

Earned Income Tax Credit (Negative Income Tax) — The results of the first year of implementation of the Law

OPENING REMARKS

At the end of the first year of operation of the Earned Income Tax Credit (EITC, negative income tax) program in Israel, this report summarizes the results and the experience gained from it. The summary of the experiment and the associated research was carried out by a joint research team¹ established to provide research support for the process of implementing the socioeconomic agenda adopted by the (previous) government.

EITC is a policy tool for reducing gaps and improving the income of the working population at the bottom of the income scale. It was introduced in Israel on an experimental basis in 2008, in areas where the "lights to employment" program was operating (Ashkelon, Hadera, Jerusalem and Nazareth), and was based on earned income in 2007. The report includes the details of the Law, including the target population and the entitlement conditions, the rate of participation in different sections of the population and in different areas, and the effect that the EITC had on the income of those participants who realized their entitlement, and its effect on the incidence and depth of poverty among them. The report also shows the proportion of total payments made that reached the group that most needed them—workers from families whose income was at the bottom of the scale. As the program was launched on the basis of income earned in 2007, a year before the Law went into effect, it is too early to examine whether the implementation of the program affected employment patterns of the target population.

To examine the effect of the EITC a special survey was organized to learn about the relevant population in the areas in which it was operating, and a control group was selected with characteristics similar to those of the target population but resident in locations where the program was not being run. Changes in the entitled population were compared with those in the control group. In addition, extensive use was made of Tax Authority data which enabled the team to identify those apparently entitled to participate in the program and to examine their rate of participation. The objective of the research was to review the effect of the program on poverty and employment, and to analyze the extent to which those who were entitled to participate took up their entitlement in full.

The average rate of take-up of entitlement was found to be 45 percent, and it increased with the size of the benefit. Variation was found between the rates of take-up in different areas, apparently related to the activity of nonprofit organizations acting to spread awareness of the program. The rates of take-up were high by international standards, taking into account that the program is still in its early stages and is operating on a modest scale in Israel.

¹ Headed by Dr Michel Strawczynski of the Bank of Israel's Research Department. The report was compiled by representatives of the Bank of Israel, the Myers-JDC-Brookdale Institute, the National Insurance Institute, and the Tax Authority.

The findings also showed that the EITC program helped to rescue about 4.5 percent of the recipients of the credit from poverty, it reduced the depth of poverty, expressed in terms of the poverty gap, by about 5 percent, and boosted the income of the bottom quintile of the recipients of the credit by some 12 percent. About 80 percent of the support transferred went to the lowest four deciles of the wage distribution. It was found that there were differences in the indices of relative poverty, the depth of poverty, employment patterns and take-up of entitlement between those with entitlement who had children (less than 19 years old) and those aged more than 55 years without children. The report also shows a decline among recipients of the credit of the share of those who had to give up essential services such as visits to a dentist, and the share whose telephones or electricity were cut off.

Based on the experience and findings to date, it can be stated that EITC is a focused and effective tool that raises the level of income of the working low-paid population, and helps to improve the situation of families with income slightly above the poverty line.

Although it is too soon to assess the effect of the program on rates of employment, as stated, based on international experience it may confidently be expected that such effect will not be substantial. Nonetheless, unlike other policy tools, EITC is not expected to have a negative impact on rates of employment.

In light of the problem of poverty among families with one wage earner and widening income gaps, and based on experience gained hitherto, we strongly recommend that the EITC program be extended country wide. Furthermore, increasing the size of the credit, when the budget so allows could contribute to the reduction of poverty among working families by means of an effective and focused tool that does not have negative side effects on incentives to join the labor force.

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