in poverty gap offset of only 12 percent for households with children.106 Only about 40 percent of households with incomes below 50 percent of the poverty line receive the EITC, while 80 percent of households with incomes between 100 percent and 150 percent of the poverty line receive the EITC.107

In 2001, with the economic recovery slowing down, the depth of poverty increased. The average amount by which individuals who were poor fell below the poverty line rose to $2,707 per poor person in 2001. This is the largest per person poverty gap since the

107 Ibid., 91.
Data has been recorded (1979). The average amount by which poor children fell below the poverty line also increased, reaching its highest point since 1979. Data indicates that children were poorer on average in 2001 than any other year since 1979 because the safety net programs did less last year than any other year since 1979. Furthermore, the limited amount of the EITC is clearly not enough to combat the effects of the welfare reforms and economic slowdown.

Table 3.6 The Effects of the EITC on Poverty Rate and Poverty Gap for Families with Children Under Age 18: 1997.

<table>
<thead>
<tr>
<th>Family Type</th>
<th>Poverty Rate</th>
<th>Poverty Gap</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No EITC (%)</td>
<td>W/EITC (%)</td>
</tr>
<tr>
<td>All families w/children (n=19,549)</td>
<td>19.2</td>
<td>16.2</td>
</tr>
<tr>
<td>Ineligible families w/children (n=3,653)</td>
<td>11.8</td>
<td>11.8</td>
</tr>
<tr>
<td>EITC families w/children (n=5,896)</td>
<td>31.5</td>
<td>22.6</td>
</tr>
<tr>
<td></td>
<td>42.9</td>
<td>31.9</td>
</tr>
<tr>
<td></td>
<td>30.0</td>
<td>19.7</td>
</tr>
<tr>
<td>No. of qualifying children</td>
<td>31.7</td>
<td>23.1</td>
</tr>
<tr>
<td></td>
<td>33.1</td>
<td>21.7</td>
</tr>
<tr>
<td></td>
<td>46.3</td>
<td>36.7</td>
</tr>
<tr>
<td></td>
<td>67.2</td>
<td>57.8</td>
</tr>
<tr>
<td>Age of household head</td>
<td>53.8</td>
<td>40.9</td>
</tr>
<tr>
<td></td>
<td>38.1</td>
<td>28.5</td>
</tr>
<tr>
<td></td>
<td>45.5</td>
<td>36.7</td>
</tr>
<tr>
<td></td>
<td>48.8</td>
<td>38.5</td>
</tr>
<tr>
<td>TANF participation</td>
<td>71.6</td>
<td>59.9</td>
</tr>
<tr>
<td></td>
<td>33.6</td>
<td>23.8</td>
</tr>
<tr>
<td>Income-to-needs ratio</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td></td>
<td>100.0</td>
<td>59.6</td>
</tr>
<tr>
<td>EITC Stage</td>
<td>84.4</td>
<td>78.9</td>
</tr>
<tr>
<td></td>
<td>67.2</td>
<td>37.1</td>
</tr>
<tr>
<td></td>
<td>11.8</td>
<td>4.9</td>
</tr>
<tr>
<td>Refundable Status</td>
<td>45.4</td>
<td>32.7</td>
</tr>
<tr>
<td></td>
<td>0.2</td>
<td>0.2</td>
</tr>
</tbody>
</table>


Estimates report that 2.5 million children are lifted out of poverty every year due to the EITC. However, since in 2001 there were 17.8 million children below the poverty
line. This means that the EITC has only reached out to 14 percent of children living in poverty. Clearly, much more is needed for the EITC to seriously combat poverty. Seeing as the program has low administrative costs and its intended recipients are being targeted, there is no reason why the EITC cannot be further increased in order for the program to become a major anti-child poverty tool in the United States.

The CCTB had similar effects upon child poverty rates. In 1999, the CCTB was reported to have increased the income of 1.2 million families with 2.1 million children. Furthermore, the low-income gap was reduced by 6.5 percent, and the number of children living in low-income families was reduced from its high of 1,499,000 in 1996 to 1,298,000 in 1999. Figure 14 shows that the number of low-income families with children is still on the decline. After declining from a peak of 20.4 percent in 1996 to 17.9 percent in 1998, the incidence of low-income families with children dropped to 17.2 percent in 1999. But 17.2 percent is still much higher than the 1989 low of 14.6 percent. The reduction translates into 16,500 families with 33,800 children moving above the LICOs between 1998 and 1999 as 668,800 families with children lived in low income. If the CCTB had not been introduced, 17.6 percent rather than 17.2 percent of families with children would have lived in low income. In other words, 685,300 families would have lived in low income if not for the CCTB. Of the 16,500 families that left low income, about 10,800 were two-parent families with 23,000 children and 5,200 were single-parent families with 10,200.

The introduction of the CCTB led to a low-income gap reduction of $400 million. The decline in low-income gap for two-parent families was $235 million, a decline of 7.5

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78
percent in the low-income gap during that year. For one-parent families the decline was $160 million or 5.5 percent.

Figure 3.8 Percentage of Low-Income Families with Children: LICOs and LIM, 1984-1999.

Table 3.7 Change in Families with Children Living in Low Income: January to December 1999.

<table>
<thead>
<tr>
<th>SLID 1999</th>
<th>ONE-PARENT FAMILIES</th>
<th>TWO-PARENT FAMILIES</th>
<th>ALL FAMILIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>PRE-TAX LICOS</td>
<td>Decline in Number of Children Living in Low Income</td>
<td>10,200</td>
<td>23,000</td>
</tr>
<tr>
<td></td>
<td>Decline in Number of Families Living in Low Income</td>
<td>5,200</td>
<td>10,800</td>
</tr>
<tr>
<td></td>
<td>Percentage Change in Number of Families Living in Low Income</td>
<td>-1.6%</td>
<td>-3.2%</td>
</tr>
<tr>
<td></td>
<td>Decline in Incidence of Low Income Among Families with Children*</td>
<td>0.7</td>
<td>0.3</td>
</tr>
</tbody>
</table>

Source: Based on Statistics Canada special tabulations from the SLID 1999.
*Decline in incidence of low income is expressed in percentage points.
Table 3.8 Changes in the Depth of Low Income: January to December 1999.

<table>
<thead>
<tr>
<th>SLID 1999 PRE-TAX LICOS</th>
<th>ONE-PARENT FAMILIES</th>
<th>TWO-PARENT FAMILIES</th>
<th>ALL FAMILIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decline in the Low-Income Gap (in millions of dollars)</td>
<td>$160</td>
<td>$235</td>
<td>$400</td>
</tr>
<tr>
<td>Percentage Change in the Low-Income Gap</td>
<td>- 5.5%</td>
<td>- 7.5%</td>
<td>- 6.5%</td>
</tr>
</tbody>
</table>

*Source: Based on Statistics Canada special tabulations from the SLID 1999.*

The Compliance Issue

No other topic has been as controversial as compliance in the EITC literature.

Transfer payments through the tax system have lower administrative costs, but the trade-off is the higher noncompliance rate. While the EITC has managed to survive almost three decades, because it encourages work and because it supports only the “deserving” poor, however, it has been the subject of much criticism due to its high levels of noncompliance. The Internal Revenue Service has expended much energy in its attempts to reduce the noncompliance rate. The endeavors have had some success in the latter parts of the 1990s. However, attempts to reduce noncompliance have generated added expenses.

Concerns over noncompliance were first heard in the late 1980s to early 1990s when studies tabulated from the IRS’s Taxpayer Compliance Measurement Program (TCMP), first presented by Holtzblatt (1991) and Scholz (1990), indicated that one-third of 1985 and 1988 recipients should have been deemed ineligible for the credit. Over half the claims were disqualified because the recipients either did not have children or should not have claimed the child, while 30 percent were disqualified because they misreported
earnings or AGI. In 1998, 10.4 million claimed the EITC, however, only 7.1 million were entitled to the credit. Therefore, of the $5.6 billion in credit payment, ineligible recipients claimed nearly $2 billion. These figures were alarming due to the fact that programs such as the AFDC had noncompliance rates of 4 percent.

However, since 1988, the IRS has made changes to the eligibility rules in an attempt to reduce noncompliance. The first modifications in response to noncompliance took place in 1990. Congress eliminated the support test that had previously been in place. The support test had been established to prove that the taxpayer provided over half the support for the child who made him eligible for the EITC. Certain items that were counted as support for the child, but not provided by the taxpayer, included AFDC, child support, and public housing benefits. If the value of these items exceeded the taxpayer’s income (including the implicit rental value of owner-occupied housing), the taxpayer failed to meet the support test and was deemed ineligible for the EITC. While these guidelines were detailed in the rules accompanying the 1040 form, it seems unlikely that many taxpayers would be aware of them as they prepared their taxes. The support test was replaced with the restriction that the qualifying child had to live with the taxpayer more than half the year. By simplifying the rules of eligibility, the IRS hoped to significantly decrease noncompliance.

The 1990 legislation also added a new two-page form titled Schedule EIC. Taxpayers have to complete the first page to receive the credit. The first page details the rules of eligibility, and gathers information about the two youngest children (including

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their social security numbers), and on nontaxable income. The second page explains how to calculate the EITC.

Further studies were conducted on tax year 1994 to see if the 1990 changes had reduced the noncompliance rates. The IRS estimated that 25.8 percent of EITC or $4.4 billion (budget had tripled) was overclaimed. On the other hand, the study also demonstrated that some EITC eligible recipients failed to receive the full amount to which they were entitled. The amount totaled $293 million, or 1.7 percent of the total EITC claimed. Scholz also demonstrated in 1990 that 13.6 to 19.5 percent of eligible recipients had not claimed the benefit in tax year 1990.

In 1994, the General Agreement on Tariffs and Trade (GATT) required taxpayers to provide SSNs for all children, even those under the age of one. PRWORA 1996 permitted the IRS to reject the EITC claims of undocumented workers. It also allowed the IRS to reject both electronic returns with missing, invalid or duplicated SSNs, and to delay paper returns with similar problems until investigators could look into the claim.

Another study, conducted in tax year 1997, determined the noncompliance rate to be around $9.3 billion or 31 percent. Even in 1994 and 1997, failure to meet the residency test was the most common qualifying child error. Other errors were related to complicated living arrangements. When the child meets the rules to be a qualifying child of more than one person, the person with the highest AGI was the one who had to claim the child, even if the person with the highest AGI did not claim the child, the person with the lower AGI could not claim the child. This rule does not apply if the other person is the taxpayer’s spouse and they file a joint return. Misreporting of filing status was also a cause of error, as well as married taxpayers who filed as single or head of household,
when they should have filed as married filing separately. Individuals who file as married filing separately are not eligible for the EITC. The last major source of error was misreporting of earned income and underreporting of investment income.

The complexity of the EITC rules makes it difficult to assess whether the errors are due to fraud or mistakes. It is especially difficult to know the intent behind the taxpayers' actions. In the 1997 tax year study, the IRS estimated that one-half of the returns with an EITC overclaim were due to intentional errors. However, the assessments were judgmental and made without any specific criteria. Therefore, they were left out of the report because of their lack of preciseness.

The subsequent Taxpayer Relief Act of 1997 required paid tax return preparers to fulfill certain due diligence requirements when preparing EITC claims for taxpayers, allowed the IRS to deny the EITC for several years to taxpayers who failed an audit unless they could provide evidence of their eligibility through a recertification process, gave the IRS access to the Department of Health and Human Services' (HHS) Federal Case Registry of Child Support Orders (a federal database containing state information on child support payments) to detect erroneous claims by noncustodial parents, as well as requiring the Social Security Administration to collect SSNs of birthparents and provide the IRS with information linking the parents' and child's SSNs. Furthermore, Congress began providing funds ($143 million a year) for a five year EITC compliance initiative beginning in fiscal year 1998.

However, one must keep in mind that the EITC error percentage reported by the IRS is the number that is erroneously claimed and not the one that is erroneously paid out. The IRS does catch some errors. Consequently, in 1994, the actual percentage should
have been 20.7 percent. Furthermore, the study does not take into account underpayment, which is estimated around two percent. Therefore, the EITC is not that much higher than the error rate for income tax as a whole, which is approximately fifteen percent. Moreover, many elements of the income tax have much higher error rates. The IRS estimates that twenty to thirty percent of business income is not reported on tax returns. It is further estimated that $100 billion is lost every year due to errors and fraud in individual and corporate income tax. The EITC losses account for less than five percent of this amount. Unreported business income alone results in $40 billion in lost individual income tax collections, substantially more than the EITC’s entire cost.\(^{111}\)

However, studies have yet to be reported on the effects of the changes since 1997 on the EITC compliance rate. Once those are available, the compliance issue will be easier to evaluate.

The CCTB compliance rate has not been studied extensively due to the recentness of the program. However, the Child Tax Benefit, which is the first tier of the CCTB and has been in place since 1993, was studied during the tax year 1997-98 and results indicated that the overall payment level was accurate. However, the money was not always going to the right person. It was estimated that five to five and a half percent of the population was not being paid the right amount. Underpayments accounted for about $70-75 million while overpayments were estimated at $75-100 million. These numbers almost cancel each other out and represent a very small percentage of the $5 billion being paid a year.

Chapter 4
The future of the Earned Income Tax Credit and the Canada Child Tax Benefit

Findings
After having assessed the characteristics of the EITC and the CCTB, one could conclude that both programs have an effect on child poverty, however minor it is. It is estimated that the EITC raised 14 percent of poor children above the poverty line in 2001, while the CCTB raised 6 percent of low-income children above the LICO in 1998-1999, its first year of operation. The programs are only targeting a limited number of poor children. Most other industrialized countries have significantly lower child poverty rates because government transfers to the poor are considerably more generous.

Tax-transfer programs have certain advantages over other safety net programs. They have lower administrative costs, and since they tend to be based largely on labor earnings, they encourage work. Furthermore, they are an income-tested transfer, and therefore, based on need. Nonetheless, by discounting earnings from other sources, such as welfare payments, the impact of tax-transfer programs on the poverty rate and poverty gap is severely limited. While the first-tier of the CCTB applies social assistance income to its calculations, the second-tier, which is the more specific anti-child poverty tier, allows provinces to count the NCBS as income, and therefore, deduct the amount from welfare benefits, substantially reducing its ability to combat child poverty. Both the EITC and the NCBS are successful at helping the poor hovering near the poverty line, but
ineffective at helping those well-below the threshold, and therefore do not significantly affect the poverty gap.

While the EITC and the CCTB are income-tested transfers, they do not target need effectively. The EITC does not reach out to those in need without labor earnings, and the CCTB professes to reach out to those in need, only to subsequently deduct the transfer through income disregards of social assistance programs. Therefore, the EITC and the CCTB are successful at meeting the needs of families with "few needs." Those living well-below the poverty line must resort to social assistance, if it is even an option. As both the United States and Canada are now implementing "workfare" measures, welfare is no longer a program of last resort for all living in poverty. Those who cannot meet the new "welfare requirements" are left without options.

Overall, the EITC and the CCTB have been somewhat successful at targeting the intended recipients. The one-parent families, the lower-income families, and those with more than one child receive higher benefits. Unfortunately, the EITC's phase-in rate, established to encourage work, inhibits lower income families from receiving more benefits, as need would dictate. Furthermore, the lack of differentiation by family size larger than one or two children in the United States, limits the antipoverty effect of the EITC, as larger families have greater needs. Both these barriers to poverty reduction are unlikely to change, as they exist to encourage more work hours and smaller families among the poor. In contrast, the CCTB does not have a phase-in range, and therefore, awards the maximum credit to those in the "phase-in and stationary range" (actually one range). Furthermore, the CCTB takes family size and age of children (under seven) into account when delivering its benefits. Larger families receive larger benefits. However,
the per child supplements are not substantial, and therefore do not significantly reduce child poverty. Both the EITC and the CCTB award a large percentage of their credit to those above the poverty line. 63 percent of EITC beneficiaries are above the poverty line; while the CCTB statistics are not as clear-cut, nonetheless, 76 percent of recipient families earn more than $15,000 and 60 percent of recipient families earn more than $26,000. The percentage of families above the poverty line is quite similar for both programs. These statistics point to a need to restructure the programs to target more families below the poverty line if it is to take its goal of anti-child poverty seriously.

Tax-transfer programs are assumed to have an effect, even if limited, on employment rate. Since they lessen the marginal costs associated with returns to the workforce, they encourage individuals to enter the labor market. The EITC has been proven to increase the employment of single-mothers more than any other group. As this group tends to be poorer than other groups, these results are encouraging. However, a return to the workforce does not necessarily imply that the women and their families are moving above the poverty line. Due to its recentness, the CCTB has not yet been proven to have a positive effect on employment.

Welfare caseload effects are even more difficult to assess. Both the United States and Canada have undergone major reforms in their social policy, particularly in their programs of last resort (welfare) since the mid-1990s. Therefore, it is difficult to differentiate between welfare reforms, economy recovery, and expansions (or establishment) of the EITC and the CCTB, to measure the true impact of the latter on welfare caseload.
The EITC and the CCTB have had a positive effect on child poverty rate and gap, yet, their impact is limited and suggests that both programs provide the bare minimum to attest to their success and justify their existence. Nonetheless, both programs have the potential to be serious players in the fight against child poverty if their credit amounts are increased and they allow welfare recipients to benefit from the credits. Until these changes are enacted, both programs will remain limited, on the other hand; they will also remain uncontroversial and popular with the public.

**Proposed reforms to the Earned Income Tax Credit and the Canada Child Tax Benefit**

While many of the proposed reforms have been mentioned in passing in previous sections, they will be outlined in more detail in this section. As it stands, the EITC's contribution to the child poverty fight is modest. Most proposals to modify the EITC include increases in the credit rate and adjustments of benefits by family size. An across the board increase in the EITC would help more low-income families and make work more attractive relative to welfare. The larger credits are required to aid families with more than two children leave poverty since the current credit amounts do not take their needs into account. The EITC provides less assistance to larger families.

### Table 4.1 Low-Wage Work, EIC, and Poverty Status in 1988

<table>
<thead>
<tr>
<th>Family Size</th>
<th>Poverty Threshold</th>
<th>Year-Round Full-Time Earnings + EITC</th>
<th>Credit as Fraction of Poverty Threshold (%)</th>
<th>Post-Transfer Income (% of Poverty Threshold)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>$7,701</td>
<td>$9,375</td>
<td>11.3</td>
<td>122</td>
</tr>
<tr>
<td>3</td>
<td>$9,428</td>
<td>$9,375</td>
<td>9.3</td>
<td>99</td>
</tr>
<tr>
<td>4</td>
<td>$12,008</td>
<td>$9,375</td>
<td>7.3</td>
<td>78</td>
</tr>
<tr>
<td>5</td>
<td>$14,301</td>
<td>$9,375</td>
<td>6.1</td>
<td>66</td>
</tr>
</tbody>
</table>

Table 4.1 communicates the pattern of inequality that exists between families of different sizes. It demonstrates that as family size increases, the credit as a fraction of the poverty threshold decreases substantially. Since 1993 the credit differentiates between one and two children families, however, it still does not reflect the increasing needs of families with more than two children. The Table also illustrates how large the increases would have to be to bring families up to the threshold level. Two approaches to remedy the inequality in family size are possible. First, the credit would be adjusted for each additional child to represent the same percentage of the poverty threshold as that of one child. Phase-in rates would also have to be adjusted in this scenario. The second approach varies the maximum income on which the credit can be earned rather than the credit rate.112 These scenarios are illustrated in Table 4.2.

Table 4.2 Alternative EITC Family Size Adjustments (1988).

<table>
<thead>
<tr>
<th>Family Size</th>
<th>Poverty Threshold</th>
<th>Maximum Credit</th>
<th>Phase-In Rate</th>
<th>Earning Threshold</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>$7,701</td>
<td>$875</td>
<td>14.0%</td>
<td>$6,250</td>
</tr>
<tr>
<td>3</td>
<td>$9,428</td>
<td>$1,070</td>
<td>17.1%</td>
<td>$7,643</td>
</tr>
<tr>
<td>4</td>
<td>$12,008</td>
<td>$1,363</td>
<td>21.8%</td>
<td>$9,736</td>
</tr>
<tr>
<td>5</td>
<td>$14,301</td>
<td>$1,623</td>
<td>26.0%</td>
<td>$11,593</td>
</tr>
</tbody>
</table>


Many issues come up when attempting to devise an EITC structure that would better meet the needs of the poor. If the phase-in rate is increased, the maximum earnings at which the credit can be received will also be increased. Therefore, not only will poorer families receive larger credits, but also families above the poverty line. Therefore, the costs of the program increase substantially. While the phase-out rate could be increased, this would create labor supply disincentives. Yet another proposal is extending the

stationary range, providing the maximum credit to those in the phase-in range as well. This would involve eliminating the phase-in range (as is seen in the CCTB). This amendment would not increase costs substantially, as only 24 percent of families with children are in the phase-in range. There is no clear-cut solution to the proposed reforms as each has trade-offs.

Other proposals for reform involve integrating the Child Tax Credit with the EITC, therefore creating a basic tier, and ensuring that the majority of families receive some form of child benefit. This would further simplify the tax system, aid in the fight against noncompliance, and reduce the workload of the IRS. Other approaches involve creating federal incentives for states to enact or expand their EITCs. Many states have non-refundable EITC, which could have a larger impact on poverty reduction if they were converted to refundable credits.

Other concerns are due to the high implicit marginal tax rate in the phase-out range. The phase-out rate is analogous to a marginal tax rate. This problem applies to any sort of benefit that is conditioned by the recipient’s income; as individuals increase their incomes, there are negative consequences in terms of taxes paid. The extent of the tax could discourage work. Since 60 percent of EITC recipients are in the phase-out range, lowering the tax could encourage greater work effort.

Adjusting the EITC for family size and increasing the credit rate are the two most crucial reforms. Children in families with three or more children have poverty rates of 29 percent, and 23 percent when the EITC and various non-cash benefits are counted. In both cases, this is more than double the poverty rate among children in smaller

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families. Furthermore, larger families have more difficulty making the transition between welfare and work, as expenditures increase with more children, as do TANF benefits, while wages do not rise with family size. Thus, by increasing the credits for families with three or more children, the EITC could more effectively encourage work and reduce poverty among more children. By adding an additional tier for families with three or more children, the costs of the EITC would only be increased by $700-$800 million a year, as only about 15 percent of EITC recipient families with children have three or more children.

A further expansion to the EITC would be to extend the credit to families on social assistance. As two-thirds of children in extreme poverty (with incomes below 50 percent of the poverty line) have no access to the EITC, the definition of “income” must be modified in order for the credit to assist more children living in extreme poverty. Not only must the credit be increased, but it must be expanded to incorporate the extreme poor within its reach. By eliminating the current Exemptions for Children, which mainly aid families above the poverty line, the increases in the EITC could be funded. If the Child Tax Benefit and a more expansive EITC were integrated, all families would receive some form of child benefits. The child benefit system would be characterized by progressive targeting, aiding more families in need. Furthermore, if the EITC were modified to be delivered on a monthly basis to recipients, it would be more responsive to the needs of beneficiaries. Integration of EITC advance payments and the TANF and Food Stamp delivery system would further meet the needs of the poor.

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The CCTB has already incorporated many of the reforms proposed for the EITC. The program already provides supplements for families with more than two children, although they are not significant in the NCBS. They could be increased to further reduce poverty among low-income families with three or more children. Furthermore, the CCTB already has a two-tier structure and no phase-in rate. The maximum credit is offered to all recipients below the maximum income where phase-out begins. The program has already integrated previous child exemptions and other child benefits within one structure and is currently offered on a monthly basis to all recipients. It can be modified if parents separate or a spouse dies. In addition, the CCTB extends the credit to those receiving social assistance. However, the second-tier, the NCBS, is deducted by the provinces from the recipient’s welfare income. This eliminates the potential benefits of the NCBS. As it is structured, it exists to aid those earning less than $22,000, yet, by using it as an income disregard for social assistance programs completely eliminates the idea behind the credit: to raise low-income families above the poverty line.

An across the board increase will also be necessary for the CCTB to have a more substantial effect on child poverty. It has been estimated (conservatively) that $4,200 per child annually is the amount required to lift most children in low-income families near the poverty line. The increases in credit rate should be accompanied by a new definition of income. Gross income rather than net income should be used to calculate the CCTB, as using net income allows horizontal inequity, as families with the same gross income receive different amounts of child benefits, depending on how much they are able to deduct to reduce their net income for child benefit purposes. Vertical inequities also occur when upper-income families end up with similar amounts of child benefit as
middle-income families, and when some middle-income families qualify for the same benefits as low-income families. Therefore, the use of net rather than gross income results in a systematic bias in favor of higher-income families.\textsuperscript{115}

\textsuperscript{115} Battle, \textit{Benefits for Children}, 135.
Conclusion

Welfare legislation in the United States and Canada has undergone major reforms in the last decade. Neither the United States nor Canada has an entitlement “welfare” program. Canada discarded CAP in 1995, in favor of transfers to the provinces, which they may use at their discretion. The United States followed suit in 1996 and replaced the AFDC with TANF: block funds bestowed upon states, with requirements on time limits. As long as states met the “time-limit” conditions and spent at least 75 percent of what they paid out in the last year of the AFDC, they could structure their programs according to their needs.

These reforms reflect the dislike by the public toward programs regarded as handouts. In theory, most individuals feel that governments should not let their citizens starve, however, in reality, when faced with policy choices, these same individuals will vote to reduce taxes, cut social spending to the “undeserving poor”, and lately, increase spending on military and security issues. The poor represent a large percentage of our society, however, their collective voice does not carry much weight.

American and Canadian societies seem to have reached a critical juncture in public policy. The masses no longer feel that their respective societies need to support the “undeserving” poor. They are perceived as lazy and unwilling to take responsibility for their fate and the fate of their families. Children are too often the innocent victims of these views. It is not surprising, that in this era, programs such as the EITC and the CCTB have gained popularity and their budgets have actually been increased. These programs draw support across the ideological spectrum because they reduce child
poverty, even if only minimally, and because they encourage work, discourage larger families, and target children. However, the factors that make the EITC and the CCTB popular, also limit their reach. Because the programs target the working poor, their ability to effectively reduce child poverty is limited, as a large percentage of the poor are not within reach of the tax system. In addition, since the programs limit the per child credit, or in the case of the EITC do not offer per child credits beyond two children, the effects of the credits are severally restricted, since larger families tend to be poorer. It would appear as if the EITC and the CCTB are caught in a vicious cycle. The reforms required for the programs to effectively combat child poverty, challenge the inherent characteristics of the programs that guarantee their popularity. While the EITC and the CCTB have the potential to eliminate or reduce child poverty, if they are expanded, their expansion would most likely lead to their demise.

It the end, analyzing the effectiveness of child poverty programs is a farce, as the United States and Canada do not strive to eliminate or seriously reduce child poverty. They maintain programs that require the least amount of resources, avoid controversy, and serve as decoy when their efforts are challenged. Much poorer countries have significantly lower child poverty rates because there is a political will. Similarly, elderly poverty has been reduced drastically since the latter have been labeled the deserving poor. Children are not so lucky, even if, more than any other group they deserve to be raised from poverty, as they are the future of our nation. They can contribute positively or negatively to society, depending on what opportunities they are given during their childhood years.
The United States and Canada are quick to label other nations undemocratic or to judge the manner in which these nations treat their citizens. However, the time has come to look within our borders, and to evaluate our own actions. The neglect of our own children is an affront to their rights, and an act of child exploitation by our governments. In the end, there is no justification for turning our back on our children. They are the future citizens, workers, parents, and leaders. They will ensure the survival of our nations, however, only if our governments ensure their survival first.
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Articles


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**Internet**


