

# Transfer Facts

A knowledge-based series by the  
Tax and Transfer Policy Institute

## What are the limitations and benefits of an earned income tax credit (EITC)?

EITCs have been implemented across various countries and are an integral part of their tax and transfer systems. In The United States, the EITC is one of the most significant tax and transfer policies, impacting millions of low-to middle-income families [1]. While an EITC was considered in the late 1990s in Australia, it does not form part of the current tax and transfer system [2]. Instead, in 2003, Australia introduced the Working Credit program, a more targeted and low-cost policy, that shared some characteristics of an EITC, but also with some differences [3]. For example, the Working Credit, only assisted individuals as they transitioned from welfare to work, but not afterwards. By contrast, an EITC is not directly tied to welfare.

Generally, the literature has identified several positive impacts of EITCs, as well as some of their limitations. This Transfer Fact reviews these in detail [\[see our related Transfer Fact #4 – "What is an earned income tax credit \(EITC\)?"\]](#).

### Employment incentives of the EITC

The primary aim of an EITC is to increase workforce participation by improving employment incentives for low income individuals. By increasing disposable incomes, EITCs can improve the living standard of beneficiaries.

EITC programs, targeted at low and middle income earners, in the United States, United Kingdom and Sweden have increased employment rates among recipients [4, 5]. In the United States, research found that EITCs engender benefits beyond workforce incentives, showing improved outcomes for educational attainment, economic activity, income, and health benefits for mothers, infants and children [6].

While there is a broad consensus that EITCs are one of the most effective anti-poverty programs, particularly in the United States, there is still some ambiguity concerning the extent to which EITC programs have met their goal of increasing employment. In part, the ambiguity stems from cross-country variation in the design of EITCs, and differences in tax and transfer systems. It also arises however, when the employment effects are considered across different groups.

In particular, the literature provides evidence of heterogeneous effects of EITCs on female employment rates. Research consistently shows a larger employment response among single mothers, especially those out of the labour market [1, 3, 7, 8]. EITCs provide significant incentives for single mothers to increase workforce participation without losing other income support payments. Consequently, researchers estimate a significant reduction in poverty among disadvantaged single mothers with children [7].

Yet, among married couples in the United States, the literature shows EITCs may negatively impact labour supply decisions of those already in the labour force (in terms of hours worked), particularly among secondary earners in families (who are disproportionately women). This behaviour appears to depend on the EITC's design (the share of taxpayers eligible and whether the EITC is based on individual or family earned income) and the degree to which they respond to incentives [9].

## Impacts on child development

There is a growing focus on the impacts of EITCs for children's development. A commonly stated goal of EITCs is to improve the welfare of the children. Studies (primarily from the US) find that EITCs broadly improve child development outcomes where there are greater financial resources available to parents [7]. However the literature also documents the importance of parental time investment for child development [10, 11]. While EITCs mean mothers spend less time with their children, international studies demonstrate there is a positive long run effect of the tax credit as mothers have greater financial resources. This outweighs the negative impact that the decrease in parental time with the child might have [1].

## Health impacts

Research has also considered the impact of EITCs on health outcomes of women and their dependent children [6, 12]. It supports that short-term improvements in household health outcomes arise from greater disposable incomes, spent on health care or healthy food, especially among infants and children. Over the longer term, a recent study also showed improvements in women's physical health, but no significant improvement to mental health [12].

In summary, the literature suggests that while the benefits of an EITC are multifaceted, those benefits disproportionately impact single mothers.

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