

Yet Another Economist Advocating Negative Income Taxes

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Big Tax Ideas of the Last 75 Years

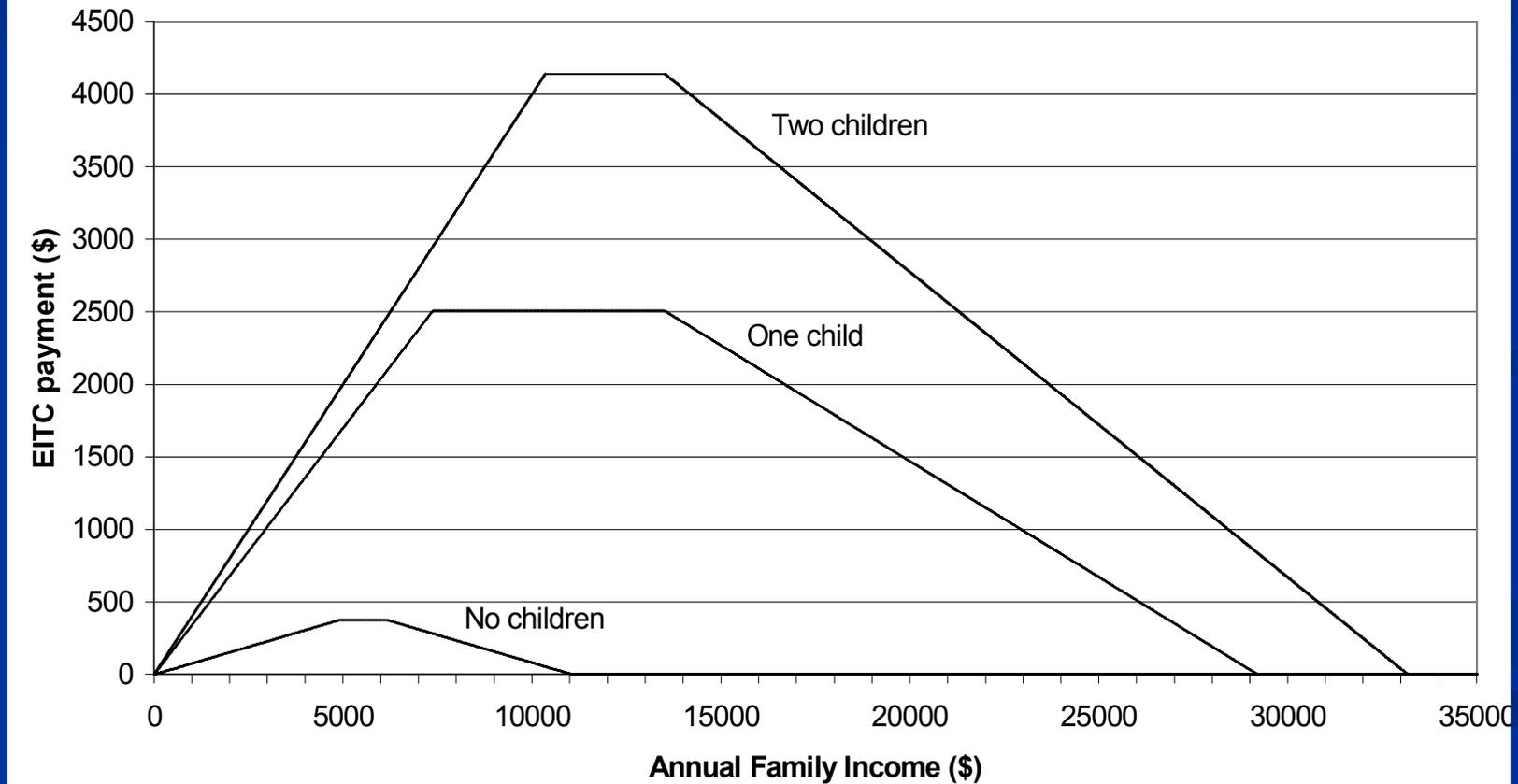
Tax Idea	Milton Friedman thought of it first	Most Australian economists support it	Australia has it
Collection of tax by employers (PAYE)	Yes	Yes	Yes
Income-contingent loans for higher education (HECS)	Yes	Yes	Yes
Negative income taxes (EITCs)	Yes	Yes	No

What is the EITC?

- The EITC is a subsidy to low-wage workers. Under an EITC, not only do these workers not pay taxes, but they receive money back from the tax office. Annually, this can amount to US\$4000 / £3025.
- By contrast, the best you can do out of the current Australian tax system is to pay zero tax.

US EITC schedule

Figure 1: Federal EITC Schedule - 2002



UK EITC schedule

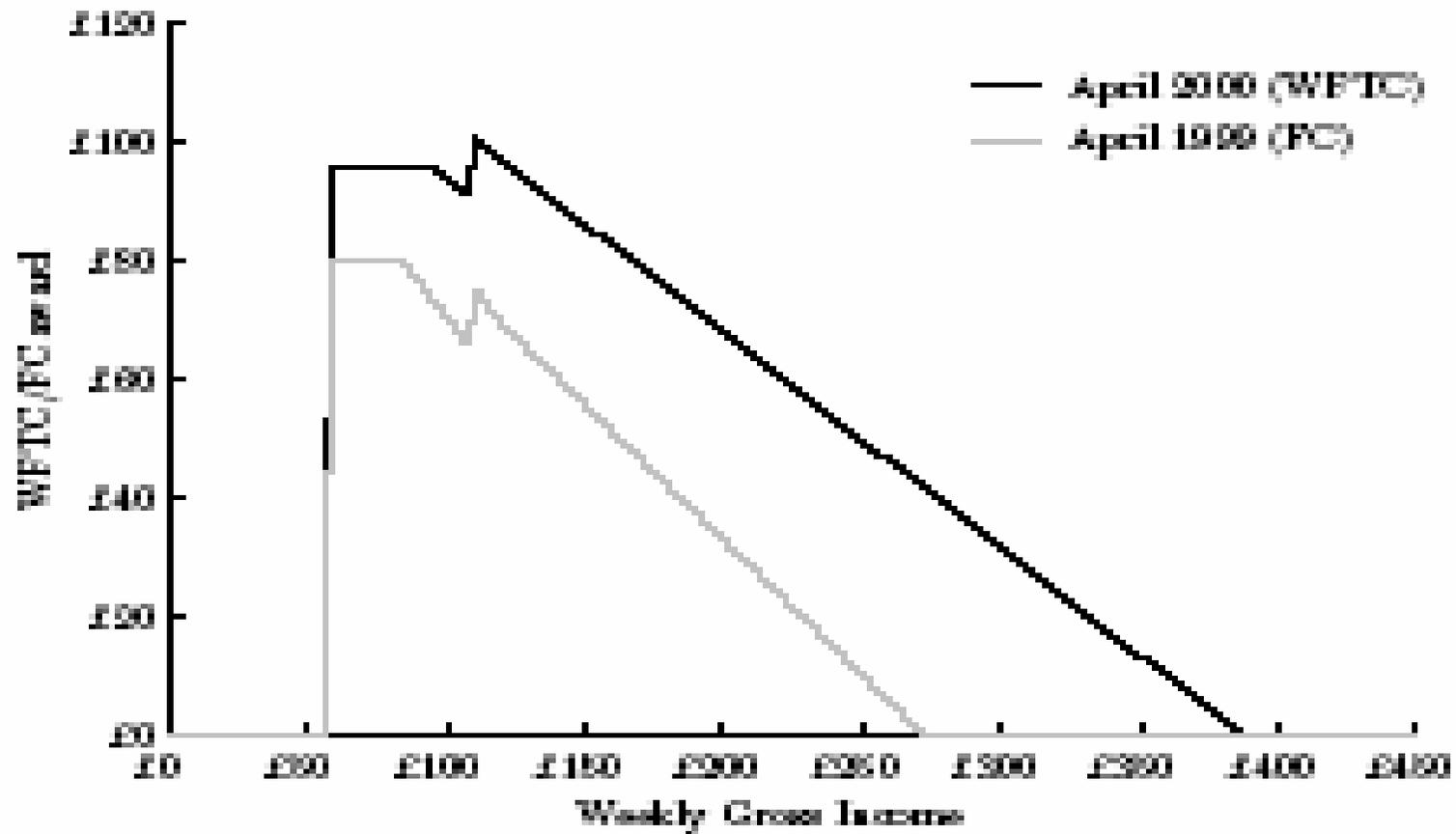


Figure 12: Example WFTC Schedule

Why an EITC?

- There are three reasons for introducing an EITC:
 - a) to increase labour supply;
 - b) to transfer income to the poorest; and
 - c) to transfer resources to children.

- A spate of studies in the US, UK and Canada show positive effects in each of these three domains.

Effects of the 1999 UK EITC Expansion

TABLE 2
FULL SAMPLE

	(1) Employed	(2) Total weekly hours	(3) >16 hours	(4) >30 hours	(5) Log (pre-tax earnings)	(6) Log (post-tax earnings)
<i>Treat*After</i>	0.009* [0.005]	1.284*** [0.387]	0.025*** [0.009]	0.031*** [0.010]	0.046*** [0.012]	0.033*** [0.011]
<i>After</i>	-0.008** [0.003]	-1.266*** [0.270]	-0.008 [0.006]	-0.028*** [0.007]	0.004 [0.009]	0.01 [0.007]
Indiv. FE?	Yes	Yes	Yes	Yes	Yes	Yes
N	31,391	23,625	23,625	23,625	10,192	10,084
R ²	0.90	0.57	0.69	0.74	0.95	0.95

Note: ***, ** and * denote significance at the 1%, 5% and 10% levels, respectively. Robust standard errors, clustered at the individual level, are in parentheses. Specifications including work hours are restricted to those in employment. Earnings are combined weekly earnings from main job and any secondary job. Post-tax earnings take into account income taxes and tax credits. "Treat" denotes individuals in the treatment group, while "After" denotes observations after October 1999.

Source: Leigh, "Earned Income Tax Credits and Labor Supply: New Evidence from a British Natural Experiment", *National Tax Journal*, 2007

Critiques of the EITC

1. We already have one
 - Not true. Australia's tax/transfer system almost always discourages work.
2. May reduce participation from secondary earners
 - Small effects; largely caused by income effect
3. May cause equilibrium wages to fall
 - True of tax cuts too.

Critiques of the EITC

4. Can create a marriage penalty
 - Not if carefully designed.
5. Potentially susceptible to fraud
 - Manageable if carefully designed.
6. It's complicated to implement in Australia
 - True. But should that always prevent reform?

Many Developed Countries Have EITCs

Table 1
The Evolution of 'Making Work Pay' Policies

Country	Current programme	Year of introduction*	Agency responsible for payment	Unit of assessment	Maximum entitlement (euros p.a.)	Conditions of entitlement			
						Phase-in range?	Phase-out range?	Minimum hours condition?	Minimum income condition?
UK	Working Tax Credit (WTC)	1971	Benefits agency (1971–1999) Tax administration (1999–)	Families	6150+	No	Yes	Yes	Yes
US	Earned Income Tax Credit (EITC)	1975	Tax administration	Families	4000	Yes	Yes	No	No
Canada	Canadian Child Tax Benefit (CCTB)	1978	Tax administration	Families	3150	Yes	Yes	No	No
Ireland	Family Income Supplement (FIS)	1984	Benefits agency	Families	2260+	No	Yes	Yes	Yes
New Zealand	Family Tax Credit (FTC)	1986	Tax administration	Families	750	No	Yes	Yes	No
Finland	Earned Income Tax Credit	1996	Tax administration	Individual	290	Yes	Yes	No	Yes
Belgium	Income Tax Credit	2001	Tax administration	Individual	500	Yes	Yes	No	Yes
France	Prime pour l'emploi (PPE)	2001	Tax administration	Individual	630	Yes	Yes	No	No
Netherlands	Employment Tax Credit	2001	Tax administration	Individual	920	Yes	No	No	No
Denmark	Earned Income Tax Credit	2003	Tax administration	Individual		Yes	No	No	No

Sources: Gradus and Jusling (2001); Pearson and Scarpetta (2000); Duncan and Greenaway (2004).

Notes: *'Year of introduction' refers to the *first* instance of the MWP policy in the country concerned, and *not* the date of introduction of the current programme.

(Since 9/03, Australia has had a very modest – and temporary – form of EITC, called 'the Working Credit').

Conclusions

- Negative Income Taxes are an extremely effective way of boosting labour supply, and a politically sustainable way of transferring money to poor families and children.
- They have disadvantages, but probably fewer than alternatives (eg. minimum wage increases).
- Plenty of other developed countries have decided to make work pay. Should we?

Comparing US & UK Tax Credits

	US EITC	UK EITC
No children	Phase-in rate: -7.65% Phase-out rate: 7.65% Max amount: \$400	Phase-in rate: immediate (at 16 hours) Phase-out rate: 37% Max amount: £1525
One child	Phase-in rate: -34% Phase-out rate: 16% Max amount: \$2500	Phase-in rate: immediate (at 16 hours) Phase-out rate: 37% Max amount: £3025 (plus 70% childcare rebate)
2+ children	Phase-in rate: -40% Phase-out rate: 21% Max amount: \$4000	Phase-in rate: immediate (at 16 hours) Phase-out rate: 37% Max amount: £3025 (plus 70% childcare rebate)
	<i>Typically paid in a lump sum at the end of the year.</i>	<i>Typically paid in fortnightly pay packets.</i>