CBO TESTIMONY

Statement of
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Director
Congressional Budget Office

before the
Committee on the Budget
U.S. House of Representatives

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NOTICE

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Mr. Chairman, I appreciate the opportunity to appear today before the Committee to discuss working families with children, their incomes, and the taxes they pay. In recent years, concern has been growing about the relative and absolute positions of working families with children. My testimony today will examine how working families are doing relative to other families, what their tax burden is relative to other families, and how their income and tax situations have changed over the past decade and one-half.[1]

Three conclusions arise from this analysis:

- Working families with children have lower incomes than other working families, but have significantly higher incomes than families without workers.

- Among working families with children, incomes vary markedly depending on family characteristics. In particular, married couples, families headed by older workers or parents with more schooling, and families with two workers do better than other families with children.

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1. For the purposes of this analysis, working families are defined as those in which the head or the head's spouse, if any, works at least 1,000 hours during the year. Individuals not living with relatives are treated as one-person families, so families include the entire noninstitutionalized population. To compensate for differences in family size, we use adjusted family income that measures incomes relative to the appropriate poverty thresholds of the Bureau of the Census. Income consists of all cash income, including realized capital gains, plus employers' share of payroll taxes and corporate income taxes imputed to individuals, while federal taxes include individual and corporate income taxes, payroll taxes, and excise taxes.

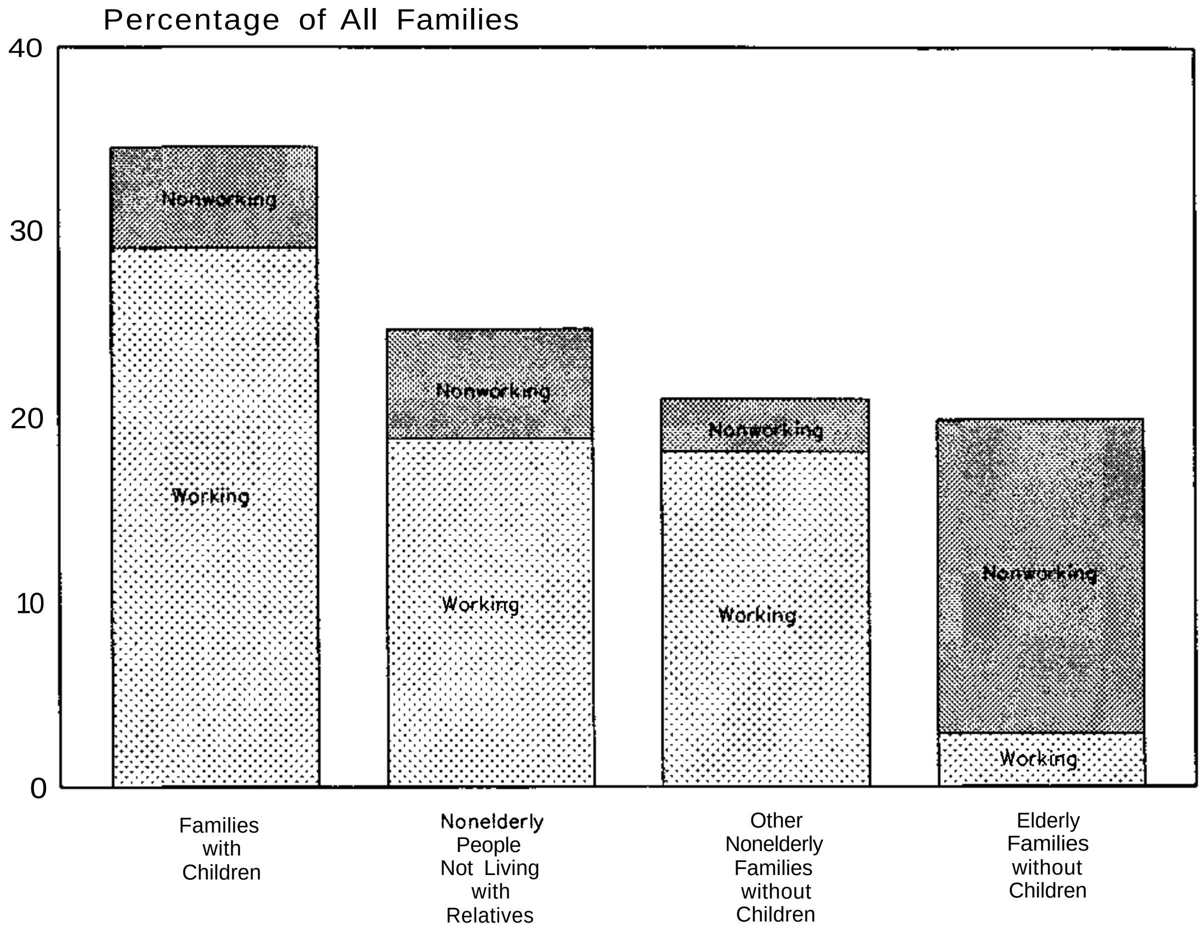
- Except for those with the lowest incomes, working families with children face **effective** federal tax rates similar to those of other working families.

DISTRIBUTION AND INCOMES OF ALL FAMILIES

In 1988, families with children made up about one-third of all families, and contained about 53 percent of all people. People under age 65 not living with relatives accounted for another quarter, while other nonelderly families and elderly families without children each constituted about one-fifth (see Figure 1). Except among the elderly, most families were working in 1988. About four-fifths of all nonelderly families had one or more members who worked at least 1,000 hours. As would be expected, only about 15 percent of elderly families worked.

Most families with children had at least one parent who worked during 1988, although single mothers were much less likely to work than married couples or single fathers (see Figure 2). About 55 percent of single mothers worked at least 1,000 hours in 1988, compared with roughly 80 percent of single fathers and over 90 percent of married couples.

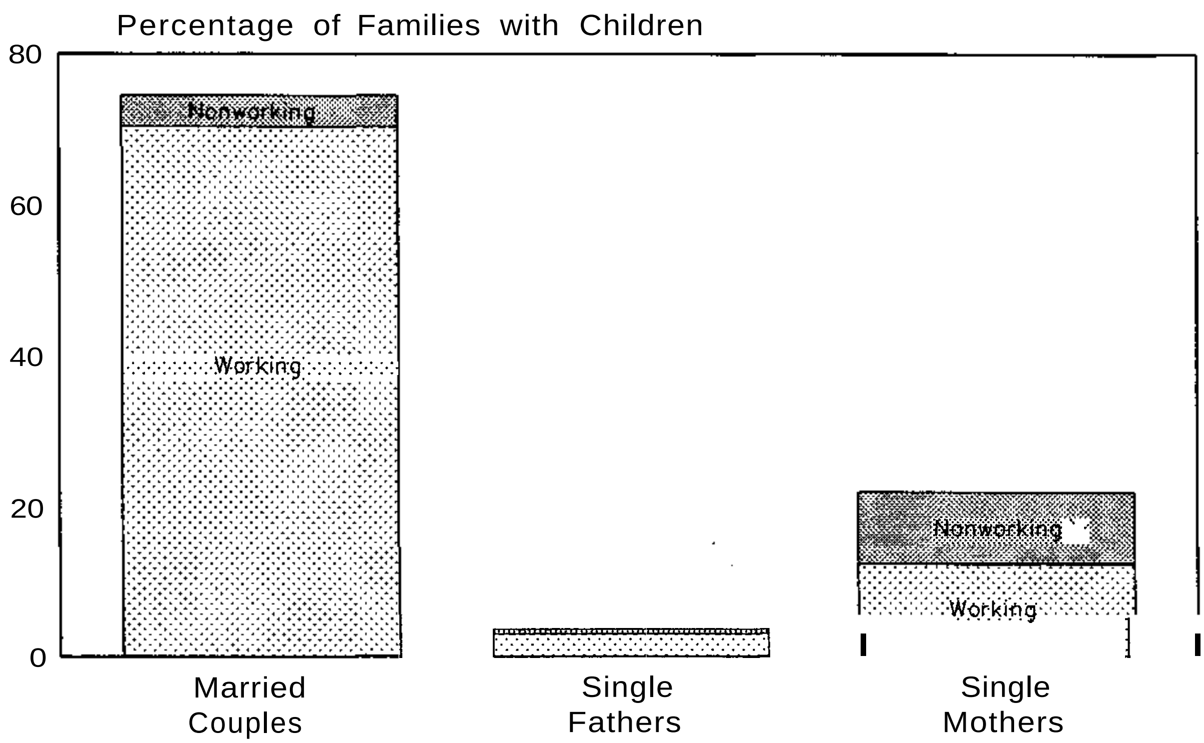
Figure 1.
Distribution of Families by Work Status and Type, 1988



SOURCE: Congressional Budget Office tabulations of data from the integrated Current Population Survey-Statistics of Income file.

NOTE: Working families are those in which either the head or the head's spouse worked at least 1,000 hours in 1988.

Figure 2.
Distribution of Families with Children by Work Status and Type of Family, 1988



SOURCE: Congressional Budget Office tabulations of data from the integrated Current Population Survey-Statistics of Income file.

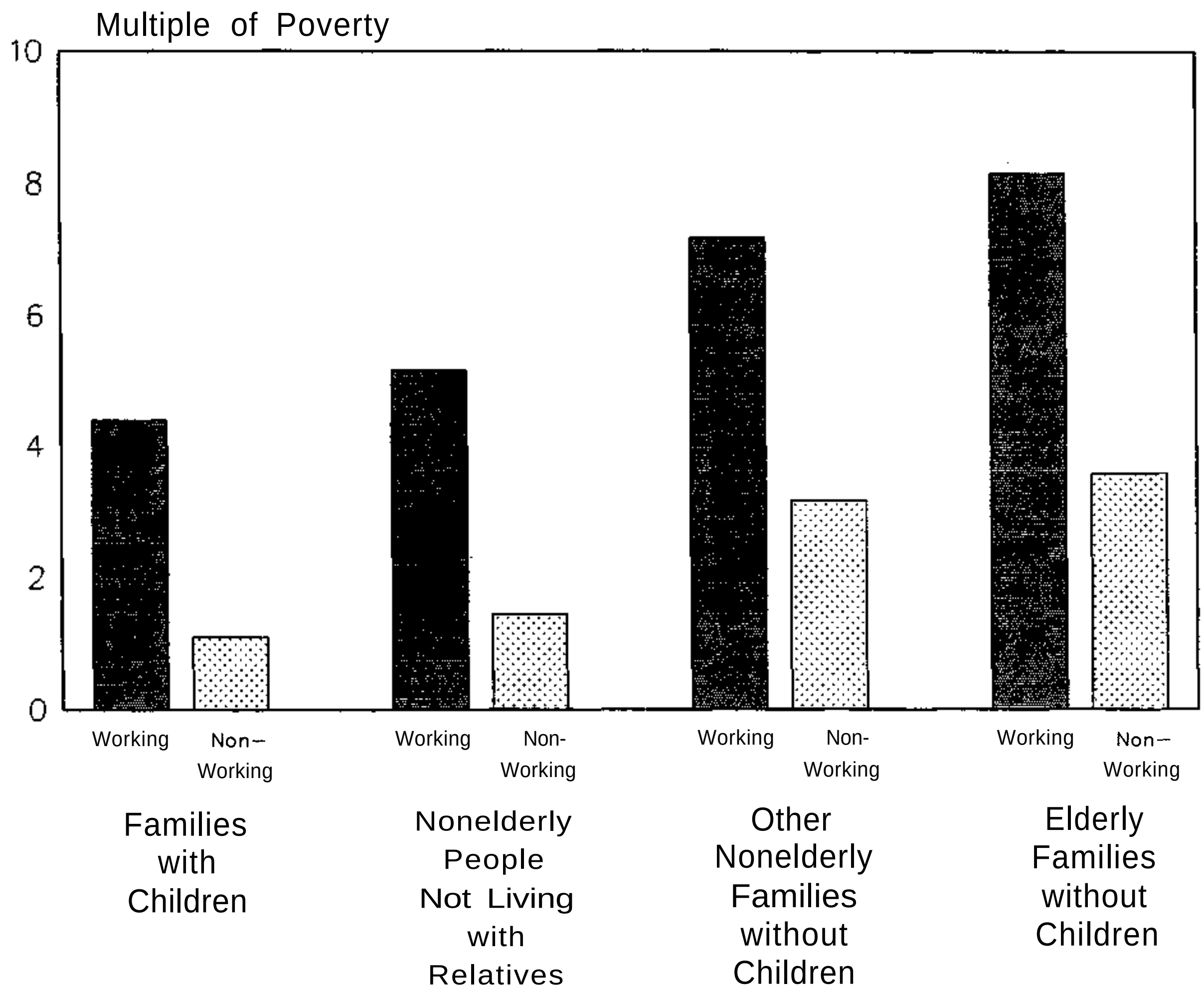
NOTE: Working families are those in which either the head or the head's spouse worked at least 1,000 hours in 1988.

Among working families, families with children had lower average adjusted income in 1988 than other types of families, although their incomes were higher than those of nonworking families (see Figure 3). Working families with children had average incomes nearly four and one-half times the poverty level, compared with incomes of about five times poverty for single working people under age 65, about seven times poverty for other nonelderly working families, and more than eight times poverty for the working elderly. This pattern of relative well-being among types of working families has prevailed since the mid-1970s.

INCOMES OF WORKING FAMILIES WITH CHILDREN

The incomes of working families with children vary widely, depending on the type of family and the characteristics of the parents. Married couples have significantly more income than single parents, even after adjusting for differences in family size. On average, married couples with children had 1988 pretax incomes nearly five times the poverty level, while the incomes of single mothers were only slightly more than 2.5 times poverty. These facts are reflected in the distribution of families among income quintiles--that is, fifths of the income distribution of all families: 33 percent of couples are in the bottom two quintiles and 44 percent are in the top two quintiles, compared with 63 percent and 15 percent of single mothers, respectively (see Table 1).

Figure 3.
Average Family Income by Work Status and Type of Family, 1988



SOURCE: Congressional Budget Office tabulations of data from the integrated Current Population Survey-Statistics of Income file.

NOTES: Working families are those in which either the head or the head's spouse worked at least 1,000 hours in 1988.

Adjusted family income is total family income as a multiple of the appropriate poverty threshold.

One reason why the incomes of single-parent families are lower than those of married couples with children is perhaps the most obvious: they have only one parent to send into the labor force. However, even among married couples with just one worker, average income in 1988 was higher than for single parent families: 4.2 times the poverty level compared with 3.6 for single fathers and 2.6 for single mothers

TABLE 1. DISTRIBUTION OF WORKING FAMILIES WITH CHILDREN BY TYPE OF FAMILY AND INCOME QUINTILE FOR ALL FAMILIES, 1988 (In percent)

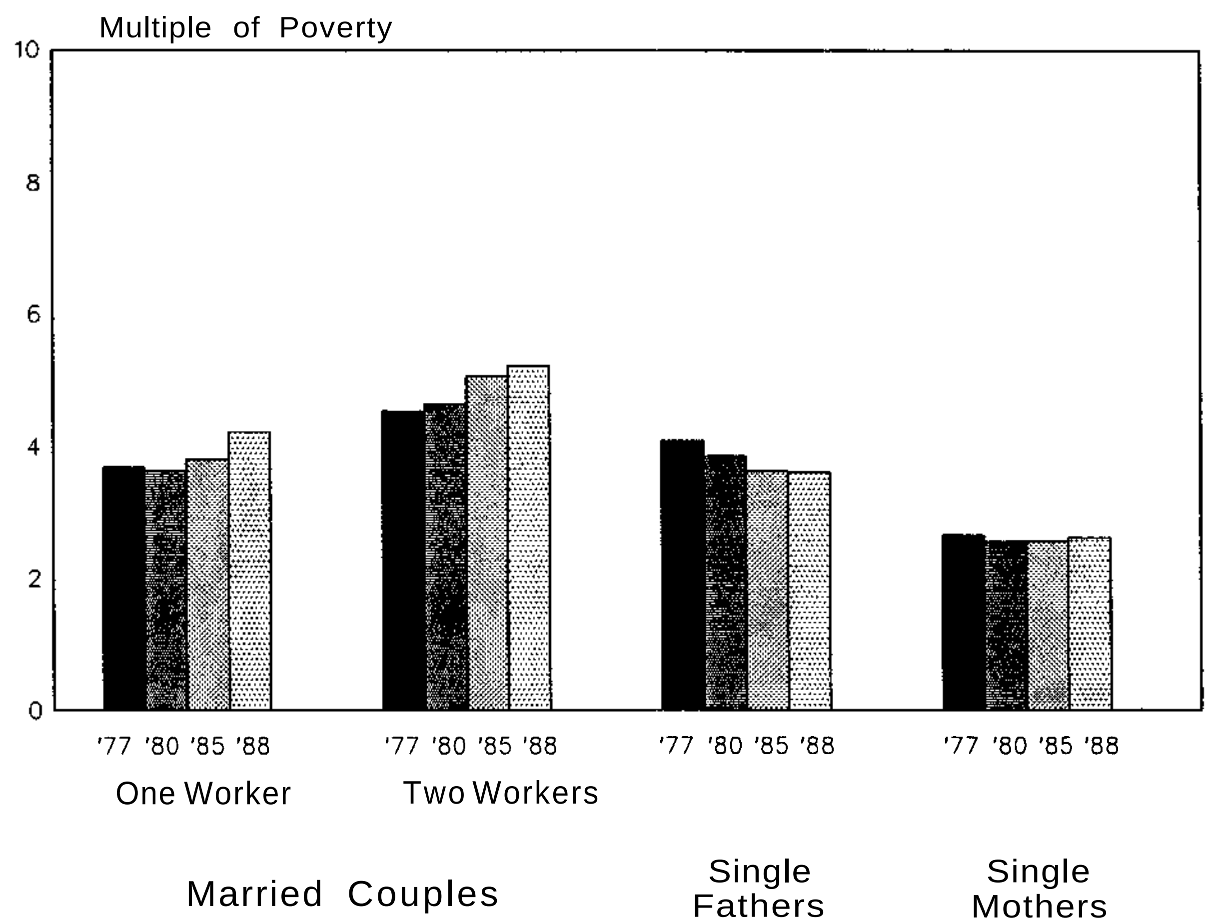
Quintile	Married Couples	Single Fathers	Single Mothers
Lowest	11	17	30
Second	22	26	33
Middle	24	26	21
Fourth	25	20	11
Highest	19	12	4
Total	100	100	100

SOURCE: Congressional Budget Office tabulations of data from the integrated Current Population Survey-Statistics of Income file.

(see Figure 4). Perhaps more important, the disparity in incomes has grown over time, as incomes of married couples--adjusted for inflation--have risen steadily since 1977, while incomes of single fathers have declined and those of single mothers have remained roughly constant. Perhaps surprisingly, the difference in average incomes between married couples with one or two spouses each working at least 1,000 hours is less than 25 percent. This difference may indicate that families with low-earning workers are somewhat more likely to have both parents working than those with high-earning workers.

Families with children in which parents have had more schooling have higher incomes than their counterparts in which parents have had less schooling, and the disparity has grown over time. On average, in 1988, families in which parents did not graduate from high school had incomes only 60 percent as great as families headed by high school graduates and less than one-third those of college graduates (see Figure 5). Families without high school graduates experienced a steady decline in family incomes during the preceding decade, while families headed by high school graduates experienced virtually no growth in income and those headed by college graduates saw their incomes increase by more than one-fourth. These differences hold for each type of family, although the effects of education are greater for married couples than for single parents.

Figure 4.
Working Families with Children: Average Adjusted Family Income by Type of Family, 1977-1988



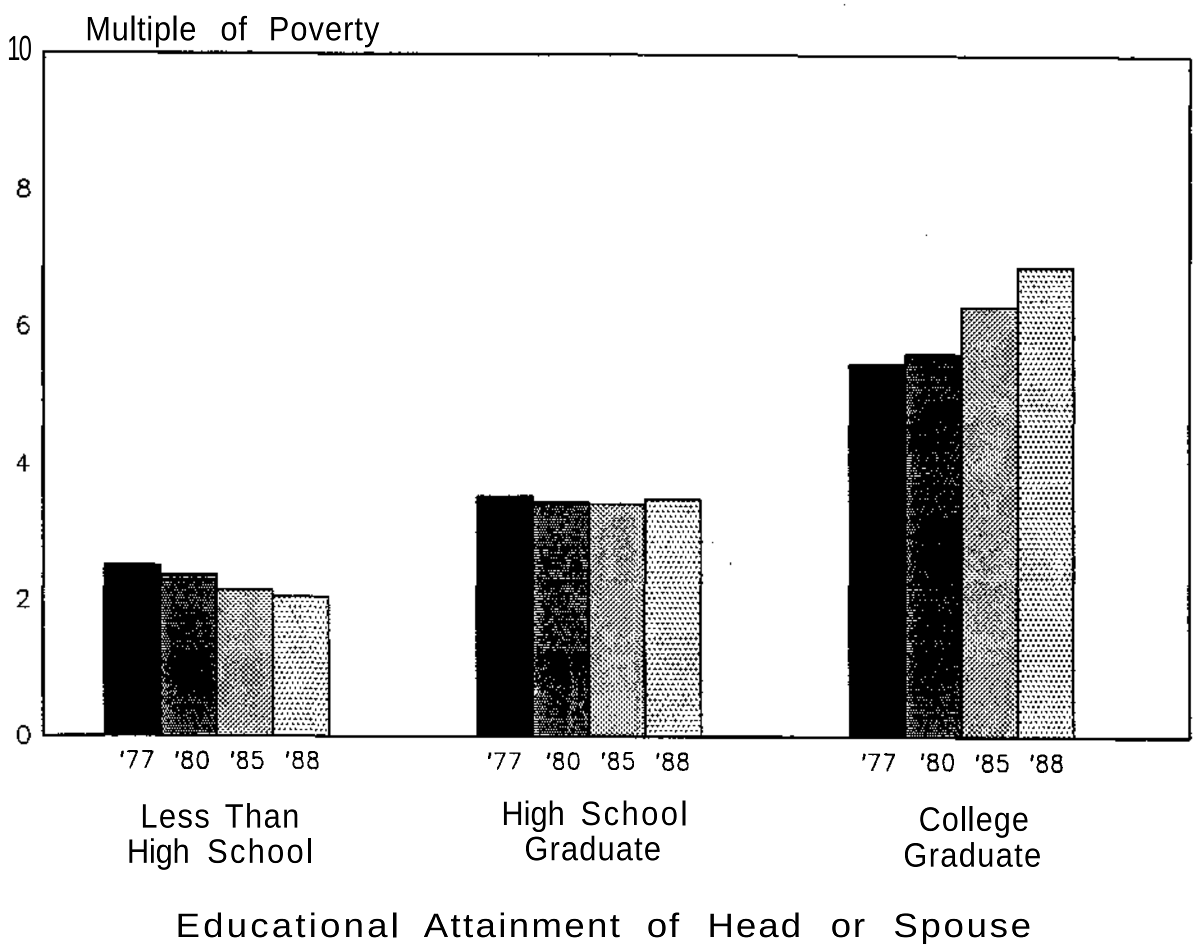
SOURCE: Congressional Budget Office tabulations of data from the integrated Current Population Survey–Statistics of Income file.

NOTES: Working families are those in which either the head or the head's spouse worked at least 1,000 hours during the year.

Adjusted family income is total family income as a multiple of the appropriate poverty threshold.

Figure 5.

Working Families with Children: Average Adjusted Family Income by Educational Attainment of Head or Spouse, 1977-1988



SOURCE: Congressional Budget Office tabulations of data from the integrated Current Population Survey-Statistics of Income file.

NOTES: Working families are those in which either the head or the head's spouse worked at least 1,000 hours during the year.

Adjusted family income is total family income as a multiple of the appropriate poverty threshold.

Educational attainment of married couples is that of the parent with the greater amount of schooling.

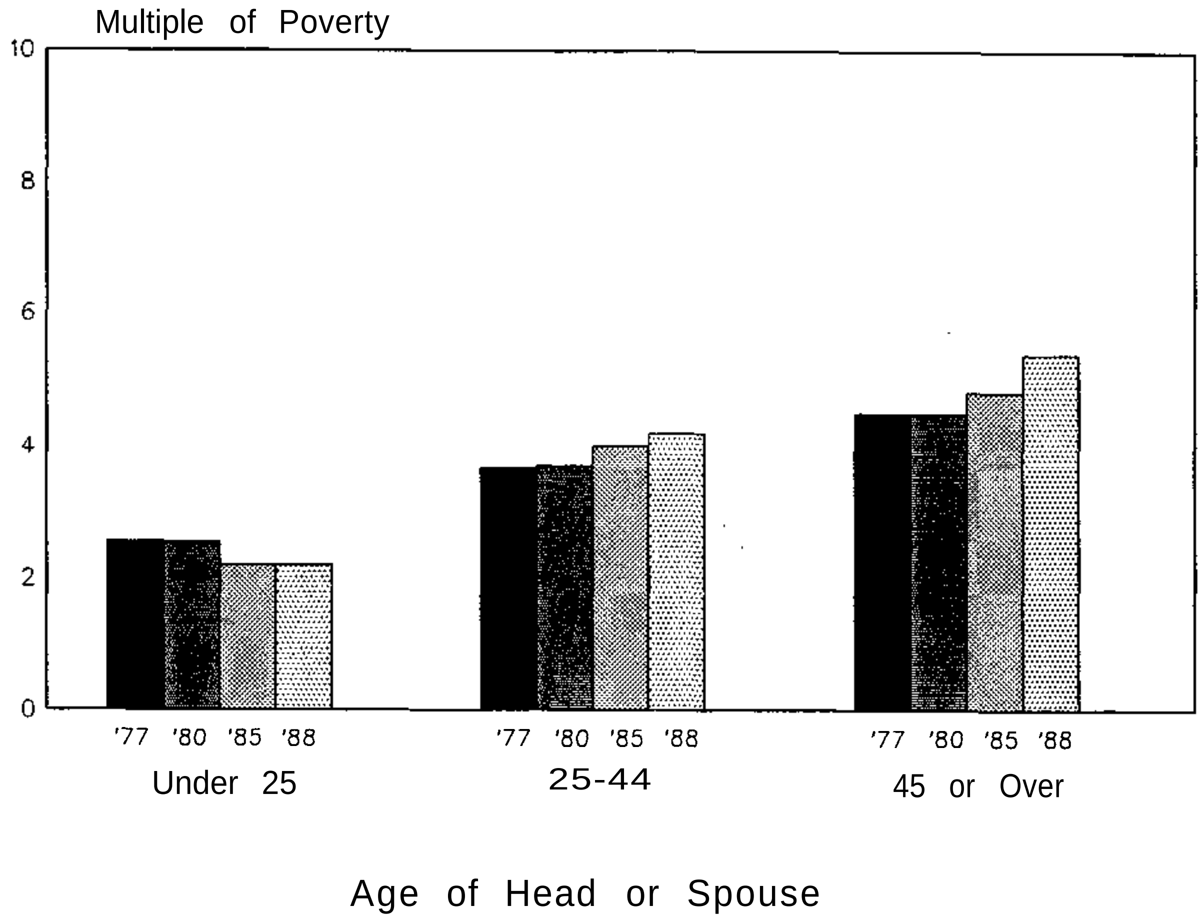
Incomes also rise sharply with parents' age, and again the differences have increased over time, as shown in Figure 6. In 1988, families headed by parents under age 25 had average incomes barely twice the poverty level, down about 15 percent over the preceding decade. In contrast, families with parents between 25 and 44 had incomes more than four times poverty, up 14 percent from 1977, and families with parents ages 45 or older had incomes averaging more than five times poverty, nearly 20 percent higher than in 1977. Again, the differences among age groups are smaller but still present among single-parent families as well as among couples.

What then are the incomes of working families with children? Single mothers and parents without high school degrees or under age 25 are poorest, with average incomes at or just above twice the poverty level. Furthermore, their incomes have stagnated or declined since the mid-1970s. In contrast, couples with two working parents and families with older or college-educated parents have the highest incomes, more than five times poverty in 1988, up sharply over the preceding decade.

TAXES OF WORKING FAMILIES

Effective federal tax rates are best examined using projections for 1992 by when most provisions of the Omnibus Budget Reconciliation Act of 1990 (OBRA 1990) will be fully phased in. Total tax rates that working families with children will face in 1992

Figure 6.
Working Families with Children: Average Adjusted Family Income by Age of Head or Spouse, 1977-1988



SOURCE: Congressional Budget Office tabulations of data from the integrated Current Population Survey–Statistics of Income file.

NOTES: Working families are those in which either the head or the head's spouse worked at least 1,000 hours during the year.

Adjusted family income is total family income as a multiple of the appropriate poverty threshold.

For married couples, age is that of the older parent.

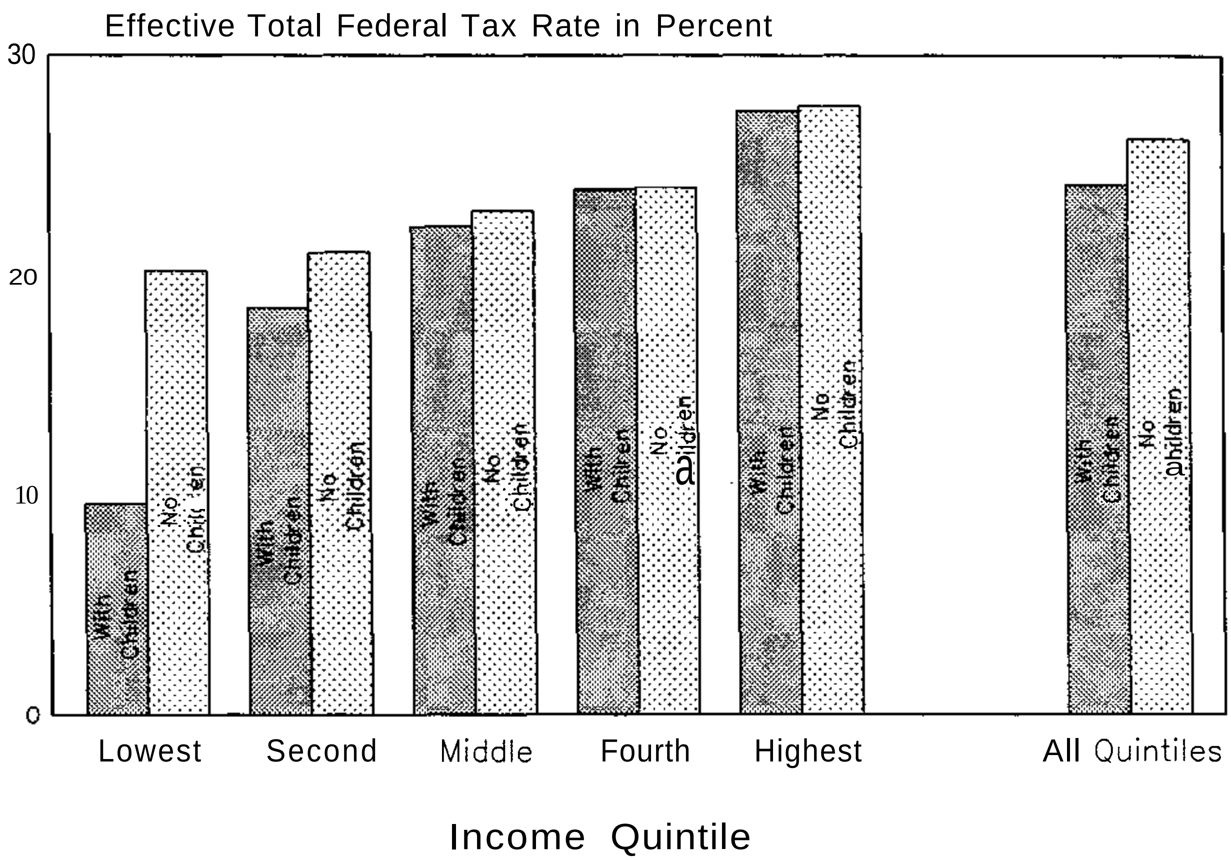
are similar to those that other working families will face, except among families with the lowest incomes (see Figure 7). As a result, except for improving the well-being of the poorest working families with children, the tax system does little to change the distribution of income between working families with and without children.

Overall, in 1992, working families with children will pay about 24 percent of their incomes in federal taxes, compared with 26 percent other working families will pay. The difference results in part because of tax preferences favoring working families with children--the Earned Income Tax Credit (EITC), the Dependent Care Credit, and dependent exemptions--and in part because families with children have lower incomes than their childless counterparts. Total federal tax rates are similar for working families with and without children throughout most of the income distribution. For families in the lowest income quintile, however, effective tax rates will differ widely between the two groups: 12 percent for those with children versus 20 percent for childless families.

Individual Income Taxes

The federal individual income tax has undergone significant changes over the past 15 years, as shown in Figure 8. For the poorest working families with children, the effective individual income tax rate has become more negative as a result of large

Figure 7.
Projected 1992 Effective Total Federal Tax Rates of Working Families, by Income Quintile



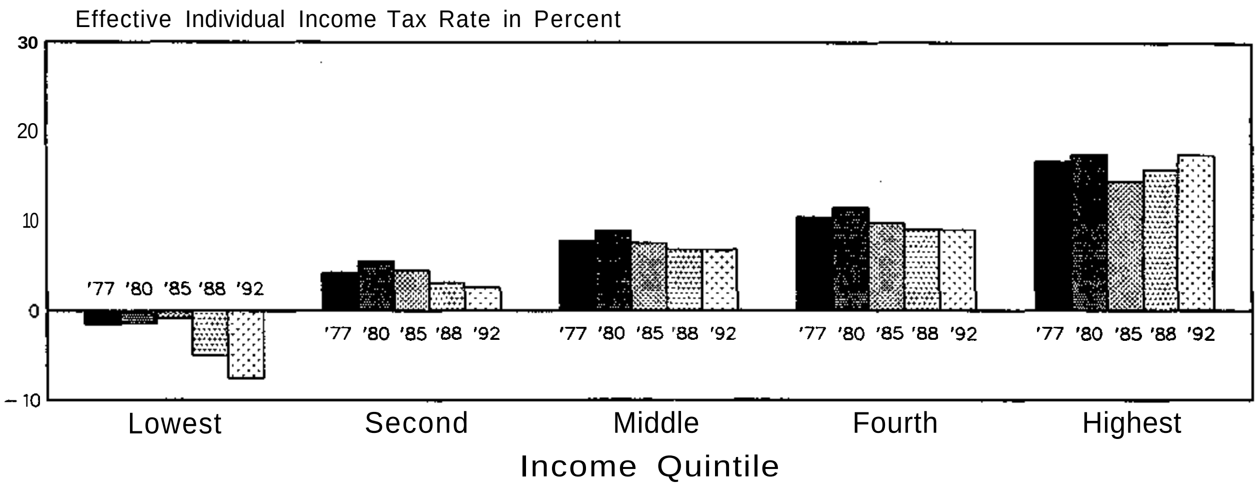
SOURCE: Congressional Budget Office tax simulation model.

NOTES: Working families are those in which either the head or the head's spouse is projected to work at least 1,000 hours in 1992.

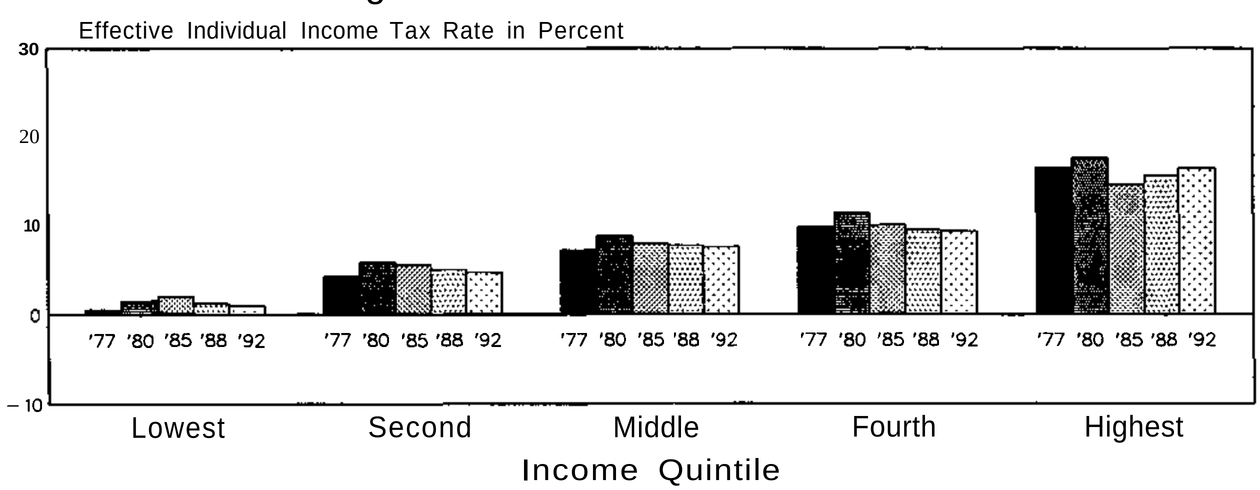
Income quintiles are for all families.

Figure 8.
Effective Federal Individual Income Tax Rates by Income Quintile, 1977-1992

Working Families with Children



Working Families without Children



SOURCE: Congressional Budget Office tax simulation model.

NOTES: Working families are those in which either the head or the head's spouse worked at least 1,000 hours during the year.
Income quintiles are for all families.

increases in the refundable EITC in both the Tax Reform Act of 1986 and OBRA 1990. As a result, working families with children will receive average credit refunds in 1992 equal to about one-tenth of their pretax incomes. Because low-income working families without children do not qualify for the EITC, they will face slightly positive income tax rates, and those rates have fallen only marginally.

Working families with and without children in the middle three quintiles will face similar 1992 income tax rates, rates only slightly lower than they faced in 1980. Except for families with children in the second quintile, some of whom will benefit from the expanded EITC and thus face lower tax rates, the decreases will leave middle-income families with effective tax rates similar to those they faced in 1977.

At the top end of the income distribution, having children has virtually no impact on effective tax rates. Because various tax preferences have been eliminated, individual income tax rates have risen steadily since 1985 after the large rate decreases of the early 1980s. The recent increases will bring the effective 1992 tax rates of families with high incomes back up to near the peak levels of 1980.

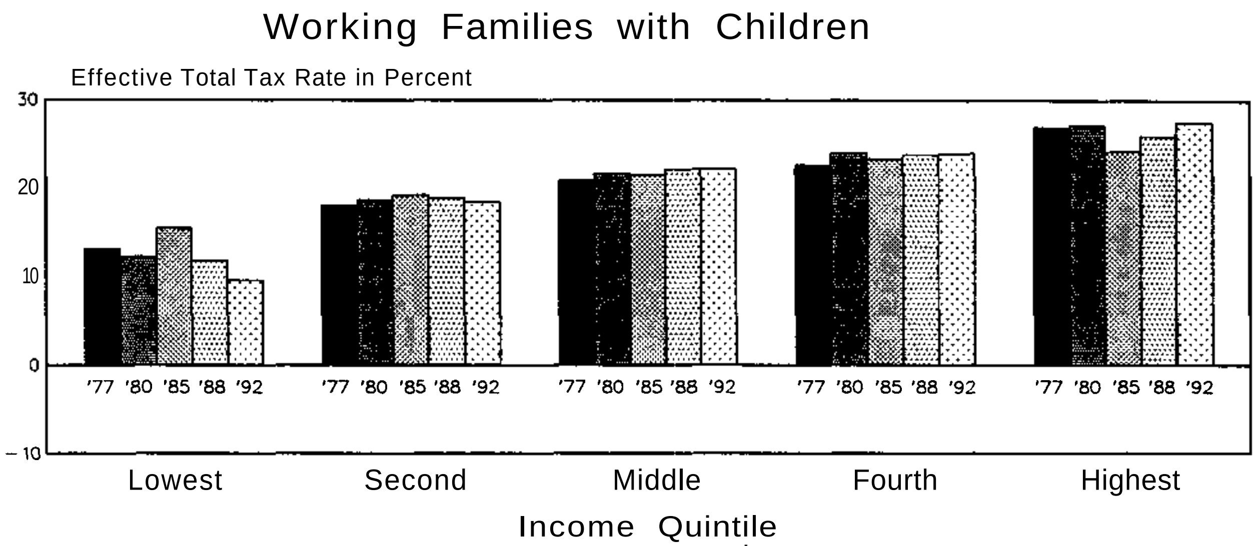
The general similarity of effective individual income tax rates between working families with and without children results from the federal tax law providing few advantages for families with children. Aside from the EITC and the dependent care credit, families with children are treated the same as other families, although larger families have somewhat lower taxes because they can take more dependent exemptions. For example, in 1992 each additional dependent exemption will reduce taxable income by $2,300. This reduction will represent a tax savings of $345 for families in the 15 percent tax bracket and $644 for families in the 28 percent bracket. For working families with children in the middle income quintile, the $345 savings will represent about 12 percent of the average tax bill.

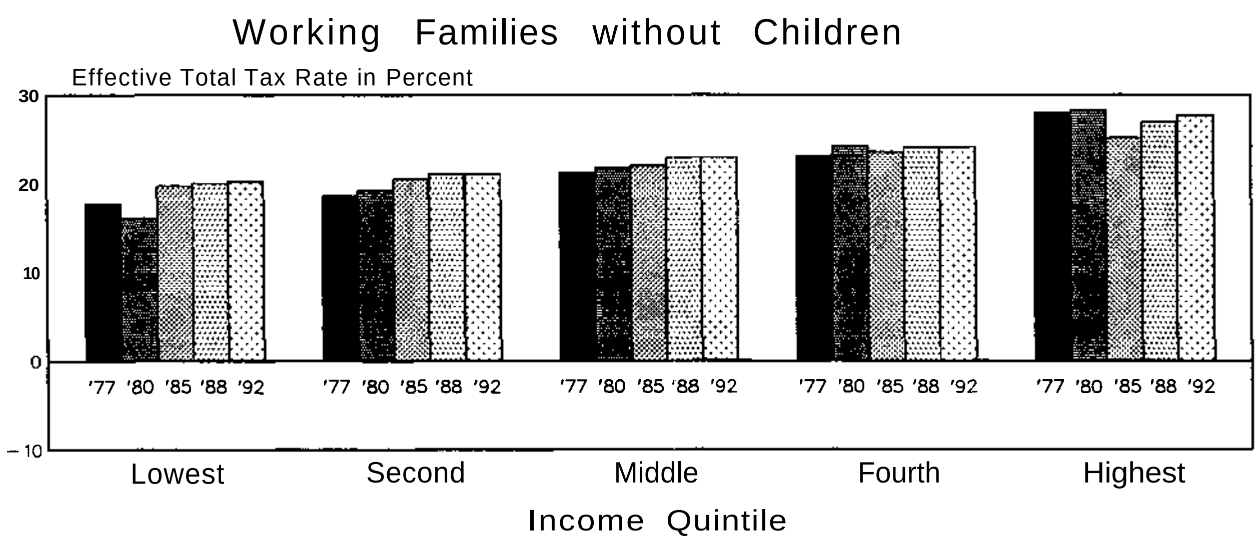
Total Federal Taxes

Over the last 15 years, effective total federal tax rates have generally increased for working families, both those with children and those without children (see Figure 9). Among working families, only low-income working families with children will face lower tax rates in 1992 than similar families faced in 1977. For those families, marked tax reductions since 1985 have more than offset the increases they experienced during the early 1980s.

The increase in tax rates has been primarily the result of rising payroll taxes. Since 1977, the Social Security tax rate has risen from a combined 11.7 percent of taxable earnings on employers and employees to 15.3 percent, while the limit on taxable earnings has been increased by about half after adjusting for inflation. As a result, the effective social insurance tax rate for working families with children--

Figure 9.
Effective Total Federal Tax Rates by Income Quintile, 1977-1992





SOURCE: Congressional Budget Office tax simulation model.

NOTES: Working families are those in which either the head or the head's spouse worked at least 1,000 hours during the year.
Income quintiles are for all families.

including both Social Security and unemployment insurance taxes--will rise from 8 percent in 1977 to about 10 percent in 1992. (The effective social insurance tax rate is less than the combined Social Security tax rate because not all income is subject to Social Security taxes.) The EITC was initially enacted and has been increased over time in part to offset the impact of these taxes on low-income working families. Working families without children will face a similar increase in payroll taxes, but do not benefit from the EITC. All working families who pay these taxes, however, can potentially benefit from the social insurance programs the taxes fund.

CONCLUSION

Pretax incomes primarily determine the well-being of families. While federal taxes overall are modestly progressive, with higher effective rates for families with higher incomes, the distribution of after-tax incomes is similar to that of pretax incomes, albeit with slightly less inequality. Because of payroll taxes, working families face somewhat higher tax rates than do nonworking families, but most of the difference in post-tax incomes of working and nonworking families results from differences in their incomes before taxes. For working families with children at the bottom end of the income distribution, the EITC raises incomes significantly. Earnings make up most of the incomes of working families in the middle income quintiles; these earnings are subject to both income and payroll taxes with essentially no preferential treatment.

Some people have expressed concerns about the well-being and incomes of working families with children. If concern focuses on the low incomes of the poorest working families, further expansion of the EITC may provide a reasonable approach for improvement, at least in the short run. More permanent solutions, however, would address the causes of low incomes and attempt to improve the earnings capacity and willingness of families to work. Specifically, policies could deal with education, job training, employment opportunities, and assistance in obtaining and keeping jobs, including child care.

If concern focuses more generally on the incomes of all working families with children, solutions may be more straightforward but also more expensive. Tax credits or allowances targeted on these families could increase their incomes, and the tax system might provide an efficient delivery mechanism. The costs, however, would be substantial. To raise the incomes of all working families with children by as little as $10 a week would reduce revenues or increase spending by about $15 billion in 1992 and more in the future. As an alternative, however, larger and longer lasting gains could derive from small increases in productivity that would benefit the entire economy.