Comment on Michael A. Stegman, Walter R. Davis, and Roberto Quercia's "The Earned Income Tax Credit as an Instrument of Housing Policy"

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Abstract

In their discussion of the relationship between the Earned Income Tax Credit (EITC) and housing cost burdens for lower-income families, Stegman, Davis, and Quercia propose to significantly modify the EITC's benefit structure based on housing cost burdens. But leveraging the EITC to better address housing cost burdens does not require that EITC become housing policy, that its legislative authority be substantially rewritten, or that its funding be increased by billions of dollars. Moreover, substantially shifting policy justification and rationale for the EITC could undermine its broad-based political popularity while further marginalizing the authority of the U.S. Department of Housing and Urban Development over lower-income housing programs.

A first step toward better leveraging the EITC to improve housing opportunities is to increase the program's claims rate while helping taxpayers to access lower cost tax preparation assistance. In addition, the manner in which households claim the EITC can be better managed to allow them to more effectively offset rent or mortgage payments. Finally, the EITC can serve as an important financial resource that could help many families establish banking relationships that lead to asset development and homeownership.

Keywords: Affordability; Low-income housing; Tax issues

Focusing on affordable housing

The proposal by Stegman, Davis, and Quercia to recast the Earned Income Tax Credit (EITC) as an instrument of housing policy sparks an important conversation in making the linkage between housing policy and an income support policy operating through the tax code. Housing costs often comprise the single largest expenditure for low- and moderate-income individuals and families; thus, using the housing cost burden measure to expand the EITC, which explicitly relates income to housing costs, is an important concept to consider. Stegman, Davis, and Quercia highlight how the EITC can have a significant impact on the ability to afford suitable housing and set forth a justification for increasing this credit based on its ability to alleviate housing needs for the working poor.

The proposal, while thoughtful, raises a number of issues:

1. The proposal is centered on a technical discussion of how the EITC could be expanded as housing policy by benchmarking benefits to a median housing cost measure. That program modification is estimated to cost $25 billion annually. For this proposal to be successful, a well-articulated political discussion of why such a modification should be supported is necessary. In particular, the proposal would be well served by a discussion of why people who are not housing advocates but support the EITC (and not necessarily housing policy) should support recasting their successful program as a housing program.

2. If the proposal were enacted, it would result in a $59 billion housing program run through the Department of the Treasury. This could fuel arguments by opponents of the U.S. Department of Housing and Urban Development (HUD) that it is unnecessary and could lead to the reduction or elimination of existing HUD programs—or of HUD itself.

3. If an additional $25 billion were appropriated for housing, it seems reasonable to expect that level of funding to address the nation's housing challenges in a more fundamental manner. It should consider the growing housing affordability problems of a broader subset of the population, including those working families and individuals just above the EITC-eligibility threshold, such as fire fighters, police officers, and teachers.

Our comment builds on the ideas raised in Stegman, Davis, and Quercia's proposal and suggests an alternative that maximizes the current benefits of the EITC. Current administrative weaknesses in the EITC program must be addressed to increase utilization. Further, benefits could be enhanced through greater voluntary taxpayer assistance and by linking the EITC to broader financial education and financial services outreach efforts.

Exploring the interplay between the EITC and housing policy

The proposal by Stegman, Davis, and Quercia is centered on a discussion of how the EITC could be expanded by pegging its benefits to a median housing cost measure. Their proposal calls for nearly doubling the EITC to $59 billion. However, in light of annual budget deficits of more than $500 billion, such a large expansion of the EITC seems unrealistic. But even setting aside the price tag, an important challenge is convincing people who are not housing advocates to approve a major increase in funding to serve a housing goal and to accept transforming a successful income support program into a housing program.

Explicitly identifying the linkages between the EITC and housing policy

Focusing attention on affordable housing issues by building coalitions is valuable. Housing advocates increasingly recognize the need for and benefit of drawing out salient intersections between housing and other policy areas. For example, housing advocates are more and more making the case that decent and affordable housing is positively associated with and can contribute to a variety of social and economic outcomes, including education, health, family stability, and job opportunities.

Effectively linking different policy areas cannot be a one-way street. The EITC enjoys strong and widespread political support specifically because the tax credit is *earned*.[1] That is to say, as Stegman, Davis, and Quercia do, that the "EITC is designed to reward work by lowering the tax burden of lower-income working families" (246). The EITC suggests that working individuals and families that follow the rules should not be taxed in a manner that diminishes their already low incomes—or, alternatively, that these working poor should not be taxed into poverty. These are compelling and successful arguments as witnessed by the overwhelming success of the program. Proponents would need to be assured that recasting their successful initiative would not ultimately undermine its support. As the proposal currently stands, it benefits housing, and EITC proponents pick up the tab. We do not claim to know how this argument could be made; however, we do know that it would have to be explicitly articulated before the proposal could be meaningfully pursued.

Further, making the link between housing policy and the EITC does not mean that it needs to *become* housing policy, any more than education, health care, employment, or any of the other myriad policy areas that might be linked to affordable housing policy need to become housing policy. The median housing cost proposal requires that the EITC be recast as housing policy because it sets benefits according to housing costs. Having to discuss the EITC as a housing program could undermine support from those who agree with the central argument made by

[1] At present, the EITC is an extremely popular initiative, having enjoyed multiple significant expansions over its nearly 30-year history.

Stegman, Davis, and Quercia that the program might be improved by linking EITC benefits to housing cost burdens.

Reframing the EITC and undermining HUD

Affordable housing programs, and HUD—the primary agency that administers them—do not enjoy the same level of broad political support that the EITC does. In fact, the last major federal housing initiative was the Home Investment Partnership Program, which was created by the National Affordable Housing Act of 1990. It has been 14 years since the federal government did anything of consequence to expand affordable housing opportunities. Further, such programs are not perceived by politicians and policy makers as something that individuals and families have *earned*.[2]

However, the EITC is projected to continue to grow gradually to $35.6 billion by 2007, a 1,000 percent increase in real terms from an initial investment of $3.2 billion in 1975 (Gitterman, Howard, and Cotton 2003). Stegman, Davis, and Quercia do not explain how recasting the EITC as housing policy would increase its political support.

Further, linking the EITC to housing policy could have the unintended effect of undermining HUD. Opponents of HUD could argue that more is being done with the EITC alone to directly address the housing needs of low-income individuals and families than with HUD's entire subsidy and construction program.[3] It is worth noting that in the Bush administration's 2005 budget, released on February 22, 2004, 11 community development and affordable housing programs were slated for elimination, including HOPE VI, Empowerment Zones and Enterprise Communities, the Brownfields Program, the Rural Community Development Initiative, and Section 108 Guarantee Loans. In addition, when HUD has figured prominently in recent national debates on housing, it was to call for its abolition.[4] However, even if HUD and its programs

[2] Surveys by the Fannie Mae Foundation and the National Association of Realtors demonstrate that the public sees housing affordability as a major issue on the same level as health care and unemployment; however, housing is not a salient political issue (Lang and Hornburg 2004).

[3] The actual HUD annual program budget, excluding salaries and expenses, ranged from $25 to $29 billion from 2000 to 2004 (National Low Income Housing Coalition 2004).

[4] Following the Congressional elections in 1994, and during Bob Dole's presidential candidacy in 1996, critics of HUD called for its abolishment (Lang and Hornburg 2004).

were to remain untouched, its influence would be greatly diminished. The Internal Revenue Service (IRS), as the administrator of an expanded EITC program, could potentially have more say in national housing discussions than the housing experts at HUD.

The need for housing policy to address demand and supply challenges

Stegman, Davis, and Quercia's proposal would address only the housing cost burdens of EITC-eligible individuals and families with a gap between 50 percent of their family income and median housing costs. Other working individuals and families above the EITC thresholds (including, fire fighters, teachers, police officers, and so on) that are also experiencing important and growing challenges in finding affordable housing would not benefit. Moreover, this level of new resources, appropriately targeted by HUD, could go a long way toward increasing the production and preservation of affordable housing units for many more households.

Further, the proposed $25 billion increase in funding would not address the fundamental issue of rapidly rising housing costs. Much of this increase is unnecessary and is driven by regulatory barriers, restrictive local land use and permitting practices, housing discrimination, and lack of public awareness about local ordinances that contribute to high housing costs in many markets. Multibillion-dollar enhancements of funding to help bring down the cost of housing without addressing the contributors to rising costs would, in one way, reward communities for their failure to be responsive to the housing needs of their residents.

Many ways to measure housing burdens

Access to decent, affordable housing is also a nuanced issue. At the micro level, families that cannot access decent, affordable housing generally react in one of two ways. First, they can reduce their consumption of housing, perhaps by doubling- or tripling-up with other families in a single unit or by living in a unit that is too small for their family size, or they can live in housing with undesirable characteristics. These could include inconvenience, such as being far from employment; safety problems, such as being in a high-crime neighborhood; or quality issues, such as putting up with deferred maintenance. In the extreme, homeless families and individuals have reduced their housing consumption to zero.

Alternatively, families could respond by devoting an excessive share of their income to housing, which could result in housing of adequate quality and appropriate size in a reasonable location, but critical secondary effects as well. When families, particularly lower-income families, spend a large portion of their income on housing, they have fewer financial resources to pay for medical care, food, clothing, education, transportation, and other essentials. Lower-income families working and living in areas with high-cost housing too often find themselves with difficult choices, each of which can be tied to negative outcomes for adults and children alike.

In attempting to capture these affordable housing challenges statistically, analysts frequently take the most accessible measure, which is the ratio of income to housing costs. As Stegman, Davis, and Quercia lay out in detail, there are a variety of common measures that center on identifying a household as facing a critical housing affordability dilemma when its housing costs exceed 50 percent of income. These measures are carefully tracked by housing advocates and policy makers and are a useful indicator of the degree to which households devote an excessive share of their income to housing. Their virtue—simplicity—is also their weakness. They cannot fully capture the lack of access to decent, affordable housing. In fact, severe housing cost burdens for owner households are rising at a faster rate than they are for renter households (Lipman 2002).

These measures do not capture, for example, the families that react to the inaccessibility of decent, affordable housing by reducing their consumption. Of course, the families that are worst-off, the families that may devote over half their income for inadequate housing or even become homeless, would be represented, but the depth of their crisis would not be captured.

Further, demand-side policies need to incorporate measures that capture more than cost burden: access to affordable housing that is appropriate in size, quality, and location. A full exposition of this discussion is beyond the scope of this comment.

Focusing on the financial health of lower-income families and individuals

An alternative to the median housing cost proposal or some first steps would be to improve the administration of the EITC program so as to enhance the current unrealized benefits it offers. These steps should be taken first even if the proposal is adopted. (Stegman has been the leading authority in this area.[5]) They include the following:

1. Improve utilization rates for the EITC and other asset-building tax credits (the Child Tax Credit [CTC],[6] the Tax Savers Credit[7]). As much as $3.5 billion of the EITC went unclaimed in 2001 (IRS 2002).

2. Provide EITC recipients with access to low-cost tax preparation services to maximize their tax refunds. Currently, far too great a share of the proceeds from the EITC and other tax programs goes to for-profit tax preparers, whose fees drain up to an additional $1.8 to $1.9 billion[8] from EITC recipients every year.

3. Provide comprehensive financial outreach and education to lower-income consumers so that they can more effectively use the EITC for monthly housing payments or asset-building opportunities, and combine these efforts with access to lower-cost mainstream financial services.

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[5] See Stegman 1999. See also Carr and Schuetz (2001) and the Fannie Mae Foundation's publication *Building Blocks* (2002a, 2002b, 2004) for more information on the EITC, ways to connect low-income families to the financial mainstream through technology, and examples of financial institutions that bring more affordable financial services to low- and moderate-income communities.

[6] The tax credit per child is $600 for 2001 through 2004, $700 for 2005 through 2008, $800 in 2009, and $1,000 in 2010. The CTC provides income support to a broader range of families than the EITC; under current law, the CTC begins to phase out at $75,000 for a single head of household and at $110,000 for couples. The CTC is used first to eliminate any tax liability that a family has after all other credits (except for the EITC) are taken into account. However, the CTC is partially refundable to families with children but no income tax liability. Unlike the EITC, the CTC is refundable only for families above an income threshold of $10,350 in 2002.

[7] The Tax Savers Credit targets low- and moderate-income taxpayers who contribute to their retirement. The tax credit rebates up to 50 percent of the first $2,000 put into a 401(k) plan or an IRA (Individual Retirement Account). For example, a $2,000 IRA contribution can cut tax liability by $1,000. On single returns, a person gets a 50 percent credit only if the adjusted gross income is under $15,000. On single returns, the credit drops to 20 percent and then to 10 percent as income moves up to $25,000. Income thresholds are doubled for married couples. The credit phases out as incomes rise, and it is scheduled to disappear after 2006.

[8] These are annual national estimates of the fees siphoned away from EITC recipients by high-cost tax preparers and by high interest rates charged for short-term "tax advance" loans. In addition, check-cashing outlets also charge unbanked consumers an addition 2 or 3 percent to cash their refund checks (National Consumer Law Center and the Consumer Federation of America 2003).

EITC utilization rates and low-cost tax preparation services

Before program funding for the EITC is dramatically increased, attention should focus on ensuring that current benefits are fully leveraged. Stegman, Davis, and Quercia assume that the EITC's utilization rate will increase to 100 percent, but do not indicate how this will be accomplished or how much it will cost. They cite IRS statistics indicating that some 15 percent of eligible lower-income families and individuals failed to claim the EITC in 1996. In 1999, 17.2 million taxpayers were eligible for the EITC, but only 12.9 million claimed the credit (U.S. General Accounting Office [GAO] 2001). Fully 4.3 million workers or 25 percent of eligible taxpayers did not claim the credit (GAO 2001; Scholz 1994). These levels of nonfiling resulted in forgone benefits of between $2.1 and $3.5 billion annually (IRS 2002). Further, many low-income individuals and families accessing the credit use high-cost tax preparers and check-cashers to claim their refunds, further diminishing their value. As it stands, the EITC—the largest antipoverty program—is not being optimally used to fight poverty.

Supportive services for EITC recipients

Volunteer tax assistance. Any future expansion of the EITC should also include the growth of the Volunteer Income Tax Assistance program (VITA), which provides assistance to taxpayers who cannot afford to pay for professional help. The Department of the Treasury provides a useful and important service in the VITA program, but it must assume an increasingly large part in ensuring full participation and should be expanded to better meet the needs of its target population.[9]

Comprehensive financial education. Financial counseling and education should also be more widely available to help lower-income families and individuals more appropriately and effectively manage their finances. Providing comprehensive financial education, in conjunction with tax preparation assistance, could help low-income individuals and families fully realize the benefits of the EITC along with other tax credits such as the CTC and the Tax Savers Credit. And, as Dolbeare noted in 2001 and in her comment in this issue, such programs could possibly help such individuals and families access other public assistance programs they are eligible for but do not use, such as food stamps, supplemental security income, or housing vouchers.

[9] VITA provides free tax assistance to disabled, non-English-speaking, elderly, and special-needs taxpayers with an adjusted gross annual income under $35,000.

Further, financial counseling could help recipients better manage current EITC benefits to help meet housing cost burdens. Many consumers intentionally choose to claim their tax benefit in the form of a lump sum, which limits their ability to use the credit throughout the year to meet monthly rent or mortgage payments. Other households might be better off collecting a lump sum but do not because of the lack of a savings account or knowledge about how best to manage that relatively large refund.

The U.S. financial services industry can be crudely described as one in which moderate- to upper-income households living in nice neighborhoods enjoy the benefits of efficient mainstream financial services such as commercial banks and thrifts. Lower-income households and particularly lower-income minority households frequently access high-cost financial services from check-cashing agencies, payday lenders, and rent-to-own establishments. Access to mainstream financial services, in addition to financial counseling and education, could help such households manage their finances responsibly, ultimately and ideally helping them to build assets.

Further, when low-income (particularly minority) individuals and families become homeowners, it is often under suboptimal terms that can contribute unnecessarily to high housing cost burdens. Subprime home purchase lending has increased at a faster rate than prime lending over the past 10 years—44 percent in the past 2 years alone. By comparison, prime lending grew only 23.6 percent during the same period (ACORN [Association of Community Organizations for Reform Now] 2004). And subprime lending is disproportionately relied on by minority consumers.

When consumers who could qualify for prime loans secure subprime mortgages or predatory loans, the full benefits of homeownership—particularly asset building—are undermined. Failure to access mainstream financial services and products prevents many families from efficiently and effectively managing the income they have, building savings, becoming homeowners, and accumulating wealth (Huh and Kolluri 2004). Financial education and access to mainstream banking are directly linked to the asset-building outcomes of individuals (America Saves 2002; Bernheim and Garrett 1996; Schreiner et al. 2001). Furthermore, mainstream financial services help individuals develop documented credit histories, which ultimately influence home mortgage terms (Joint Center for Housing Studies 2002).

Initiatives by nonprofits. A clear income-supportive policy connecting the related issues of nonfiling by EITC-eligible families and unnecessary income loss to tax preparation firms would be increasing the availability of low-cost tax preparation services. The Annie E. Casey Foundation launched a major initiative in 2003 in the form of the National Tax Assistance for Working Families Campaign.[10] It works through local partners and thousands of volunteers in 30 communities across the country to provide families with free assistance in filing tax returns, claiming the EITC and other tax credits, and learning about ways to build assets and financial stability. In 2003, the campaign reached nearly 97,000 households, with a median adjusted gross income of $14,845, and generated over $115 million in federal and state tax refunds. This included $55 million in federal EITC credits, $16 million in child tax credits, and $11 million in state tax refunds. The median EITC refund was $1,322. The campaign estimated that it saved participating families over $8 million in fees for tax preparation and refund anticipation loans that they would otherwise have paid to commercial tax preparers (Annie E. Casey Foundation 2004).

The need for holistic financial services. Expanding the discussion beyond the EITC, other estimates show that more than $9.2 billion in revenue is generated annually from transactions at check-cashers, payday lenders, auto title lenders, pawnshops, and rent-to-own establishments.[11] This amount is larger than the annual budget for the Community Development Block Grant and HOME programs combined.[12]

Over the past decade, alternative financial service providers also experienced explosive growth in low- and moderate-income and minority communities (Carr and Schuetz 2001). This trend has diverted money that many lower-income and minority residents could have used toward rent or a down payment. Better personal financial management can help lower-income consumers achieve greater financial stability, greater housing stability, and an enhanced ability to afford education, health care, transportation, and other services essential to a reasonable quality of life.

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[10] The Tulsa Community Action Project has also done some innovative work in using the VITA program and its financial education curriculum to help constituents access the EITC and realize its full benefits.

[11] These informal calculations were made by the Fannie Mae Foundation in 2002.

[12] The HUD 2004 budget allocated $2.197 billion for the HOME program and $4.436 billion for the Community Development Block Grant program; together, they total $6.633 billion.

Concluding thoughts

Stegman, Davis, and Quercia have raised an important issue for housing advocates to consider—the link between income support policies and the reality of the effects of benefits on housing cost burdens. Their proposal also highlights the usefulness of linking housing policy to other efforts that enjoy strong political support and could greatly leverage new dollars into housing assistance, assuming that appropriate arguments can be made to show all parties how they can better achieve their own agenda. At a minimum, this proposal can encourage more housing advocates to consider ways in which they can help lower-income households better obtain the benefits for which they are already eligible and better manage and leverage the financial resources they have, particularly in light of current federal budget realities.

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