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Creating a State Earned Income Tax Credit for Missouri: Supporting Work, Families & the Local Economy

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Missouri entered 2009 in the midst of a significant recession. Economic indicators signal that this recession is likely to be deeper and perhaps longer than any in recent history:

- **Unemployment** in Missouri reached 6.7 percent in 2008, much higher than the 4.2 percent rate Missouri had in 2001¹;
- The number of Missourians living in **poverty** increased to 742,000 people in 2007, a 12 percent increase over the 2006 level of 659,000;
- The number of Missourians accessing **Food Stamps** has doubled since the last economic crisis from 417,028 Missourians in 2000 to 899,322 in June of 2008; and
- The **median income** in Missouri was \$45,924 in 2007 when adjusted for inflation, or approximately \$5,000 lower than it was in 2001, the second highest decline in the nation.²

In this time of economic turmoil, one of the most effective steps state lawmakers can take to stimulate Missouri's economy is to create a State Earned Income Tax Credit (EITC). A State EITC would benefit more than 440,000 Missouri families and is also proven to be a valuable economic stimulus, generating more than \$64.3 million in additional economic activity that would reach every corner of Missouri. Due to the proven economic and family benefits of State Earned Income Tax Credits, the EITC enjoys bipartisan support throughout the country.³ Today, more than half of states that have a state income tax have enacted a state EITC.

The Economic Impact of a State Earned Income Tax Credit:

More than 440,000 Missouri households qualify for the Federal Earned Income Tax Credit, and the benefits reach every corner of Missouri (see Table 1, below). As a result of the federal EITC, more than \$814 million federal EITC dollars were pumped into the Missouri economy in 2005.⁴

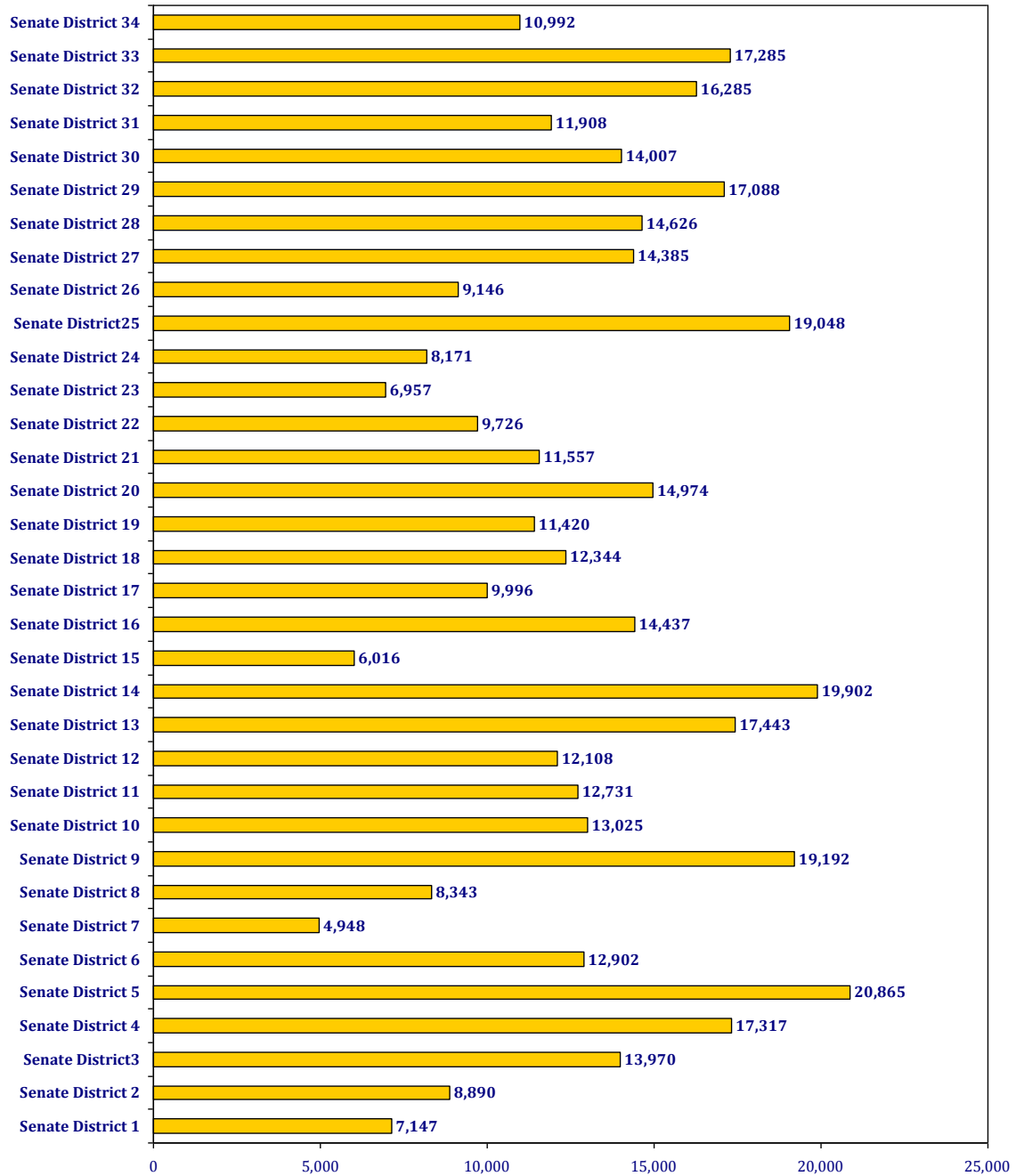
¹ Bureau of Labor Statistics, U.S. Department of Labor

² Poverty, Income and Health Insurance data is from the U.S. Census Bureau 2001 - 2007 data. Food Stamp usage data is from the Missouri Department of Social Services.

³ Based on MBP analysis of Brookings Institute data, the City of San Antonio EITC economic multiplier, assuming a State EITC at 5 percent of the Federal EITC.

⁴ Brookings Institute EITC Interactive: <http://www.brookings.edu/projects/EITC.aspx>, downloaded January 9, 2009. Data within Table 1 was retrieved by using the Brookings site.

Table 1: Missouri Households Claiming Federal EITC (Tax Year 2005)



There is a substantial body of evidence that **State EITCs have a significant economic stimulus impact. Leading national economists agree that** putting money into the hands of low and middle income families who will spend the money quickly is the best way to ensure economic growth:

Chad Stone, Chief Economist at the Center on Budget & Policy Priorities states, “The quickest, most effective way to bolster demand is to put money in the hands of people who will spend it quickly – namely, people who need it to cover basic expenses such as housing, food and transportation.....each dollar in tax cuts for low and moderate-income families – and each dollar in increased benefits....-will generate more of an increase in demand (for business and products)... Helping struggling families thus isn’t an alternative to preserving and creating jobs; it’s one of the **most effective ways to preserve and create jobs...**”⁵

A 2008 **Congressional Budget Office analysis** stated that “The efficacy of fiscal stimulus depends critically on households’ tendency to spend the income placed in their hands.....Therefore, **policies aimed at lower-income households tend to have greater stimulative effects**”.⁶

Mark Zandi, Chief Economist for Moody’s Economy.com and former advisor to Senator John McCain, concurs in testimony he provided to Congress recently that the leading stimulative measures are the ones that place funds into the hands of low and middle income families.⁷

The federal EITC has a significant impact on state and regional economies because it allows low and middle income families to retain more of their earnings from work by providing them with a refundable tax credit. For Tax Year 2008, two-parent families with two or more children qualify for the federal EITC up to an income of \$41,646. Families with incomes near the federal poverty level, or approximately \$18,740 for married couples with two children, receive the highest federal credit of \$4,824. As income increases above poverty, the credit is phased out.⁸

Low and middle-income families, those who are most likely to spend their resources quickly in their local economy, would therefore be targeted by a new Missouri State EITC that “piggybacks” on the federal eligibility levels. As a result, **a Missouri EITC would be a guaranteed investment in Missouri economic growth.** In addition, since the EITC reaches families in every county of Missouri, a State EITC would have the additional advantage of

⁵ “*Assistance for Hard-Pressed Families is One of the Best Ways to Preserve and Create Jobs*”, Center on Budget & Policy Priorities, Chad Stone, January 9, 2009.

⁶ IBID

⁷ “*Written Testimony of Mark Zandi, Chief Economist and Co-Founder of Moody’s Economy.com Before the US Senate Budget Committee*”, November 19, 2008, <http://budget.senate.gov/democratic/testimony/2008/Zandi1119081.pdf>

⁸ “*State Earned Income Tax Credits: 2008 Legislative Update*”, Center on Budget & Policy Priorities, Jason Levitis and Jeremy Koulisch, October 8, 2008.

spreading the **stimulative economic benefits statewide** (as opposed to a more specialized/targeted tax credit).

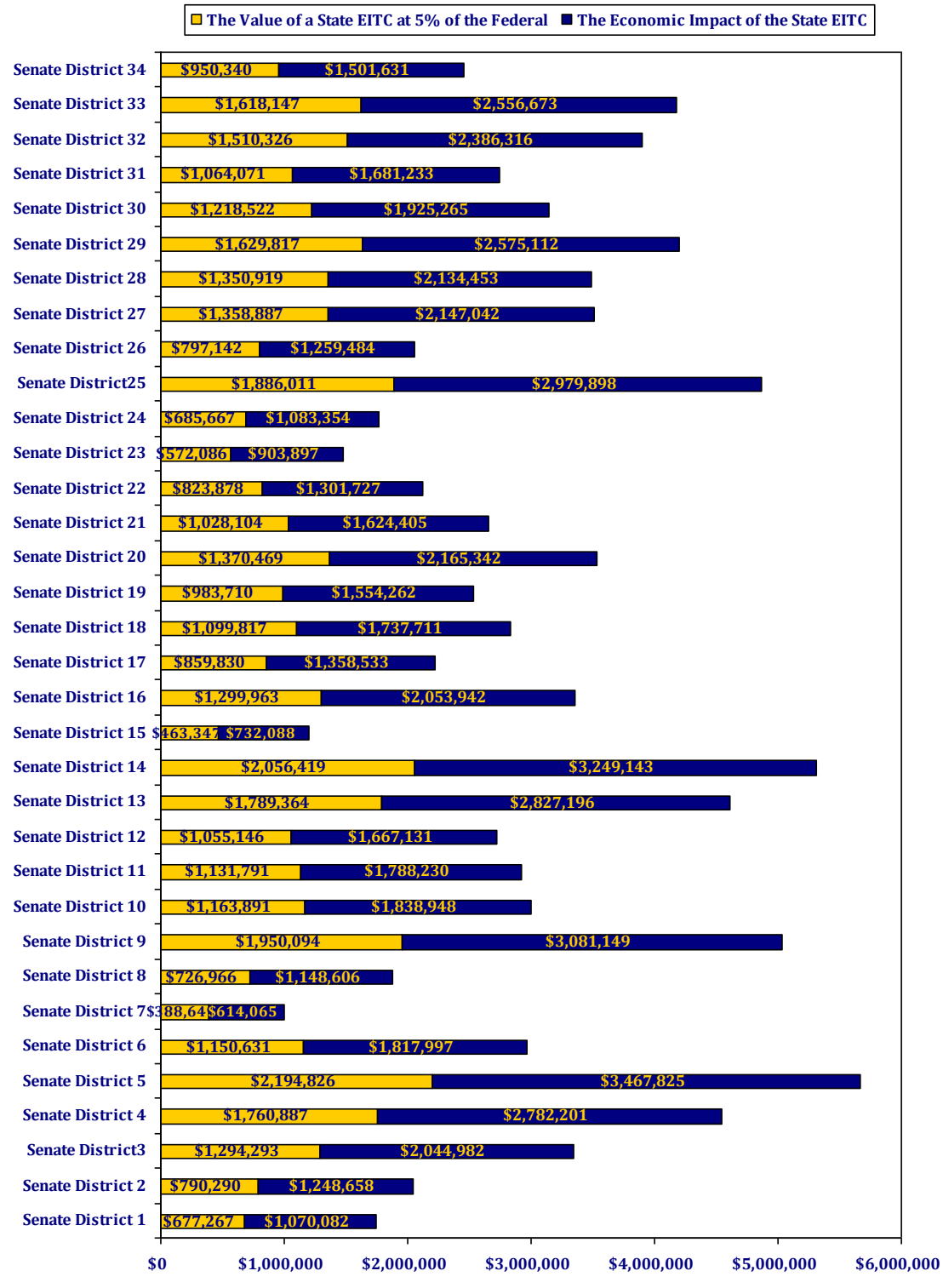
Several recent studies of state and local earned income tax credits demonstrate the stimulative impact that EITCs have in the economy. One study, conducted for the city of San Antonio estimates that **for every \$1 of EITC, an additional \$1.58 in economic activity is generated.**⁹ A Baltimore study had similar results.

State EITC benefits range from 3.5 to 43 percent of the federal credit. Assuming Missouri were to enact a state EITC valued at 5 percent of the federal credit, the maximum credit amount would be \$241. The total investment statewide for all eligible families would equal \$40.7 million. Based on the San Antonio findings, this would stimulate **an additional \$64 million in economic activity** throughout Missouri, for a **combined infusion of \$105 million into the state's economy**, supporting more than 2,800 jobs. Every county of Missouri would receive a positive economic impact (See Table 2 below, containing economic impact results by State Senate District).

Creating a Missouri EITC is one of the most effective measures the state legislature can enact to stimulate economic growth in Missouri's economy.

⁹ "2004 Update: Increased Participation in the Earned Income Tax Credit in San Antonio", Texas Perspectives Inc., November 2004, <http://www.sanantonio.gov/comminit/pdf/112604%20EITC.pdf>

Table 2: The Economic Impact of a State EITC by State Senate District



Source: MBP analysis of Brookings Institute data on Federal EITC filers by Senate District, using San Antonio Economic Multiplier.

Bipartisan Support throughout the Country Leads to 24 State EITCs:

The federal EITC was enacted in 1975 as a way to offset the impact of federal payroll taxes on low income families and reduce poverty. For more than 30 years, the federal EITC has enjoyed substantial bipartisan support. President Reagan, President George H. W. Bush, and President Clinton all supported the EITC and proposed expansions in it.¹⁰

As a result of the bipartisan support for the EITC, 24 states have enacted State Earned Income Tax Credits, including Missouri's border states of Iowa, Illinois, Kansas, Nebraska and Oklahoma (See Table 3, below).¹¹

Table 3: State Earned Income Tax Credits	
State	Percentage of Federal Credit
Delaware	20%
District of Columbia	40%
Indiana	6% increasing to 9% in 2009
Illinois	5%
Iowa	7%
Kansas	17%
Louisiana	3.5%
Maine	5%
Maryland	25%
Massachusetts	15%
Michigan	10% increasing to 20% in 2009
Minnesota	33% (average)
Nebraska	10%
New Jersey	22.5% increasing to 25% in 2009
New Mexico	10%
New York	30%
North Carolina	3.5% increasing to 5% in 2009
Oklahoma	5%
Oregon	6%
Rhode Island	25%
Vermont	32%
Virginia	20%
Washington	5%
Wisconsin	Range from 4% – 43%

Source: Center on Budget & Policy Priorities

¹⁰ "THE EARNED INCOME TAX CREDIT: Boosting Employment, Aiding the Working Poor" Center on Budget & Policy Priorities, Robert Greenstein, August 2005

¹¹ "State Earned Income Tax Credits: 2008 Legislative Update", Center on Budget & Policy Priorities, Jason Levitis and Jeremy Koulisch, October 8, 2008.

A State Earned Income Tax Credit Would Modernize Missouri's Income Tax Structure:

Missouri's income tax structure has not been broadly updated in decades. As a result, Missouri has the ninth lowest threshold for state income taxes in the nation. Families with incomes at just 82 percent of the federal poverty level, or an income of \$13,600 per year for a one parent family with two children and an income of \$17,000 per year for a two parent family with two children, are required to pay state income taxes.¹²

These families also pay state and local sales taxes, property and excise taxes, making their *effective* tax rate even higher. According to the Institute on Taxation & Economic Policy, **the poorest Missouri families (those earning less than \$15,000 per year) pay 10 percent of their income in state and local taxes.** Middle income families (those earning \$25,000 - \$41,000 per year) pay 9.3 percent of their incomes in state and local taxes in Missouri.¹³

A State Earned Income Tax Credit would offset a portion of the combined state and local taxes that are paid by Missouri working families, thus updating the State's income tax structure.

Why a State EITC: Piggybacking on the Success of the Federal EITC

One reason that so many states have chosen to enact State EITCs that are tied to federal eligibility is because they are **administratively simple and cost effective.** The federal IRS shares with state revenue departments data on federal EITC filers. This allows the state revenue department to verify eligibility in a timely and cost effective manner. Determining credit amounts is also simplified when the state credit is a straightforward percentage of the federal credit.¹⁴

More importantly, states are enacting State EITCs because they are a proven tool to **reduce poverty and support work.**

There is significant national evidence that the EITC **encourages employment** by low and middle income families, particularly among single-parent households.¹⁵ The correlation between work and the EITC results from the ability of families who are working, but still living in poverty, to retain more of their earnings. The retained income makes work "pay" and allows the family to incur greater work-related expenses such as child care and transportation over time as their income grows and the credit is phased out. (As income increases above the federal poverty level, the amount of the EITC gradually decreases.)

State EITCs are also a proven tool in **reducing poverty.** In 2007, more than 742,000 Missourians were living in poverty, including 247,482 children.¹⁶ Many of the families who

¹² "The Impact of State Income Taxes on Low-Income Families in 2006", Center on Budget & Policy Priorities, March 27, 2007.

¹³ "Missouri Taxes Hit Poor and Middle Class Harder than the Wealthy", Institute on Taxation & Economic Policy, January 7, 2003

¹⁴ "State Earned Income Tax Credits: 2008 Legislative Update", Center on Budget & Policy Priorities, Jason Levitis and Jeremy Koulisch, October 8, 2008.

¹⁵ "The Earned Income Tax Credit at 30: What we Know", The Brookings Institute, Timothy Holt, February 2006.

¹⁶ Food Research and Action Center, "State of the States 2007",
http://www.frac.org/State_Of_States/2008/states/MO.pdf

qualify for the federal and state EITC have incomes within poverty or near poverty and face significant challenges in meeting their basic needs including food, housing and health care. **The federal EITC is the nation’s most cost-effective anti-poverty program, lifting 4.4 million people out of poverty per year.¹⁷ State Earned Income Tax Credits build on this success and are a targeted, proven anti-poverty tool.**

The Mission of the Missouri Budget Project is to advance public policies that improve economic opportunities for all Missourians, particularly low and middle income families, by providing reliable and objective research, analysis and advocacy. Contact the MBP through our website at www.mobudget.org

¹⁷ “*State Earned Income Tax Credits: 2008 Legislative Update*”, Center on Budget & Policy Priorities, Jason Levitis and Jeremy Koulish, October 8, 2008.

Appendix I:

Federal EITC Dollar Amount Received by State Senate District (Tax Year 2005)

