Notes

EARNED INCOME TAX CREDIT: PATH DEPENDENCE AND THE BLESSING OF UNDERTHEORIZATION

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ABSTRACT

Some commentators have lamented that the Earned Income Tax Credit (EITC) is undertheorized—that its purpose is unclear—and that its design is therefore suboptimal. This Note explores the credit's path-dependent past, which has resulted in a present-day EITC that manifests a diverse, uncoordinated assortment of policy purposes. Although the EITC's ambiguity of purpose may yield policy inefficiencies, this Note argues that it also produces significant political benefits that would-be reformers who value the EITC's many societal benefits should take into account before they attempt to enact any major overhaul.

INTRODUCTION

Commentators have bemoaned that the Earned Income Tax Credit (EITC) is drastically undertheorized.[1] Though this may sound unequivocally bad, this Note shows that the EITC's undertheorization[2] may actually be an advantage that policymakers should not abandon lightly.

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1. *See infra* Part I.B.

2. Professor Lawrence Zelenak uses the term "undertheorized" to describe how Congress has never explained the purpose of the EITC, "except in the vaguest and most general terms." Lawrence Zelenak, *Redesigning the Earned Income Tax Credit as a Family-Size Adjustment to the Minimum Wage*, 57 TAX L. REV. 301, 301 (2004). Because the purpose of the EITC is unclear, Professor Zelenak believes its design must be far from optimal. *See id.* ("Without a clear idea of what the EITC is supposed to do, it is impossible to determine how it should be designed.").

With the EITC at a crossroads, this insight may have significant implications for its future. One reason to suspect policymakers may be primed to change the EITC is that the Speaker of the House of Representatives and the current chairmen of the House Ways and Means Committee and the Senate Committee on Finance have all expressed a desire to enact tax reform in the 114th Congress,[3] and leaders have expressed guarded optimism about tax reform's likelihood.[4] Even if tax reform—which brought with it a large EITC expansion in 1986[5]—is unlikely due to the partisan divide between Congress and President Obama, the President and Speaker Paul Ryan have both recently proposed similar EITC expansions on which there may be room for bipartisan compromise.[6] Furthermore, EITC advocates in Congress must act before 2018 to prevent a temporary EITC expansion from expiring.[7]

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3. *See* Geoff Davis & James Carter, *Ways and Means Chair's Call to Action on Taxes*, THE HILL (Dec. 2, 2015, 6:00 AM), http://thehill.com/blogs/pundits-blog/economy-budget/261707-ways-and-means-chairs-call-to-action-on-taxes [http://perma.cc/XL7D-2H3T] (detailing Kevin Brady's strategic plan to "tee up pro-growth tax reform"); Brian Faler, *Ryan's Move Could Be Big Boost for Tax Reform*, POLITICO (Nov. 2, 2015, 5:12 AM), http://www.politico.com/story/2015/11/paul-ryan-tax-reform-house-speaker-215405 [http://perma.cc/9JRH-LBKS] (describing Speaker Paul Ryan's desire to expand the EITC as part of broader plans to enact comprehensive tax reform); Aaron E. Lorenzo, *Hatch to Push Tax Rewrite as Incoming Chairman of Senate Finance Committee*, BLOOMBERG BNA (Nov. 6, 2014), http://www.bna.com/hatch-push-tax-n17179911052 [http://perma.cc/Y287-YCU2] (outlining Senator Orrin Hatch's agenda for tax reform).

4. *See, e.g.*, Jonathan Weisman, *Chance for Tax Overhaul is Seen in Shift of Power*, N.Y. TIMES (Nov. 6, 2014), http://www.nytimes.com/2014/11/07/us/politics/republican-wins-may-lead-to-fiscal-deal-with-democrats.html?_r=0 [http://perma.cc/EF4A-UDYN] (reporting on a meeting between Senate Majority Leader Mitch McConnell and President Barack Obama in which the two cite tax reform as potential common ground). *But see, e.g.*, Scott A. Hodge, *Do the Election Results Improve the Odds of Tax Reform?*, TAX FOUNDATION (Nov. 5, 2014), http://taxfoundation.org/blog/do-election-results-improve-odds-tax-reform [http://perma.cc/7BHZ-3A9Q] ("[T]he likelihood that it will be this Congress and this president making [a deal on tax reform] seem[s] pretty remote.").

5. *See infra* notes 203–20 and accompanying text.

6. *See* EXEC. OFFICE OF THE PRESIDENT & U.S. DEP'T OF THE TREASURY, THE PRESIDENT'S PROPOSAL TO EXPAND THE EARNED INCOME TAX CREDIT 5–7, 15–16 (2014), http://www.whitehouse.gov/sites/default/files/docs/eitc_report.pdf [http://perma.cc/C7NC-YB6E] (recommending an EITC expansion for childless workers, funding such expansion with additional tax revenue); PAUL RYAN, HOUSE BUDGET COMM. MAJORITY STAFF, EXPANDING OPPORTUNITY IN AMERICA: A DISCUSSION DRAFT FROM THE HOUSE BUDGET COMMITTEE 27–29 (2014), http://budget.house.gov/uploadedfiles/expanding_opportunity_in_america.pdf [http://perma.cc/D6TR-RQH2] (proposing to expand the EITC for childless workers, funding such expansion with cuts in welfare spending).

7. 26 U.S.C. § 32(b)(3) (2012).

This Note first provides background information about the EITC, discusses the cause of its undertheorization, and then explains how such undertheorization may actually be a blessing, not a curse.

I. BACKGROUND

A. *The EITC*

The EITC has been a part of the tax code for more than forty years. Congress enacted it in 1975[8] as part of a tax-reduction package designed to address economic recession and high unemployment.[9] The original EITC had a maximum value of $400.[10] Three years later, noting the EITC's efficacy in "providing tax relief for low income families while at the same time providing work incentives for these individuals,"[11] Congress expanded the credit and made it permanent.[12] Congress further expanded the EITC and indexed it for inflation as part of the Tax Reform Act of 1986[13] and expanded it in, among other years, 1990,[14] 1993,[15] and 2001.[16]

As a refundable credit, the EITC is somewhat unique among tax expenditures.[17] Unlike most tax expenditures, which individually or collectively can do no more than reduce a taxpayer's income-tax liability down to zero,[18] the EITC is refundable, meaning eligible taxpayers enjoy the credit's full value even if their precredit tax liability is already zero. In other words, it functions "as a kind of

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8. Tax Reduction Act of 1975, Pub. L. No. 94-12, 89 Stat. 26 (codified as amended in scattered sections of 26 U.S.C.).

9. H.R. REP. NO. 94-19, at 3 (1975); S. REP. NO. 94-36, at 5 (1975).

10. Tax Reduction Act of 1975 § 204. In 2015 dollars, the maximum value of the credit was about $1765. *CPI Inflation Calculator*, BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, http://www.bls.gov/data/inflation_calculator.htm [http://perma.cc/RAN2-6WNW].

11. S. REP. NO. 95-1263, at 52 (1978).

12. Revenue Act of 1978, Pub. L. No. 95-600, § 103, 92 Stat. 2763, 2771 (codified as amended in scattered sections of 26 U.S.C.).

13. Tax Reform Act of 1986, Pub. L. No. 99-514, § 111, 100 Stat. 2085, 2107 (codified as amended in scattered sections of 26 U.S.C.).

14. *See infra* notes 221–27 and accompanying text.

15. *See infra* notes 236–41 and accompanying text.

16. *See infra* notes 242–51 and accompanying text.

17. "The term 'tax expenditures' means those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." 2 U.S.C. § 622(3) (2012).

18. CONG. BUDGET OFFICE, PUB. NO. 4152, REFUNDABLE TAX CREDITS 1 (2013).

negative income tax."[19] As a simple illustration, consider a single taxpayer who earned $10,000 in 2015. This taxpayer would realize no value from a $100 deduction because her personal exemption[20] and standard deduction[21] leave her no taxable income. Similarly, she would not benefit from a $100 nonrefundable credit because she has no tax liability against which to apply the credit. In contrast, a $100 *refundable* credit would be worth $100 to her because she could receive it in the form of a payment.

The EITC's refundability is an essential feature because the credit is designed to benefit low-income taxpayers[22] whose income-tax liabilities tend to be low or nonexistent.[23] The amount of the credit is based on a taxpayer's "earned income," which includes wages, salaries, and net earnings from self-employment, but does not include investment income such as capital gains and dividends.[24] The credit's value is calculated by multiplying the taxpayer's earned income by the applicable credit percentage.[25] Thus, as the taxpayer earns more, her credit increases until it reaches a maximum value.[26] The credit then plateaus until the taxpayer reaches another earnings threshold, after which each additional dollar of earned income reduces a portion of the credit until it is completely phased out.[27] Figures 1 and 2[28] illustrate this process below.

19. RICHARD SCHMALBECK & LAWRENCE ZELENAK, FEDERAL INCOME TAXATION 791 (3d ed. 2011).

20. The personal exemption reduces taxable income. For 2015, the personal exemption amount was $4000. Rev. Proc. 2014-61, 2014-47 I.R.B. 860, at 866.

21. The standard deduction reduces taxable income. For 2015, the standard deduction for unmarried individuals was $6300. *Id.* at 865.

22. *See Earned Income Tax Credit*, IRS, https://www.irs.gov/Credits-&-Deductions/Individuals/Earned-Income-Tax-Credit [https://perma.cc/F97S-29F3] ("The Earned Income Tax Credit . . . is a benefit for working people with low to moderate income.").

23. *See* ISAAC SHAPIRO & JOEL FRIEDMAN, CTR. ON BUDGET POLICY & PRIORITIES, INCOME TAX RATES AND HIGH-INCOME TAXPAYERS: HOW STRONG IS THE CASE FOR MAJOR RATE REDUCTIONS?, at ii (2001) ("Most low- and many moderate-income families . . . do not owe federal income taxes.").

24. 26 U.S.C. § 32(c)(2) (2012).

25. *Id.* § 32(b). The credit percentage depends on the number of qualifying children the taxpayer has. *Id.*

26. *Id.*

27. *Id.*

28. The author created Figures 1 and 2 based on Rev. Proc. 2014-61, 2014-47 I.R.B. 863.

Figure 1. 2015 EITC, Married Filing Jointly

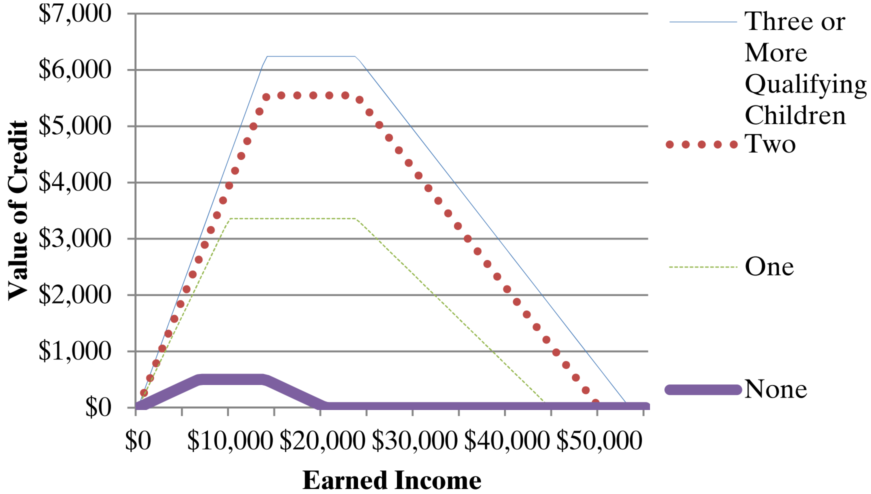
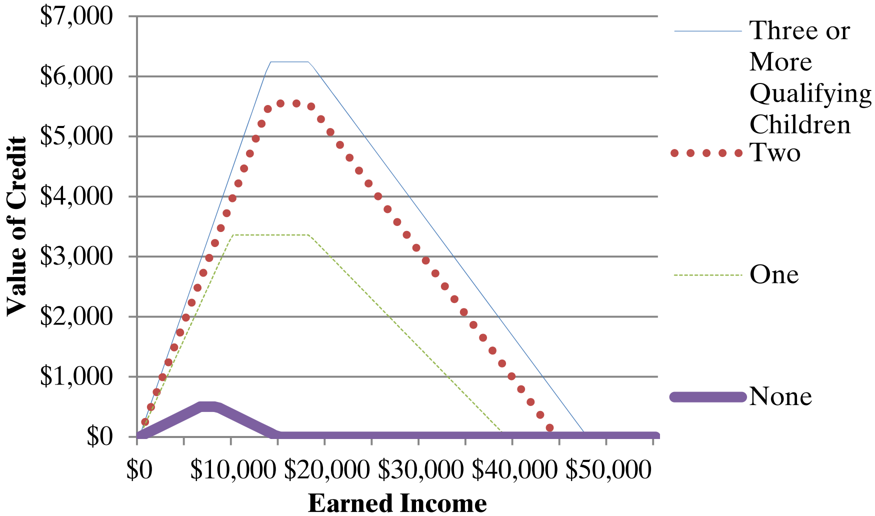


Figure 2. 2015 EITC, Single, Surviving Spouse, Head of Household



The EITC has grown from its humble beginnings[29] to become the country's "most significant federally administered anti-poverty

29. *See supra* note 10 and accompanying text.

program."[30] The EITC's projected cost for fiscal year 2015 is $70.4 billion.[31] Its recorded cost in 2012, the most recent year for which the IRS has published data, was $64.1 billion.[32] Of that amount, only $1.2 billion went toward offsetting income-tax liabilities.[33] Another $6.8 billion was used to offset other taxes, including Social Security and Medicare taxes.[34] The remaining $56.1 billion—accounting for nearly 90 percent of the credit's cost—was disbursed in the form of a government payment.[35] In total, EITC-related outlays swamp the cost of other major federally administered antipoverty programs.[36] Largely due to the enactment and growth of the EITC, the IRS has become "one of the government's principal welfare agencies, on par with the Department of Health and Human Services (HHS) and the Social Security Administration."[37]

B. *The Undertheorized EITC*

Surprisingly, the EITC is "severely undertheorized"[38] considering its age and scope. Professor Lawrence Zelenak laments that Congress has never explained the EITC's purpose "except in the vaguest and most general terms,"[39] and a number of scholars echo this sentiment.[40]

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30. SCHMALBECK & ZELENAK, *supra* note 19, at 793.

31. STAFF OF JOINT COMM. ON TAXATION, 113TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2014–2018, at 32 (Comm. Print 2014).

32. INTERNAL REVENUE SERV. STATISTICS OF INCOME, RETURNS WITH EARNED INCOME CREDIT, BY SIZE OF ADJUSTED GROSS INCOME, TAX YEAR 2012 (2014), http://www.irs.gov/file_source/pub/irs-soi/12in25ic.xls [http://perma.cc/T6UG-2LCS].

33. *Id.*

34. *Id.*

35. *Id.*

36. For example, the 2014 cost of the Temporary Assistance for Needy Families (TANF) program was $16.5 billion. CTR. ON BUDGET AND POLICY PRIORITIES, POLICY BASICS: AN INTRODUCTION TO TANF 2 (June 15, 2015), http://www.cbpp.org/sites/default/files/atoms/files/7-22-10tanf2.pdf [http://perma.cc/A6DW-39MC]. Medicaid and the Supplemental Nutrition Assistance Program (SNAP, formerly known as the Food Stamp program) cost more but are administered at the state level. *See* U.S. DEP'T OF HEALTH & HUMAN SERVS., 2014 ACTUARIAL REPORT ON THE FINANCIAL OUTLOOK FOR MEDICAID, at i (2014) (reporting Medicaid outlays in 2013 of $457.8 billion); U.S. DEP'T OF AGRIC., SUPPLEMENTAL NUTRITION ASSISTANCE PROGRAM NATIONAL VIEW SUMMARY 1 (2016), http://www.fns.usda.gov/sites/default/files/pd/34SNAPmonthly.pdf [http://perma.cc/2TBJ-HF4P] (showing that SNAP outlays for FY 2014 and FY 2015 were each just short of $70 billion); John L. Czajka, *Can Administrative Records Be Used to Reduce Nonresponse Bias?*, 645 ANNALS AM. ACAD. POL. & SOC. SCI. 171, 175 n.1 (2013) (noting that SNAP and Medicaid are administered by the states).

37. Kristen E. Hickman, *Administering the Tax System We Have*, 63 DUKE L.J. 1717, 1730 (2014).

38. Zelenak, *supra* note 2, at 301.

39. *Id.*

So how can it be that the EITC's purpose remains fuzzy after forty years of legislative history? In this Note, I do not attempt to divine a singular, unified purpose undergirding the EITC. Instead, I explain why the EITC lacks "any coherent purpose discernible from [its] structure."[41] Specifically, I examine the role path dependence has played in fueling the EITC's advancement. By analyzing the EITC's path-dependent past, I uncover a surprising insight that policymakers should take into account when considering the EITC's future.

II. PATH DEPENDENCE

This Part introduces the concept of path dependence, explains how it works in the economy and in policymaking, and describes its value as a theoretical lens.

A. Path Dependence in Economics

The concept of path dependence is that "each step in one direction makes additional steps in that same direction more likely."[42] One of the primary mechanisms driving this tendency of directional inertia is "increasing returns."[43] In the economy, increasing returns arise as a result of four conditions: "large . . . fixed costs . . . ;[44] learning effects, which lower costs as a product becomes more common; coordination effects, which confer benefits for taking action similar to others; and . . . adaptive expectations, which lead actors to

40. *E.g.*, CHRISTOPHER HOWARD, THE HIDDEN WELFARE STATE: TAX EXPENDITURES AND SOCIAL POLICY IN THE UNITED STATES 64 (1999); Jennifer Bird-Pollan, *Who's Afraid of Redistribution? An Analysis of the Earned Income Tax Credit*, 74 MO. L. REV. 251, 258, 284 (2009); John J. Infranca, Note, *The Earned Income Tax Credit as an Incentive to Report: Engaging the Informal Economy Through Tax Policy*, 83 N.Y.U. L. REV. 203, 218 n.87 (2008).

41. Zelenak, *supra* note 2, at 301.

42. Oona A. Hathaway, *Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System*, 86 IOWA L. REV. 601, 613 (2001).

43. *Id.* at 608.

44. A firm's costs can be categorized as either fixed or marginal. KENNETH S. CORTS & JAN W. RIVKIN, A NOTE ON MICROECONOMICS FOR STRATEGISTS 6 (2000). Fixed costs are expenses that a firm must pay to carry on its business, regardless of the firm's output. *Id.* For example, building rent is a fixed cost because it costs the same no matter how many units a firm produces. *Id.* Marginal costs, on the other hand—for example, raw materials and direct labor costs—are directly proportional to production levels. *Id.* In any production process, as output increases, the fixed costs per unit decrease. *Id.* at 7. Thus, a firm's overall cost per unit—that is, its combined fixed and marginal costs per unit—will decline as output increases (at least until the firm approaches its maximum production capacity). *Id.*

react to current conditions in ways that enhance the likelihood that similar conditions will persist . . . ."[45]

Path dependence is perhaps best illustrated through a historical example: the QWERTY keyboard, which Christopher Latham Sholes patented in 1868.[46] Some historians claim that Sholes arranged QWERTY's keys to resolve mechanical failures that plagued early typewriter prototypes.[47] Others argue that he intentionally designed QWERTY to be nonintuitive in order to support a marketing scheme in which typewriter manufacturer Remington could sell typing courses to typewriter purchasers.[48] Still others suggest Sholes intended QWERTY to be responsive to the morse-code-translation needs of telegraph operators.[49] Of course, none of these design purposes remain relevant in the twenty-first century. Yet, the QWERTY keyboard is still the standard keyboard arrangement for computers, tablets, and phones in English-speaking countries.[50] Path dependency best explains its longevity.

Each of the four increasing-returns conditions mentioned above contributed to the QWERTY keyboard's rise and sustained dominance. First, Sholes incurred significant fixed start-up costs in successfully bringing his invention to market; specifically, he devoted ten years to research and development.[51] Second, and perhaps most significantly, once a critical mass of people learned how to type on the QWERTY keyboard, other keyboard alternatives—which would have compelled typists to undergo expensive retraining—became less viable.[52] This learning effect has been so acute and self-perpetuating with QWERTY that the keyboard arrangement is still used today, even on thumb-only devices like phones for which ten-digit QWERTY training is only marginally beneficial. Third, within fifteen years of QWERTY's debut, the five largest typewriter manufacturers

45. Hathaway, *supra* note 42, at 609.

46. Jimmy Stamp, *Fact of Fiction? The Legend of the QWERTY Keyboard*, SMITHSONIAN (May 3, 2013), http://www.smithsonianmag.com/arts-culture/fact-of-fiction-the-legend-of-the-qwerty-keyboard-49863249/?no-ist [http://perma.cc/YJY4-9GUS].

47. *Id.*

48. *Id.*

49. *Id.*

50. *See id.* ("The fate of the keyboard was decided in 1893 when the five largest typewriter manufacturers . . . agreed to adopt QWERTY as the *de facto* standard that we know and love today.").

51. *See id.* (discussing the history of Sholes's typewriter inventions and the evolution of the keyboard).

52. *Id.*

converged on QWERTY as *the* standard typewriter system, thereby sharing, through coordination, in a larger, unified customer base.[53] Finally, both consumers and manufacturers responded to the initial ascendancy of QWERTY so as to generate a feedback loop that has not yet stopped churning: consumers bought QWERTY expecting it to remain the market-leading technology and to be the arrangement least likely to become obsolete and necessitate retraining; manufacturers embraced QWERTY presumably because its customer base was the largest and most likely to grow.[54]

One of path dependence's key insights is that increasing-returns markets' ultimate shape depends heavily on early events, which often display a significant random element.[55] In Professor Paul A. David's words, "[I]t is sometimes not possible to uncover the logic (or illogic) of the world around us except by understanding how it got that way."[56] In highlighting the role of randomness, path dependence yields an important insight about market efficiency: as with a winding fur trapper's path that evolves first into a dirt road and then into a rambling highway, current market institutions often fall short of optimal efficiency. When institutions and individuals fail to critically evaluate the increasing returns–driven directional inertia that propels market evolution, they risk forgoing alternative and more efficient paths—leaving them doomed to meander when blazing a straight trail would be better.[57]

B. Legal Path Dependence

The increasing-returns environment that precipitates path dependence is at least as prevalent in the development of statutes as it

53. *Id.*

54. *See id.* (observing that "the fate of the keyboard was decided," and the QWERTY's dominance cemented, when the QWERTY technology became the clear market leader).

55. Hathaway, *supra* note 42, at 610.

56. Paul A. David, *Clio and the Economics of QWERTY*, 75 AM. ECON. REV. 332, 332 (1985).

57. Firms in the economy—even leading ones best equipped to innovate—that fail to recognize and analyze the role of path dependence in market and product evolution may consequently miss opportunities to develop "disruptive innovations"—that is, revolutionary new technologies that service previously unidentified or underdeveloped markets. *See generally* CLAYTON M. CHRISTENSEN, THE INNOVATOR'S DILEMMA: WHEN NEW TECHNOLOGIES CAUSE GREAT FIRMS TO FAIL (1997) (describing how businesses lose market leadership because of managers' failure to abandon traditional business practices and to develop "disruptive innovation").

is in that of products and markets.[58] This Section details three factors that help cultivate an increasing-returns environment in the U.S. legislative process: collective action, policymakers' short-term orientation, and status quo bias.[59] This Section then explains the value of analyzing the role of path dependence in policy development.

1. *Factors that Contribute to an Increasing-Returns Environment in the U.S. Legislative Process*. A collective-action problem emerges when groups attempt to produce "public goods"—that is, goods that are nonrivalrous (consumption by one does not prevent consumption by others) and nonexcludable (all group members can freely consume whether or not they contributed to production).[60] Because all group members obtain the same benefit from a public good, regardless of whether they bear its production costs, they have an incentive to free ride on the production costs of others.[61] With all group members incentivized to free ride rather than produce public goods, groups tend not to produce such goods at socially optimal levels.[62]

Collective action helps facilitate path dependence in the U.S. legislative process. In the legislative context, "laws themselves have the character of public goods for those who benefit from them."[63] For example, legislators can obtain political benefits from the enactment of popular legislation simply by voting for it, even if they otherwise contribute nothing to its enactment. Moreover, the collective-action problem inherent in the legislative process is particularly severe because, unlike in economic markets in which individuals may be able to innovate independently, no single individual can create a law by herself;[64] rather, all legislative participants must depend on others'

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58. *See* Paul Pierson, *Increasing Returns, Path Dependence, and the Study of Politics*, 94 AM. POL. SCI. REV. 251, 252 (2000) ("[I]ncreasing return arguments are at least as relevant to an understanding of politics as they are in other areas of the social sciences.").

59. *Id.* at 257–58, 261–62.

60. David E. Bernstein & Ilya Somin, *Judicial Power and Civil Rights Reconsidered*, 114 YALE L.J. 591, 603 (2004). A paradigmatic example of a public good is a lighthouse: one sailor's using a lighthouse to navigate does not prevent other sailors from doing the same, and within-sight-range sailors cannot be excluded from consuming lighthouse-emitted light. For a more in-depth explanation of public goods, see generally JAMES M. BUCHANAN, THE DEMAND AND SUPPLY OF PUBLIC GOODS (1968).

61. Bernstein & Somin, *supra* note 60, at 603.

62. *Id.*

63. Pierson, *supra* note 58, at 258.

64. President Barack Obama is one possible exception. *Cf. Saturday Night Live* (NBC television broadcast Nov. 22, 2014), https://www.youtube.com/watch?v=JUDSeb2zHQ0

actions—for example, their lobbying or campaigning efforts—to achieve legislative objectives.[65] As a result, in order to effect significant policy change, a relatively large number of legislators must simultaneously overcome the temptation to free ride.[66] A policy, once enacted, thus has a strong tendency to persist.[67]

Policymakers' short-term orientation also plays a considerable role in facilitating legal path dependence. Policymakers tend to ignore long-term consequences.[68] One of the primary reasons for this is that an election-minded president or member of Congress is far more likely to care about current problems than those that arise after her retirement.[69] Resisting path dependence and implementing beneficial innovations, however, often require a lengthened time horizon.[70] In the marketplace, a firm may be willing to invest in a revolutionary technology—thereby overcoming path-dependence inertia—despite short-term losses if it expects to realize offsetting long-term benefits.[71] In contrast, short term–focused policymakers tend to discount or ignore long-term outcomes and are therefore less likely to incur any short-term political costs[72] necessary to forge an innovative policy path.[73]

Finally, the legislative process often results in path dependence because political institutions tend to be harder to change than economic institutions.[74] This status quo bias results from two different

[http://perma.cc/38H9-JMRL] (spoofing President Obama's unilateral policy response to legislative gridlock over immigration policy).

65. Pierson, *supra* note 58, at 258.

66. *See id.* ("Whether you put energy into . . . join[ing] a potential coalition . . . may depend to a considerable degree on your confidence that a large number of people will do the same.").

67. *See id.* at 258–59 ("[D]espite massive social, economic, and political changes over time, self-reinforcing dynamics associated with collective action processes mean that organizations have a strong tendency to persist once they are institutionalized.").

68. Richard Rose, *Inheritance Before Choice in Public Policy*, 2 J. THEORETICAL POL. 263, 286 (1990).

69. *Id.* As an illustrative anecdote, one of President Ronald Reagan's senior advisers responded to a bureaucrat's concerns about the future viability of Social Security by quipping, "We weren't elected to solve the problems of 2010." *Id.*

70. Pierson, *supra* note 58, at 261.

71. *Id.* at 261–62.

72. Such short-term costs may include efforts associated with lobbying colleagues, pushback from special interest groups, and short-term voter dissatisfaction during their change-adjustment period.

73. *Id.* at 262.

74. *Id.*

phenomena.[75] First, policy architects often design legislation to be difficult to change in order to prevent "their" policies from being overturned or co-opted by opponents.[76] Second, political actors often attempt to bind themselves and—especially in the case of presidents and members of their parties—to support a policy in the future by expressing support for it in the present.[77]

2. *The Implications of Legal Path Dependence*. Analyzing the role of path dependence in policy development yields three benefits. In a world of purposive actors and the invisible hand,[78] the assumption that policies exist because they serve some especially valuable purpose is tempting.[79] But scouring legislative history for evidence of path dependence can (1) expose policies premised on obsolete purposes or random historical events,[80] (2) prompt voters and policymakers to contemplate radical policy innovation,[81] and (3) fill theoretical gaps.[82] These benefits were manifest in a recent article by Professor Steven L. Schwarcz that applied path-dependence analysis to the special rights and immunities that the bankruptcy process gives derivatives counterparties.[83] Professor Schwarcz's analysis both revealed that and explained why such rights and immunities fail to fulfill their stated purpose.[84]

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75. *Id.*

76. *Id.*

77. *Id.* This type of commitment is effective because politicians are often criticized for changing their minds about policies. *See, e.g.*, *John Kerry, Flip-flopper?*, ECONOMIST, Mar. 25, 2004, at 36 (describing the potency of President George W. Bush's flip-flopping assertions against Secretary John Kerry, who was a Senator and presidential candidate at that time).

78. *See* 1 ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 453, 456 (6th ed., George Bell & Sons 1887):

> [T]he study of [an individual's] own advantage naturally, or rather necessarily leads him to prefer that employment which is most advantageous to the society. . . . [H]e intends only his own gain, and he is in this, as in many other cases, led by an *invisible hand* to promote an end which was no part of his intention.

(emphasis added).

79. *See* Pierson, *supra* note 58, at 264 ("Arguments about increasing returns, however, suggest the large dangers in any assumption that an institution arose because it serves some particularly useful purpose.").

80. *See supra* notes 46–50, 56–57 and accompanying text.

81. *See supra* note 57.

82. *See supra* notes 38–40 and accompanying text.

83. *See generally* Steven L. Schwarcz, *Derivatives and Collateral: Balancing Remedies and Systemic Risk*, 2015 U. ILL. L. REV. 699 (examining whether U.S. bankruptcy law's treatment of creditors' rights and immunities in derivatives transactions could be adapted to minimize systemic risk).

84. *Id.*

III. EVOLUTION OF THE EITC

A focus on increasing returns justifies a turn to history.

– Professor Paul Pierson[85]

This Part delves into the EITC's legislative history to set up the path-dependence analysis undertaken in Part IV. It traces the EITC's history from its predecessor proposals to its enactment and subsequent expansions.

A. Predecessor Proposals

The EITC was preceded by at least three ancestral proposals made by economist Milton Friedman and Presidents Richard Nixon and Gerald Ford.

1. *Milton Friedman's NIT.* Economist Milton Friedman has been called the "father of the negative income tax."[86] He first developed the idea for a negative income tax (NIT) while at the Treasury Department.[87] In the beginning, Friedman saw the NIT as a solution to fairness problems caused by graduated tax rates and fluctuating incomes.[88] He later came to recognize the NIT's potential as a mechanism for alleviating poverty.[89]

Friedman liked the idea of administering an antipoverty measure through the tax code for several reasons.[90] First, Friedman saw the tax code as an especially effective platform for alleviating poverty because it allowed the government to premise assistance purely on

85. Pierson, *supra* note 58, at 263.

86. VINCENT J. BURKE & VEE BURKE, NIXON'S GOOD DEED: WELFARE REFORM 169 (1974).

87. DANIEL P. MOYNIHAN, THE POLITICS OF A GUARANTEED INCOME 50 (1973).

88. *Id.* Because taxpayers generally pay higher marginal income-tax rates as their incomes rise, taxpayers with fluctuating incomes tend to pay more taxes over time than taxpayers with equivalent but steady incomes. *See* SCHMALBECK & ZELENAK, *supra* note 19, at 141 (providing an illustration). This effect was particularly acute among low-income workers because income fluctuations moved them back and forth between a zero tax bracket and a positive one. MOYNIHAN, *supra* note 87, at 50. Friedman proposed an NIT as a way of evening out net tax liabilities among similar earners over time—workers would pay taxes in good years and would receive payments from the Treasury Department in bad ones. *Id.*

89. MOYNIHAN, *supra* note 87, at 50. Professor Lawrence Zelenak points out that, though Friedman did not explicitly describe it as such, his NIT is basically a guaranteed annual income. Zelenak, *supra* note 2, at 303.

90. MILTON FRIEDMAN, CAPITALISM AND FREEDOM 191–93 (1962).

the basis of a taxpayer's low income,[91] rather than on less relevant factors like the recipient's age or career.[92] The NIT was also desirable because it provided benefits in the form most useful to the recipient: cash.[93] Friedman viewed the NIT as a less-distortionary means of raising incomes than the minimum wage, and he intended for his NIT to replace the government's "rag bag" of welfare programs as a means of reducing administrative costs associated with antipoverty.[94] In addition, Friedman noted that a single consolidated antipoverty measure would enable the public to better understand the cost and evaluate the efficacy of the government's antipoverty efforts.[95] Finally, Friedman liked that, unlike traditional welfare programs that imposed 100 percent marginal tax rates on earnings,[96] his NIT proposal would preserve work incentives by imposing marginal tax rates of 50 percent or less.[97]

2. *From Johnson's Self-Help to Nixon's Family Assistance Plan*. President Lyndon Johnson famously declared war on poverty in 1964.[98] His proposals focused on "self-help" measures designed to provide education, training, and work opportunities rather than income support.[99] Despite the Johnson administration's efforts to reduce dependence on welfare, welfare rolls grew steadily during the 1960s,[100] leading some to ridicule Johnson's war as "little more than a

91. Premising the NIT purely on low income is different from the modern-day EITC, which requires work effort.

92. *Id.* at 191–92.

93. *Id.* at 192.

94. *Id.* at 191–93.

95. *See id.* at 192 ("[The NIT] makes explicit the cost borne by society.").

96. For example, at that time, the Aid to Families with Dependent Children (AFDC) program "operated on the principle that earnings of a welfare recipient would be deducted, dollar-for-dollar, from welfare payments." MOYNIHAN, *supra* note 87, at 50.

97. Dennis J. Ventry, Jr., *The Collision of Tax and Welfare Politics: The Political History of the Earned Income Tax Credit*, *in* MAKING WORK PAY: THE EARNED INCOME TAX CREDIT AND ITS IMPACT ON AMERICA'S FAMILIES 15, 18 (Bruce D. Meyer & Douglas Holtz-Eakin eds., 2001).

98. *See* Lyndon B. Johnson, President of the U.S., State of the Union (Jan. 8, 1964), http://millercenter.org/president/speeches/speech-3382 [http://perma.cc/3SU6-GDBK] ("This administration today, here and now, declares unconditional war on poverty in America.").

99. Ventry, *supra* note 97, at 18–19.

100. Between 1960 and 1970, the number of Americans receiving welfare surged from 3.1 million to 9.0 million. *Id.* at 19. Ironically, President Johnson rejected an NIT because, in his eyes, the proposal did not provide an adequate work incentive. *Id.* at 18.

modestly financed skirmish."[101] Johnson's social reforms "had been oversold, and . . . underfinanced to the degree that seeming failure could be ascribed almost to intent."[102]

President Nixon thus inherited a welfare "crisis"[103] and turned to a version of Friedman's NIT as a solution. Social-welfare reform was uncharted territory for Republicans whose participation in that realm had traditionally consisted of opposing Democratic proposals.[104] Nixon in particular strongly opposed welfare.[105] By the time he took office, however, the problem of welfare dependency was severe, visible, and intertwined with seething issues of poverty and racial inequality;[106] Nixon felt compelled to respond.[107] Rather than addressing the problem timidly and incrementally, Nixon saw an opportunity to exalt his legacy[108] and accordingly wanted first and foremost for his reform proposal to be bold and creative.[109] But developing an ambitious and innovative proposal that might broaden the party's base of support among moderates and liberals while not alienating conservatives[110] proved difficult because the vast majority of social scientists on whom Nixon might rely for expert advice were politically liberal.[111] The NIT ultimately gained traction because it

101. STANLEY ESTERLY & GLENN ESTERLY, FREEDOM FROM DEPENDENCE: WELFARE REFORM AS A SOLUTION TO POVERTY 26 (1971); *see also* MOYNIHAN, *supra* note 87, at 55 ("A good deal of money was being expended. It could *not* be shown that it was going to the poor. It *was* going, in large degree, to purchase services which could *not* be shown to benefit the poor.").

102. MOYNIHAN, *supra* note 87, at 66.

103. *Id.* at 59.

104. *Id.* at 64–65.

105. *See id.* at 86 (describing how Nixon's "Puritan ethic" spurred his aversion toward welfare); *see also id.* at 98 (noting that "[Nixon] was not neutral about welfare; he was against it").

106. The destruction of the poor, especially the black poor, by the existing welfare system was "the most serious social problem of the time." *Id.* at 214.

107. *See id.* at 68–69 ("Nixon was fated to deal with welfare" because, by the time he took office, welfare dependency "was making its way to the center of national politics" and had become "a condition about which something had to be done.").

108. *See id.* at 74 (observing that Nixon's awareness of his reputation in American history played a role in his adopting an aggressive approach to welfare reform).

109. *See id.* at 74, 97 (describing Nixon's desire to be both bold and innovative with respect to welfare reform).

110. Sixty-eight percent of the population at the time described itself as either moderate or conservative. *Id.* at 70.

111. *See id.* at 70, 96 (describing how Nixon enlisted advisers from the predominately liberal ranks of social science, the inclination of whom was to "search for ways to provide more welfare rather than less"). *But see* Fred T. Goldberg, Jr., *From FDR to W: The IRS as Financial Intermediary*, 29 OHIO N.U. L. REV. 1, 8 (2002) (pointing out that the team of advisers who oversaw Nixon's welfare reform efforts also included Donald Rumsfeld and Richard Cheney).

satisfied Nixon's aspirations of boldness and innovation[112] while also obscuring—with its conservative origin[113]—the proposal's progressivity.[114]

The NIT became the central tenet of Nixon's landmark 1969 welfare-reform proposal, the Family Assistance Plan (FAP). Before proposing an NIT, Nixon had already ushered through Congress a "low income allowance"[115] that removed two million low-income families from the federal income-tax rolls.[116] Nixon's NIT was designed to provide further assistance in the form of an income floor administered through the tax code.[117] Subject to a "work requirement,"[118] families would receive a maximum benefit[119] corresponding with an earned income of zero up to a phaseout threshold.[120] Beyond that threshold, the maximum benefit would be

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112. *See* MOYNIHAN, *supra* note 87, at 143 ("The alternatives open to the president were to advocate some incremental changes in the existing system, or take the giant step to [the NIT]. He chose the latter.").

113. *See supra* Part III.A.1.

114. *See* MOYNIHAN, *supra* note 87, at 127 (noting the NIT's potential for obscuring a guaranteed-income proposal); *see also id.* at 65 (describing how one liberal commentator, upon learning about Friedman's NIT, exclaimed, "[T]his conservative has provided us with a way to get guaranteed income").

115. Tax Reform Act of 1969, Pub. L. No. 91-172, § 802, 83 Stat. 487, 676 (codified as amended in scattered sections of 26 U.S.C.).

116. MOYNIHAN, *supra* note 87, at 114–15. Eliminating low-income families from the tax rolls received little attention, but may have been "the most important development to that date of the War on Poverty." *Id.* at 115.

117. *See* SOC. SEC. ADMIN., WELFARE REFORM FACT SHEET (1969), *reprinted in* MOYNIHAN, *supra* note 87, at 229, 235 [hereinafter WELFARE REFORM FACT SHEET] (presenting a sample NIT benefit schedule).

118. *Id.* at 231. The work requirement attached to the FAP stipulated that all "[e]mployable" recipients would sacrifice *their portion* of NIT benefits if they refused to accept either training or employment. *Id.* In other words, if an employable parent refused to work, his or her family's NIT benefit would be reduced by $300 in the bill sent to Congress, an amount which was raised to $500 by the Committee on Ways and Means, but not eliminated entirely. MOYNIHAN, *supra* note 87, at 220. Thus, the "work requirement" was really more of a work incentive, a moderate penalty for refusing to work. *Id.*

119. The maximum benefit varied depending on family size: $500 per person for the first two family members and $300 per person for each additional family member. WELFARE REFORM FACT SHEET, *supra* note 117, at 229, 230. Thus, a family of eight would have qualified for a maximum benefit of $2800. *Id.* At $1600 for a family of four, Nixon's NIT provided a benefit (in inflation-adjusted dollars) more than four times larger than the maximum benefit provided by the EITC when it was first enacted and more than 50 percent larger than the maximum benefit provided to a family of four by the current EITC. *See supra* note 10 and accompanying text; *supra* Figures 1–2. Figure 4 below compares the EITC to Nixon's NIT in terms of current dollars.

120. WELFARE REFORM FACT SHEET, *supra* note 117, at 229, 235.

phased out at a rate of 50 percent for each dollar of additional income.[121] Figures 3 and 4[122] below illustrate the impact of these programs.

Figure 3. Nixon NIT Benefit Schedule, Family of Four

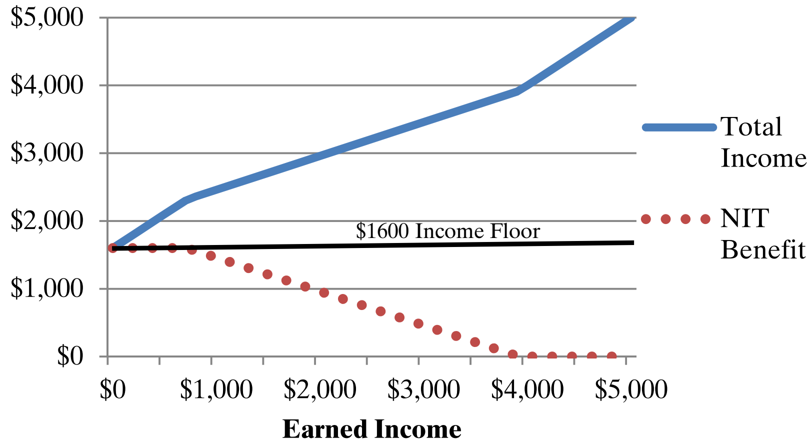
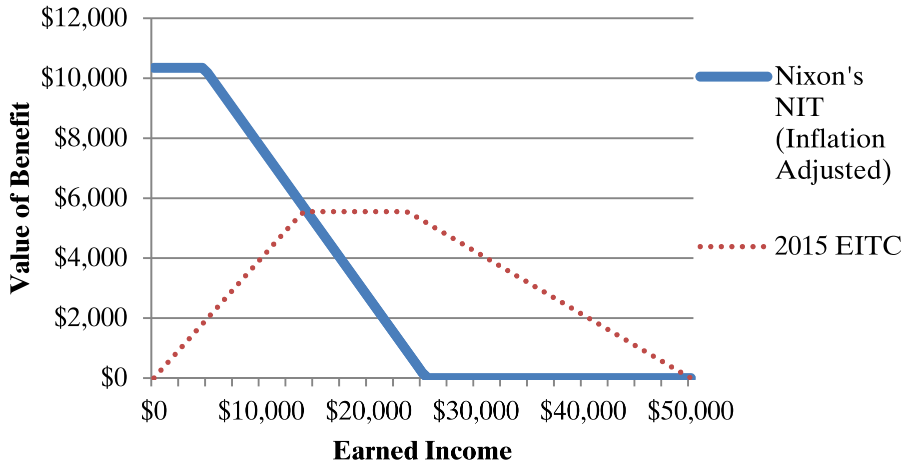


Figure 4. Comparison of Benefit Provided Under Nixon's NIT and 2015 EITC for a Family of Four



121. *Id.* A 50 percent phaseout rate is much higher than the applicable rate under the current EITC, which ranges from 7.65 percent to 21.06 percent, *see supra* Figures 1–2, but it was a significant improvement over the AFDC, which imposed a 100 percent phaseout rate, *see supra* note 96.

122. The author created Figures 3 and 4 based on information contained in WELFARE REFORM FACT SHEET, *supra* note 117, at 235.

Although conservative economist Milton Friedman had come up with the idea for the NIT,[123] Nixon's implementation was far from politically conservative, a fact he tried to conceal. A negative income tax is inherently neither conservative nor liberal; rather, it is a tool that can be presented as consistent with either side's preferred policy objectives.[124] In the case of Nixon's FAP, the NIT provided a guaranteed minimum income, "an idea of the left."[125] In fact, the FAP's large-scale[126] guaranteed-income provision made the proposal arguably "the most progressive welfare reform theretofore proposed by an American president."[127] Fearing rejection by conservatives and by the public,[128] Nixon endeavored to make the FAP seem more conservative than it was.[129] In a speech about the proposal, Nixon denied that it implemented a guaranteed income,[130] characterized the plan's modest work incentive[131] as a "work requirement,"[132] and generally used rhetoric that would appeal to conservatives.[133] At least some listeners immediately saw through the façade: shortly after Nixon's speech, James Reston, a New York Times columnist, remarked that the President had "cloaked a remarkably progressive welfare policy in conservative language."[134]

123. *See supra* Part III.A.1.

124. For example, conservatives, like Milton Friedman, might use the NIT to replace welfare, whereas progressives may use it to redistribute income.

125. *See* MOYNIHAN, *supra* note 87, at 127 ("The original proponents of a guaranteed income tended to be apocalyptic about capitalism and more or less disdainful of bourgeois virtue.").

126. *See supra* note 119 and accompanying text.

127. William H. Simon, *Rights and Redistribution in the Welfare System*, 38 STAN. L. REV. 1431, 1501 (1986); *see also* BURKE & BURKE, *supra* note 86, at 127 (noting the observation in the press that Nixon's FAP was "more radical than virtually anything done by the Johnson administration"). Interestingly, Robert F. Kennedy rejected the idea of a guaranteed income during his 1968 presidential campaign as a proposal to "pay men to sit at home." MOYNIHAN, *supra* note 87, at 61–62.

128. In a 1968 Gallup Poll, 58 percent of those surveyed opposed guaranteed income because they perceived it as undermining the incentive to work—"nobody should get something for nothing." MOYNIHAN, *supra* note 87, at 245.

129. One of Nixon's speechwriters stressed that the primary purpose of Nixon's speech about the FAP was "to make a radical proposal seem conservative." *Id.* at 218.

130. Richard Nixon, President of the U.S., Address to the Nation on Domestic Programs (Aug. 8, 1969), http://www.presidency.ucsb.edu/ws/?pid=2191 [http://perma.cc/6N4B-KV3Q].

131. *See supra* note 118 and accompanying text.

132. Nixon, *supra* note 130.

133. *See, e.g.*, *id.* ("What America needs now is not more welfare, but more 'workfare.'").

134. James Reston, *President Nixon, Poverty and Peace*, N.Y. TIMES, Aug. 10, 1969, at E10.

Nixon's efforts to control the message surrounding the FAP did not quell resistance from either liberal or conservative forces. An optimistic Nixon hoped conservatives would accept at face value his conservative portrayal of the FAP while liberals would look past his words and regard the proposal's progressive substance.[135] To some extent, just the opposite happened. Liberal activists[136] opposed Nixon's FAP because they (1) believed his assertion that it was not really a guaranteed income,[137] (2) feared that the NIT was a pretext for unraveling existing antipoverty measures,[138] (3) felt that, even if the NIT *was* a guaranteed income, it was insufficient,[139] (4) simply distrusted[140] and disliked[141] President Nixon, and (5) did not want to see the President achieve a victory on "their" social-reform territory.[142] Some conservatives[143] on the other hand denounced the FAP as a redistributive[144] attack on self-reliance,[145] emphasizing their

135. MOYNIHAN, *supra* note 87, at 216–17.

136. Liberal opposition forces included the National Welfare Rights Organization (NWRO), the Congressional Black Caucus, the California CAP Directors Association, the National Association of Social Workers, the American Federation of State, County, and Municipal Employees, and the National Urban League. *Id.* at 226, 249, 311, 318, 325, 339–40. Notably, the AFL-CIO did not actively oppose the FAP, treating the proposal instead with "tolerant ambivalence." *Id.* at 276, 285.

137. *Id.* at 127.

138. *Id.* Though Nixon's FAP would have, in large part, displaced the AFDC, welfare recipients would have received at least the same level of benefits and in many cases greater benefits. WELFARE REFORM FACT SHEET, *supra* note 117, at 229, 231. In particular, the Southern states, where state-administered AFDC benefits were notoriously sparse, would have seen an increase in benefits. *See* MOYNIHAN, *supra* note 87, at 163.

139. The NWRO, for example, wanted to raise the minimum guaranteed income from $1600 to $5500 for a family of four. MOYNIHAN, *supra* note 87, at 247. Today, a $5500 guaranteed income would equal $35,568. BUREAU OF LABOR STATISTICS, *supra* note 10. Such a proposal would have required providing benefits to over half of the U.S. population and would have cost about $415 billion a year in inflation-adjusted dollars. *See* MOYNIHAN, *supra* note 87, at 247.

140. Distrust for President Nixon was particularly acute among African Americans. MOYNIHAN, *supra* note 87, at 263–68.

141. *See id.* at 365–66 (observing that liberal opposition to the FAP was due in part to a "loathing for Nixon").

142. *Id.* at 440–42, 446.

143. Notable conservative opponents included Ronald Reagan, then governor of California; William F. Buckley, Jr., editor of *National Review*; and Milton Friedman, conservative economist and father of the NIT. *Id.* at 365, 370.

144. *Id.* at 372.

145. This argument had two primary elements: (1) the FAP's work incentive was insufficient and (2) its 50 percent phaseout provision, in concert with other various income phaseouts, was estimated to impose marginal tax rates as high as 80 percent on welfare-dependent (that is, nonworking) families, which chilled their entry into the labor market. *Id.* at 369–72, 411–12.

disappointment that the provision added to, rather than replaced, the patchwork of existing public-assistance programs.[146] Nixon and his administration struggled to adequately address either side's concerns due, in part, to the NIT's relative complexity.[147] Meanwhile, in the din of all this political maneuvering, the political parties lost sight of the fact that a strong majority of the public supported the FAP.[148]

Facing political headwinds from both the right and left, the FAP sailed into a Congress in which Democrats controlled both the House and Senate.[149] The House Committee on Ways and Means was the first to act, voting to approve Nixon's FAP by a remarkable vote of twenty-one to three.[150] Representative Wilbur D. Mills, chairman of the Committee, sponsored the bill[151] and advocated on its behalf, repeating Nixon's claim that the FAP was not a guaranteed-income proposal.[152] The House passed the bill by a vote of 243 to 155, with 63 percent of House Democrats and 59 percent of House Republicans[153] voting in favor.[154]

The administration's hopes were high that the Senate, widely considered more liberal than the House, would follow suit.[155] The Senate Finance Committee, however, failed to report the FAP to the Senate floor in part due to strategic Democratic opposition[156] and the

Analysis later revealed that marginal tax rates could be even higher than 80 percent. *See infra* note 158 and accompanying text.

146. Friedman lamented that the FAP as an *additional* public-assistance program was "a striking example of how to spoil a good idea." MOYNIHAN, *supra* note 87, at 370. The NIT as he conceived it would have replaced rather than added to the existing welfare scheme. *See supra* notes 94–95 and accompanying text.

147. MOYNIHAN, *supra* note 87, at 115, 139–40, 215–16.

148. *Id.* at 268–69.

149. *Id.* at 418, 439; *see also* U.S. GOV'T PRINTING OFFICE, NINETY-FIRST CONGRESS CONGRESSIONAL PICTORIAL DIRECTORY 181 (1969) (showing that Democrats held a majority, holding fifty-seven seats, in the U.S. Senate during the 91st Congress).

150. The three dissenting votes were Democrats who opposed the working poor being "added to the welfare rolls" and the prioritization of cash payments over work incentives. H.R. REP. NO. 91-904, at 84 (1970).

151. Family Assistance Act of 1970, H.R. 16311, 91st Cong. (1970).

152. MOYNIHAN, *supra* note 87, at 431.

153. George H.W. Bush, a congressman from Texas at the time, was one of only three Texas congressmen and the sole Republican from that state to vote in favor of the bill. *Id.* at 438.

154. *Id.* at 437–38.

155. *Id.* at 439, 441.

156. *See id.* at 446–52 (discussing multiple strategies).

regional makeup of the Committee,[157] but principally because of revelations about unintended work disincentives of high marginal tax rates implicated by the FAP and its interaction with other social-welfare programs.[158] Though Nixon's administration scrambled to revise the FAP and renew the fight,[159] it never fully overcame concerns about work disincentives.[160] The revised bill was defeated in the Finance Committee by a vote of ten to four, with seven of the Committee's ten Democrats voting against it.[161]

3. *President Gerald Ford's Income Supplement Program.* Nixon failed to enact his NIT, but the administration of his successor, President Gerald Ford, did not give up on the idea. In 1974, the Department of Health, Education, and Welfare under Ford introduced the Income Supplement Program (ISP),[162] which would have implemented an NIT to replace Aid to Families with Dependent Children (AFDC), Food Stamps, and Supplemental Security Income (SSI).[163] Under the ISP, an individual[164] or family would receive an NIT payment in an amount "equal to one-half of the difference between its actual income level and its breakeven income level."[165]

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157. Committee Democrats hailed primarily from Southern states where the FAP was particularly unpopular, and committee Republicans came from "Western states where welfare was a minimal problem, and reform a marginal concern." *Id.* at 455.

158. *Id.* at 474–81. Programs like Medicaid and public housing had income thresholds such that an individual's benefits were cut off completely if she earned more than the threshold amount. Thus, earning a single additional dollar of income might cause an individual to lose thousands of dollars in public-assistance benefits. Republican Senator John J. Williams showed that these "notch effects," in concert with state and federal taxes, Social Security taxes, and the FAP phaseout could impose effective marginal tax rates above 100 percent. *Id.* at 474, 480. In other words, under some (atypical) scenarios involving the FAP, individuals would be better off financially "sit[ting] in a rocking chair" than working to earn additional income. *Id.* at 481.

159. *Id.* at 483–98.

160. *Id.* at 534–35.

161. *Id.* at 535.

162. OFFICE OF INCOME SEC. POLICY, U.S. DEP'T. OF HEALTH, EDUC., & WELFARE, TECHNICAL ANALYSIS PAPER NO. 11, INCOME SUPPLEMENT PROGRAM: 1974 HEW WELFARE REPLACEMENT PROPOSAL 7 (1976).

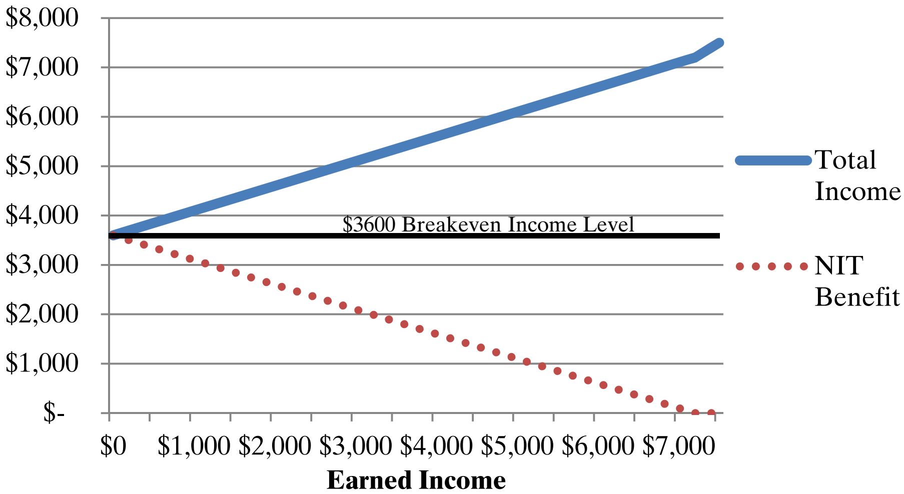
163. *See id.* at 8, 11 ("AFDC, SSI and Food Stamps could be absorbed into a more efficient, consolidated negative income tax.").

164. Unlike Nixon's FAP, the ISP provided benefits to both single adults and childless couples. BRIAN STEENSLAND, THE FAILED WELFARE REVOLUTION: AMERICA'S STRUGGLE OVER GUARANTEED INCOME POLICY 179 (2008).

165. OFFICE OF INCOME SEC. POLICY, *supra* note 162, at A-2. The ISP's "breakeven income level" was equal to a family's standard deduction plus its personal exemptions. *Id.* "[T]ogether, the standard deduction and personal exemptions ensure that taxpayers are not taxed on an amount of income roughly equal to the official poverty level, as adjusted for family size."

Figure 5[166] below provides a sample illustration for a family of four. In effect, the ISP would have provided a guaranteed income of $3600 for a family of four.[167] Ford never fully embraced the proposal,[168] and Congress rejected it before it ever gained much momentum.[169]

Figure 5. Ford Administration's ISP, Family of Four



B. The EITC's Enactment

Though his administration's NIT proposal failed, President Ford would end up signing into law the first federal NIT,[170] the "Earned

SCHMALBECK & ZELENAK, *supra* note 19, at 11. Thus, the ISP's "breakeven point" was useful for two reasons: (1) it provided a reasonable cutoff point for NIT payments (NIT recipients would not receive payments beyond the family size–adjusted poverty level), and (2) it avoided the inefficiency of requiring a family to pay taxes to Treasury on the one hand while receiving NIT payments from Treasury on the other.

166. The author created Figure 5 based on information contained in OFFICE OF INCOME SEC. POLICY, *supra* note 162, at E-1 to E-2.

167. *See id.* ("A family of four with no other income would receive an annual benefit of $3,600.").

168. *See* STEENSLAND, *supra* note 164, at 179 ("Despite the fact that Ford had voted for the FAP twice as a member of Congress, he rejected [an NIT proposal] in favor of more incremental goals.").

169. *See* Ventry, *supra* note 97, at 24–25 (describing reasons for the ISP's rejection, which included its being too similar to FAP, redistributive, not sufficiently pro-work and pro-growth, and not doing enough to "alleviate the welfare problem").

170. CONG. BUDGET OFFICE, *supra* note 18, at 6.

Income Credit" (EIC).[171] Senate Finance Committee Chairman, Democrat Russell Long, was a key opponent of Nixon's FAP.[172] Even before the FAP's defeat, Long had begun to push his own variation of an NIT,[173] which provided a payment equal to 10 percent of income[174] for workers who earned $4000 or less.[175] Long, who had caustically criticized the FAP for its work disincentives,[176] designed his proposal to mitigate work disincentives by phasing out payments at a rate of 25 percent instead of 50 percent,[177] and to provide payments only to the *working* poor.[178] Long's proposal was defeated in 1972, but, through his continuing efforts, it remained visible in the policy discussion.[179] When President Ford called for $16 billion in tax cuts in his 1975 State of the Union address,[180] Long seized the opportunity to renew the fight for his proposal, which by that time he had renamed the "Earned Income Credit."[181] Long got his EIC into the Tax Reduction

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171. Although the credit was originally dubbed the "Earned Income Credit," it is commonly known today as the "Earned Income *Tax* Credit." *See* IRS, *supra* note 22 (using the terms "EITC" and "EIC" interchangeably, but listing "EITC" first). This Note uses the term "Earned Income Credit" and abbreviation "EIC" only when referring to the credit in its earliest postenactment stages.

172. Long, motivated by his "implacable hostility" toward the FAP vocally opposed the proposal as "a guaranteed wage for not working," offered an alternative proposal, and strategically delayed action on the bill long enough to enable special interest groups to organize lobbying efforts against it. BURKE & BURKE, *supra* note 86, at 177, 183–85.

173. Long was careful not to refer to his proposal as an NIT or guaranteed income, instead characterizing it as a "tax cut," "work subsidy," "tax refund," "tax credit," and "work bonus." 118 CONG. REC. 33,010, 33,013 (1972) (statement of Sen. Russell Long).

174. This 10 percent payment was intended to "refund" the amount of Social Security taxes paid by low-income workers and most of such taxes paid by employers on their behalf. *Id.* at 33,010, 33,013. Framed as a Social Security tax refund, the amount of the payment had no connection to family size. *Id.* at 33,013.

175. *Id.* at 33,010.

176. Long once condemned Nixon's FAP as enabling "people who lay about all day making love and producing illegitimate babies." MOYNIHAN, *supra* note 87, at 523.

177. *Compare* 118 CONG. REC. at 33,010 (statement of Sen. Russell Long) (explaining that payments under Long's proposal would be phased out at a rate of 25 percent for income over $4000), *with supra* note 121 and accompanying text (demonstrating the 50 percent phaseout of Nixon's NIT proposal); *supra* Figures 3–4 (same).

178. *Compare* 118 CONG. REC. 33,010 (statement of Sen. Russell Long) ("[T]he benefits are entirely work related."), *with supra* note 118 and accompanying text (explaining how employable nonworking individuals and their families could still receive Nixon's NIT).

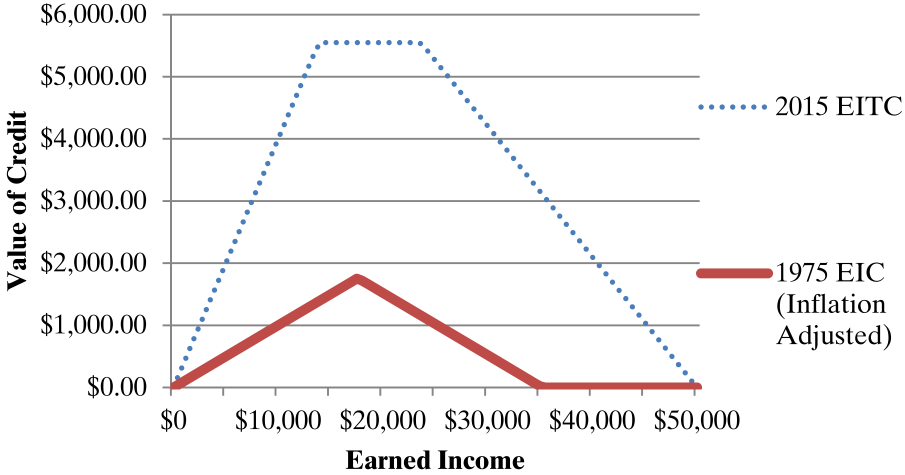
179. Ventry, *supra* note 97, at 23.

180. Gerald R. Ford, President of the U.S., State of the Union (Jan. 15, 1975), http://www.ford.utexas.edu/library/speeches/750028.htm [http://perma.cc/H479-AZR6].

181. 121 CONG. REC. 7230 (1975) (statement of Sen. Russell Long). Long had also changed his proposal slightly, targeting the credit to those with dependents and reducing his suggested phaseout rate to 10 percent. *Id*.

Act of 1975's final version,[182] which President Ford signed into law on March 29, 1975.[183] Though the EIC might have been characterized as an NIT[184] or structured as welfare reform or guaranteed income, the concept that originated as Friedman's NIT proposal finally achieved political success as a new kind[185] of tax credit and a relatively small provision[186] in a familiar-seeming tax-reduction bill. Figure 6 illustrates how the EIC compares in size and structure to the modern-day EITC.[187]

Figure 6. Comparison Between 2015 EITC and 1975 EIC, Family of Four



182. H.R. REP. NO. 94-120, at 58–59 (1975).

183. Tax Reduction Act of 1975, Pub. L. No. 94-12, 89 Stat. 26 (codified as amended in scattered sections of 26 U.S.C.).

184. Apparently, only opponents of the EIC characterized it as an NIT. *See, e.g.*, H.R. REP. NO. 94-19, at 101 (1975) ("[T]o inaugurate [a negative income tax] in an emergency tax cut bill is silly."); *id.* at 95 ("[T]he 'earned income' credit . . . introduces a 'negative income tax' to the tax code and includes in a so-called 'tax cut' many who now pay no taxes. This is neither the time nor the place for such a provision."); *id.* at 89 ("To the extent that [the EIC] is available to persons who have no tax liability, it amounts to a negative income tax.").

185. The EIC was the first refundable tax credit enacted at the federal level. CONG. BUDGET OFFICE, *supra* note 18, at 6.

186. That the EIC was modest in cost ($3.59 billion in 2015 dollars) "reflected the prevailing welfare reform consensus" that public resources could be used to reduce welfare dependency but not poverty. Ventry, *supra* note 97, at 25.

187. The author created Figure 6 based on information contained in Rev. Proc. 2014-61, 2014-47 I.R.B. 863, and the Tax Reduction Act of 1975.

C. Expansion

Since the EIC—which is now popularly known as the EITC[188]—was enacted during the Ford administration, every U.S. president has signed into law an EITC expansion.

1. *President Jimmy Carter*. President Jimmy Carter initially tried to expand the EITC as part of a larger welfare-reform proposal. In 1977, President Carter announced that "continu[ing]" the EITC—which was scheduled to expire at the end of that year[189]—"to help the working poor" would be one of twelve policy goals he hoped his welfare-reform proposal would achieve.[190] In fact, Carter's Program for Better Jobs and Income (PBJI) went beyond merely continuing the EITC.[191] Instead, it proposed to expand the credit to provide benefits "almost up to the median income level."[192] Some members of Carter's administration, however, were disappointed that the proposed expansion extended some benefits to middle-income families rather than targeting low-income households exclusively.[193] The latter approach would have better enabled Carter to achieve his "desired distribution of benefits" without a corresponding "rapid expansion of the welfare caseload."[194] Echoing the demise of Nixon's FAP,[195] the PBJI was met by hostility from both conservatives and liberals, and Carter ultimately dropped it from his agenda in 1978.[196]

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188. *See supra* note 171.

189. *See* Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (codified as amended in scattered sections of 26 U.S.C.) (amending the EITC to expire at the end of 1977).

190. Jimmy Carter, President of the U.S., Welfare Reform Remarks at a News Briefing on Goals and Guidelines (May 2, 1977), http://www.presidency.ucsb.edu/ws/?pid=7434 [http://perma.cc/2KX6-V2VX].

191. Under Carter's PBJI, the EITC would have added an additional 5 percent credit on top of the existing credit that would have kicked in when a family surpassed $4000 in earnings and phased out starting at about $9000 in earnings. JOINT ECON. COMM., THE PROGRAM FOR BETTER JOBS AND INCOME—A GUIDE AND A CRITIQUE 10 (1977). The precise point at which phase out would begin depended on family size. *Id.*

192. *Id.* at 11.

193. Ventry, *supra* note 97, at 30.

194. *Id.* at 28. In addition to reducing welfare dependence, the EITC promised a number of other policy benefits: administrative simplicity, improved work incentives, and reduced beneficiary stigma relative to means-tested welfare. *Id.* at 28–29. One of the EITC's benefits was purely political—it appeared less costly because some of it could be scored in the budget as a loss of tax revenue rather than a cash outlay. *Id.* at 29–30.

195. *See supra* notes 136–46 and accompanying text.

196. Ventry, *supra* note 97, at 30.

Its association with the unpopular PBJI, however, did not taint the EITC. In fact, the EITC had become immensely popular.[197] In the same year the PBJI was defeated, Congress expanded the EITC's income thresholds slightly and ensconced the credit as a permanent fixture of the U.S. tax code.[198]

2. *President Ronald Reagan.* Six years after the EITC was made permanent, President Ronald Reagan oversaw a modest expansion. Years before, when he was governor of California, Reagan had been a vocal opponent of President Nixon's FAP.[199] He rejected the notion that the government should provide a minimum income, believed that the FAP was too expensive, and felt that it would exacerbate welfare dependency rather than alleviate it.[200] As president, Reagan acted on these conservative sensibilities by cutting social-welfare spending.[201] Reagan's aversion toward Nixon's FAP—an EITC ancestor—and his penchant for cutting welfare spending, however, did not sour his attitude toward the EITC. In fact, Reagan signed into law a modest EITC expansion toward the end of his first presidential term.[202]

197. *See* LAURENCE E. LYNN, JR. & DAVID DEF. WHITMAN, THE PRESIDENT AS POLICYMAKER: JIMMY CARTER AND WELFARE REFORM 247 (1981) (observing that by the late 1970s, the EITC had developed into "[e]verybody's favorite" program).

198. Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2763 (codified as amended in scattered sections of 26 U.S.C.).

199. *See* MOYNIHAN, *supra* note 87, at 365 (recalling Reagan's participation in a televised debate in which he sided against the FAP).

200. Steven Hayward, Editorial, *Welfare Reform: Another Win for the Gipper*, ASHBROOK CTR. AT ASHLAND U. (Dec. 1999), http://ashbrook.org/publications/oped-hayward-99-gipper [http://perma.cc/VCR7-FWWT]. Interestingly, Reagan testified before the Senate Finance Committee regarding his opposition to the FAP and proposed refunding low-income workers' Social Security taxes as a policy alternative. HOWARD, *supra* note 40, at 68. Committee Chairman Russell Long was in attendance for Reagan's testimony and, several months later, introduced his strikingly similar work-bonus proposal, which would later be modified and enacted as the EITC. *Id.* at 68–69. Based on this circumstantial evidence, some conservatives credit Reagan as the true inventor of the EITC. *Id.* at 67–68.

201. *See* Ventry, *supra* note 97, at 31 (noting that the Omnibus Budget and Reconciliation Act of 1981, passed under President Reagan, cut $4 billion in federal and state welfare expenditures and removed more than four hundred thousand families from the welfare rolls); *see also* Mark Neal Aaronson, *Scapegoating the Poor: Welfare Reform All Over Again and the Undermining of Democratic Citizenship*, 7 HASTINGS WOMEN'S L.J. 213, 220–21 (1996) (describing how Reagan campaigned on and fought for welfare cuts; Congress enacted his proposals with little resistance).

202. The Deficit Reduction Act of 1984, which Reagan signed into law on July 18, 1984, increased the EITC's maximum benefit from $500 to $550. Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 1042, 98 Stat. 494, 1043–44 (codified as amended in scattered sections of 26 U.S.C.).

During his next term, Reagan presided over a more significant EITC expansion as part of the Tax Reform Act of 1986.[203] In January 1984, Reagan announced his intentions to comprehensively reform the tax code and delegated to his Treasury Secretary the task of developing a proposal.[204] Shortly after Reagan's November 1984 reelection, his Treasury Department released a report, nicknamed "Treasury I,"[205] that called for the EITC to be expanded and indexed for inflation.[206] The Treasury Department advocated EITC expansion, along with two other proposals,[207] in order to (1) eliminate nearly all families with incomes below the poverty line from the income-tax rolls[208] and (2) ensure that its tax-reform proposal approached distributional neutrality overall.[209] President Reagan altered many of Treasury I's details before releasing his official proposal ("Treasury II"),[210] but he kept intact the EITC's expansion and indexation.[211] Some Republicans lamented that EITC indexation and similar proposals in Reagan's tax-reform plan, paid for with corporate tax increases, amounted to a windfall for "low-income Democrats at enormous expense to core Republican constituencies."[212] But such

203. Tax Reform Act of 1986, Pub. L. No. 99-514, § 111, 100 Stat. 2085, 2107–08 (codified as amended in scattered sections of 26 U.S.C.).

204. *See* Ronald Reagan, President of the U.S., State of the Union (Jan. 25, 1984), http://www.presidency.ucsb.edu/ws/?pid=40205 [http://perma.cc/UF6Y-RCKK] ("I am asking [Treasury] Secretary Don Regan for a plan for action to simplify the entire tax code.").

205. TIMOTHY J. CONLAN, MARGARET T. WRIGHTSON & DAVID R. BEAM, TAXING CHOICES: THE POLITICS OF TAX REFORM 46 (1990).

206. The Treasury Department proposed indexing the EITC's maximum benefit and its phaseout thresholds. U.S. DEP'T OF THE TREASURY, TAX REFORM FOR FAIRNESS, SIMPLICITY AND ECONOMIC GROWTH: THE TREASURY DEPARTMENT REPORT TO THE PRESIDENT 37, 71 (1984).

207. The other two proposals were (1) increasing the personal exemption by nearly 100 percent and (2) increasing the standard deduction. CONLAN ET AL., *supra* note 205, at 62.

208. *Id.* President Nixon was successful in eliminating impoverished families from the income-tax rolls in 1969. *See supra* notes 115–16 and accompanying text. But inflation in the 1970s gradually unraveled Nixon's efforts by driving low-income taxpayers into higher tax brackets. CONLAN ET AL., *supra* note 205, at 62.

209. *See* CONLAN ET AL., *supra* note 205, at 64 (explaining that achieving distributional neutrality—that is, reforming the tax code so that no income class, with the exception of the working poor, would bear a larger or smaller share of the overall tax burden than before—was one of the Treasury Department's ground rules for tax reform). Democrats and Republicans in Congress agreed with the Treasury Department that tax reform should achieve distributional neutrality. HOWARD, *supra* note 40, at 148.

210. CONLAN ET AL., *supra* note 205, at 74.

211. U.S. DEP'T OF THE TREASURY, THE PRESIDENT'S TAX PROPOSALS TO THE CONGRESS FOR FAIRNESS, GROWTH, AND SIMPLICITY 18 (1985).

212. CONLAN ET AL., *supra* note 205, at 87.

protests did not deter Reagan, who coveted tax reform's potential benefits,[213] and, by 1985, made tax reform his top domestic priority.[214] Treasury II underwent changes in the Democrat-controlled House,[215] the Republican-controlled Senate,[216] and in conference between the two.[217] But Reagan's EITC proposal survived and grew,[218] and when he signed into law the Tax Reform Act of 1986,[219] he touted the bill as "the best antipoverty bill [and] the best profamily measure . . . to ever come out of the Congress of the United States."[220]

3. *President George H.W. Bush*. President Reagan's Vice President and successor, President George H.W. Bush, further expanded the EITC and amended it to be more generous to families with children. When then–Vice President Bush ran for president in 1988, family issues were high on the priority list of both political parties.[221] For his part, Bush campaigned on helping families by creating targeted tax credits.[222] In his first year as president, Bush set out to fulfill his promise by proposing a new refundable tax credit to provide financial support to working parents of young children, the design of which closely resembled the EITC.[223] In 1990, President Bush's Supplemental Young Child Credit (SYCC) was added to the EITC as a 5 percent bonus credit for families with children under the

213. Reagan saw tax reform as an opportunity to lower tax rates, increase long-term support for the Republican Party, and cement his domestic-policy legacy. *Id.* at 47, 70–71.

214. *Id.* at 94.

215. *Id.* at 116–28.

216. *Id.* at 163–66, 174–76, 178–79, 181–86.

217. *Id.* at 218–21.

218. *See* HOWARD, *supra* note 40, at 148–49 (explaining that EITC expansion—a proposal that never faced significant opposition—helped tax-reform legislators achieve overall distributional neutrality by offsetting reform measures that benefited the wealthy).

219. Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (codified as amended in scattered sections of 26 U.S.C.).

220. Ronald Reagan, President of the U.S., Remarks on Signing the Tax Reform Act (Oct. 22, 1986), http://millercenter.org/president/speeches/speech-5678 [http://perma.cc/TKR2-TFVC].

221. HOWARD, *supra* note 40, at 152.

222. *Id.* at 153.

223. Bush's new child tax credit would have provided families with children under the age of four with a benefit of 14 percent of earned income up to a maximum benefit of $1000, which would then phase out at a rate of 20 percent for families with incomes between $8000 and $13,000. George H.W. Bush, President of the U.S., Statement on Proposed Child-Care Legislation (Mar. 15, 1989), http://www.presidency.ucsb.edu/ws/index.php?pid=16789 [http://perma.cc/Y4YW-TLJC].

age of one.[224] President Bush also supported amendments to the EITC that expanded the credit[225] and—as an additional perk for families—adjusted it to provide additional benefits to larger families for the first time.[226] Between the beginning of Reagan's presidency and the end of Bush's, the EITC grew at an average annual rate of 11.4 percent, faster than any other major U.S. social program during that time.[227]

4. *President Bill Clinton*. Upon taking office, President Bill Clinton attached policy objectives of his own to the fast-moving EITC vehicle. First, President Clinton saw EITC expansion as a tool for fighting poverty. In his first speech before Congress, Clinton shared his vision for the EITC to become a work-premised living-wage guarantee for parents: "[I]f you work 40 hours a week and you've got a child in the house, you will no longer be in poverty."[228] Second, like Reagan before him,[229] Clinton relied on the EITC to solve a budget-politics quandary: expanding the EITC would be expensive[230] and was therefore inconsistent with Clinton's campaign promise to reduce the federal deficit.[231] At the same time, Clinton's proposed energy tax—designed to offset EITC costs and reduce the deficit—was criticized as disproportionately burdensome on low-income individuals.[232] The two proposals were therefore perfect complements in a clever

224. Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11,111, 104 Stat. 1388, 1388-408 to -413 (codified as amended at 26 U.S.C. § 32 (2012)). President Clinton's administration presided over the SYCC's elimination in 1993 as part of its efforts to restructure and expand the EITC. Michael J. Caballero, *The Earned Income Tax Credit: The Poverty Program that Is Too Popular*, 48 TAX LAW. 435, 450–52 (1995).

225. *See* George H.W. Bush, President of the U.S., Statement on Signing the Omnibus Budget Reconciliation Act of 1990 (Nov. 5, 1990), http://www.presidency.ucsb.edu/ws/index.php?pid=19000 [http://perma.cc/9MX9-RZEQ] (confirming that Bush and his administration requested and strongly supported the expansion and creation of tax credits for families).

226. Omnibus Budget Reconciliation Act of 1990 § 11,111.

227. *See* HOWARD, *supra* note 40, at 141.

228. Bill Clinton, President of the U.S., Address Before a Joint Session of Congress (Feb. 17, 1993), http://millercenter.org/president/clinton/speeches/speech-3435 [http://perma.cc/M7TU-JZXQ].

229. *See supra* note 209 and accompanying text.

230. *See* JOINT COMM. ON TAXATION, 103D CONG., ESTIMATED BUDGET EFFECTS OF THE ADMINISTRATION'S REVENUE PROPOSALS CONTAINED IN THE FISCAL YEAR 1994 BUDGET 3 (1993) (estimating that President Clinton's proposed EITC expansion would cost about $28 billion over five years).

231. *See* Ruth Marcus & Ann Devroy, *Asking Americans to 'Face Facts,' Clinton Presents Plan to Raise Taxes, Cut Deficit*, WASH. POST, Feb. 18, 1993, at A1 (noting President Clinton's campaign pledge to "halve the deficit in four years").

232. Caballero, *supra* note 224, at 448.

legislative scheme—by providing additional benefits to the poor, the EITC expansion mitigated worries about the regressive impact of the energy tax while the energy tax softened concerns about swelling EITC costs.

President Clinton's ambitions to reduce poverty through the EITC apparently did not extend to individuals without children. His proposal provided the EITC to individuals who did not have a "qualifying dependent,"[233] but only in an amount sufficient to offset his new energy tax, thus yielding no net antipoverty assistance.[234]

President Clinton proposed a number of additional changes in accordance with his antipoverty policy goals. Clinton's plan drastically increased the EITC's credit rate and phase-out range in order to increase a family of four's maximum credit 123 percent.[235] In addition, Clinton proposed to make EITC benefits more responsive to family size, providing a 20 percent larger credit to households with multiple qualifying dependents than to households with only one qualifying dependent.

After the EITC expansion cruised through the House and survived turbulence in the Senate, President Clinton signed it into law as part of the Omnibus Reconciliation Act of 1993 (OBRA).[236] Both Clinton's energy tax and his EITC expansion were approved, largely unaltered, by the House.[237] The Senate, on the other hand, exerted far more resistance, effectively killing Clinton's energy tax and slashing his EITC expansion by about one-third.[238] Despite the fact that OBRA no longer included Clinton's energy-tax proposal, the EITC for individuals without a qualifying dependent was included in the conference bill.[239] That provision, as part of a compromise expansion, ultimately survived and was signed into law on August 10, 1993.[240]

233. *Id.* at 451. In the current EITC, the analogous term is "qualifying child," which generally refers to a taxpayer's child but can also refer to a sibling, niece, or nephew. 26 U.S.C. § 152(c) (2012).

234. *See* Caballero, *supra* note 224, at 451–52 (explaining that "[t]he credit for these individuals would offset the effects of the [energy] tax, and therefore was considerably smaller than the credit for individuals with qualifying dependents").

235. *Id.* at 451.

236. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, 107 Stat. 312.

237. Caballero, *supra* note 224, at 454.

238. *Id.*

239. *Id.*

240. *Id.* at 456.

Individuals without qualifying children still receive the EITC today, but their credit amount is still strictly limited.[241]

5. *President George W. Bush*. Eleven years after the first Bush administration acted to expand and to supplement the EITC, President George W. Bush presided over a further expansion as part of his 2001 tax-cut legislation. Bush made large tax cuts the cornerstone of his 2000 presidential campaign.[242] Shortly after assuming the presidency, he introduced a $1.6 trillion tax-cut plan[243] that proposed to, *inter alia*, reduce the marriage penalty[244] by reviving an expired 10 percent deduction for two-earner couples.[245] Critics attacked the President's tax-cut plan because it provided greater tax savings to wealthy taxpayers than lower-income taxpayers.[246] Thus, when the Republican-controlled House Ways and Means Committee introduced a bill[247] to increase the EITC for married couples, it intended to accomplish two objectives: respond to President Bush's call for marriage-penalty relief[248] and neutralize criticism by making Bush's overall proposal more progressive.[249] On June 7, 2001, Bush signed into law the Economic Growth and Tax Relief Reconciliation

241. *See supra* Figures 1–2.

242. Richard W. Stevenson, *Bush Tax Plan: The Debate Takes Shape*, N.Y. TIMES (Aug. 26, 2000), http://www.nytimes.com/2000/08/26/us/the-2000-campaign-the-tax-plan-bush-tax-plan-the-debate-takes-shape.html [https://perma.cc/7DZQ-XJWZ].

243. Mona Lewandoski, *The Bush Tax Cuts of 2001 and 2003: A Brief Legislative History* 9 (Harvard Law School, Budget Briefing Paper No. 37, 2008), http://www.law.harvard.edu/faculty/hjackson/2001-2003TaxCuts_37.pdf [http://perma.cc/BPQ6-84LE].

244. Married individuals suffer from a marriage penalty when they pay higher taxes under a joint return than they would have paid as single taxpayers. SCHMALBECK & ZELENAK, *supra* note 19, at 772. Marriage penalties are most severe "when the division of earnings between the spouses is relatively even." U.S. DEP'T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2002 TAX RELIEF PROPOSALS 5 (2001).

245. U.S. DEP'T OF THE TREASURY, *supra* note 244, at 5.

246. *See e.g.*, SHAPIRO & FRIEDMAN, *supra* note 23, at vii ("Under the Bush plan, after-tax income for the top one percent of taxpayers would grow by 6.2 percent. This is more than three times the income growth of 1.9 percent for the fifth of the population in the middle of the income spectrum."); Bob McIntyre, *CTJ Analysis of Bush Plan Updated to 2001 Levels*, CTJ NEWS (Citizens for Tax Justice, Washington, D.C.), Feb. 27, 2001, at 1–3, http://www.ctj.org/pdf/gwbin01.pdf [http://www.perma.cc/DP3Y-KHXA] (noting that "more than sixty percent of Bush's proposed tax cuts would go to the best-off 10 percent of Americans").

247. H.R. 6, 107th Cong. (2001).

248. H.R. REP. NO. 107-29, at 11 (2001).

249. Critics, however, were not placated. *See id.* at 34 ("[T]he [EITC-related] improvements made by the Chairman to the Bush proposals do little to change the overall unfairness of the Republican tax plan.").

Act of 2001 (EGTRRA),[250] which included the House's proposal to expand the EITC for married taxpayers.[251]

6. *President Barack Obama*. President Barack Obama followed in the tradition of his predecessors by enacting family-oriented EITC expansions. As a presidential candidate, Obama promised to "increase [EITC] benefits for families with three or more children, and reduce the EITC marriage penalty."[252] Within thirty days of becoming president, Obama delivered on those promises by signing into law EITC expansions as part of the $789 billion post-financial-crisis economic stimulus measure,[253] the American Recovery and Reinvestment Act of 2009 (ARRA).[254] President Obama signed those EITC expansions into law as part of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010[255] and again as part of the American Taxpayer Relief Act of 2012.[256]

IV. THE EITC'S PATH-DEPENDENT PAST

This Part examines the legislative history detailed in Part III through the theoretical lens of path dependence. Specifically, it identifies increasing-return factors that have helped carry the EITC forward with its basic, original structure intact[257]: large set-up costs,

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250. Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (2001) (codified as amended in scattered sections of 26 U.S.C.).

251. Specifically, EGTRRA increased by $3000, in $1000 periodic increments between tax years 2002 and 2007, the beginning and ending of the EITC phaseout. The legislation also provided that the new phaseout thresholds would be indexed for inflation after 2007. JOINT COMM. ON TAXATION, JCS-1-03, GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN THE 107TH CONGRESS 33 (2003).

252. OBAMA FOR AMERICA, BARACK OBAMA'S COMPREHENSIVE TAX PLAN 2 (2008), http://halebobb.com/Obama/Factsheet_Tax_Plan_FINAL.pdf [https://perma.cc/8J2F-PXB4].

253. David M. Herszenhorn & Carl Hulse, *House and Senate in Deal for $789 Billion Stimulus*, N.Y. TIMES, Feb. 12, 2009, at A1.

254. *See* American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, div. B, tit. I, § 1002, 123 Stat. 115, 312 (amending 26 U.S.C. § 32 (2012)) (increasing temporarily the credit percentage for taxpayers with three or more qualifying children and reducing the EITC marriage penalty).

255. Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, tit. I, § 103, 124 Stat. 3296, 3299 (codified at 26 U.S.C. § 32(b)(3) (2012)).

256. American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, tit. I, § 103(c), 126 Stat. 2313, 2319–20 (amending 26 U.S.C. § 32 (2012)).

257. *See* Caballero, *supra* note 224, at 435 (noting that the underlying structure of the EITC has generally remained unchanged since it was enacted).

collective action, policymakers' short-term orientation, and status quo bias.

A. Legislative Analogue to Large Set-Up Costs

President Nixon's failed efforts to enact his FAP illustrate how costly it can be to attempt radical policy innovation. Nixon expended substantial political capital for the majority of his first term and ultimately achieved no legislative victory.[258] By extending his hand to political opponents with an extraordinarily progressive welfare-reform proposal,[259] Nixon alienated political allies[260] and was snubbed by opponents anyway.[261] Senator Long also experienced high legislative costs. Even though his EIC was much less ambitious than Nixon's FAP, it still required three years of steady effort by Long, chairman of the powerful Senate Finance Committee, to orchestrate its enactment.[262]

These examples show how the EITC only came into being after significant start-up costs, which paved the way for subsequent path dependence. In a production process, high start-up or fixed costs create an incentive to rely on previously incurred fixed costs for as long as feasible.[263] To illustrate, imagine an old printing press in which letters must be painstakingly arranged by hand. A publisher would have an incentive to continue printing using preset printing plates for as long as possible, tolerating incremental textual obsolescence and favoring incremental changes over large ones. This concept, by analogy, helps explain why policymakers rationally would not overhaul or replace the EITC, even if some of the purposes underlying its original design were merely a product of historical anomaly or had otherwise become obsolete.

B. Collective Action

President Nixon's legislative failure also illustrates how acute the collective-action problem can be in the context of trying to enact a revolutionary policy. Nixon's groundbreaking FAP was a textbook

258. *See supra* Part III.A.2.
259. *See supra* notes 123–27 and accompanying text.
260. *See supra* notes 143–46 and accompanying text.
261. *See supra* notes 136–42, 156–61 and accompanying text.
262. *See supra* Part III.B.
263. *See supra* note 44 and accompanying text.

public good[264]: he could not exclude legislators from realizing the political benefits of supporting it at the eleventh hour if it turned out to be popular. In the meantime, they could remain passive, or even actively oppose, the policy, thereby free riding on President Nixon's substantial lobbying and campaigning efforts.[265] In fact, most legislators—even those who should have appreciated the EITC's progressive substance—did just that.[266] More or less on his own, President Nixon was no match for the winds of political resistance.[267]

In contrast, after the EITC was enacted and its popularity was established, it no longer exhibited the characteristics of a public good. For example, President Reagan did not have to lobby anyone to expand the EITC in 1986: Democrats wanted expansion and Republicans accepted it as their ticket to lower tax rates.[268] The elevated presence of the collective-action problem in the context of radical policy change helps explain why the EITC has not been overhauled or substantially refined in its forty-year history.

C. Policymakers' Short-Term Orientation

Policymakers' short-term orientation also contributed to the EITC's path-dependent development. First, Nixon provides a counterexample. Ex ante, it would have been irrational for him to attempt such risky, costly, and ambitious policy reform if he did not greatly value his long-term political legacy.[269] But for Reagan, Clinton, and both Bushes, expanding the EITC was either a political gain in itself or the low-cost ticket to some other *immediate* legislative gain.[270] Trying to completely overhaul the EITC likely would have entailed significant political costs and yielded only marginal short-term benefits. This may help explain why the EITC has never been comprehensively reevaluated.

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264. *See supra* notes 60–61 and accompanying text.

265. For examples of such efforts, see *supra* notes 129–33 and accompanying text.

266. *See supra* notes 135–46 and accompanying text.

267. *See supra* notes 149–61 and accompanying text.

268. *See supra* notes 209–19 and accompanying text.

269. *See supra* notes 108–09 and accompanying text. It makes sense that when a policymaker sees a single piece of legislation as one that could define her political legacy, she could overcome any tendency to be short-term focused.

270. *See supra* Part III.C.

D. Status Quo Bias

Status quo bias also played a profound role in the EITC's development. One of the most striking features of the EITC's legislative history is the extent to which conservative policymakers have supported the EITC, the tax code's most progressive provision.[271] One plausible explanation for this high degree of support over time is that initial support (actual or apparent) by former Republican presidents and notable conservatives has been self-reinforcing. As the logic goes, if Friedman originated the idea and Reagan supported it, how could any conservative be against it?[272]

Furthermore, EITC-perpetuating factors were sewn into the fabric of congressional lawmaking. For example, the EITC appeared less costly to budget estimators than it actually was because some of it could be scored as a loss of tax revenue rather than a cash outlay.[273] This exceptional bang for the buck almost certainly contributed to the EITC's attractiveness as a policy tool and its utility in matters made tricky by budget politics.[274] Like other factors detailed above, this and other manifestations of status quo bias may have helped propel the EITC along its original path, with all of its random bumps and obsolete detours.

V. IMPLICATIONS OF EITC PATH DEPENDENCE

Now that specific increasing-returns factors have been identified, this Part presents the implications of EITC path dependence. First, it describes how path dependence helped cause the EITC's undertheorization. Next, it concludes that this path dependence–generated undertheorization is, all things considered, an advantage, not a hindrance.

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271. THOMAS L. HUNGERFORD & REBECCA THIESS, ECON. POLICY INST., THE EARNED INCOME TAX CREDIT AND THE CHILD TAX CREDIT: HISTORY, PURPOSE, GOALS AND EFFECTIVENESS 2 (2013), http://s3.epi.org/files/2013/The-Earned-Income-Tax-Credit.pdf [http://www.perma.cc/XR7L-U8E7] ("The EITC is, by far, the most progressive tax expenditure in the income tax code.").

272. As a contemporary example of this phenomenon, House Speaker (and former House Ways and Means Chairman) Paul Ryan recently proposed an EITC expansion that he touts as having "conservative origins." Brian Faler, *Republicans' Love-Hate Relationship with a Tax Credit*, POLITICO (Jan. 17, 2014, 5:04 AM), http://www.politico.com/story/2014/01/republicans-gop-earned-income-tax-credit-paul-ryan-marco-rubio-102294.html [http://www.perma.cc/W5GD-AJ9Y].

273. *See supra* note 194.

274. *See supra* notes 209, 229–32 and accompanying text.

A. How Path Dependence Led to the EITC's Undertheorization

Path dependence helps explain the EITC's undertheorization. Professor Zelenak bemoaned the facts that the EITC lacks "any coherent purpose discernible from [its] structure" and that Congress has never elucidated its purpose.[275] He thus proposed a comprehensive overhaul that would give the EITC a unified and contemporarily relevant purpose.[276] That the EITC lacks a single coherent purpose is a direct result of its path-dependent past. Since the EITC was enacted, policymakers have lacked sufficient incentive to enact the kind of foundational EITC modernization that Professor Zelenak proposed.[277] Instead, changes have been incremental, preserving the EITC's original structure[278] while manifesting an assortment of different purposes.[279] Some of these purposes may no longer be relevant and others likely contributed to political ends at the expense of good, coherent policy. For example, President Reagan's 1986 EITC expansion was designed to preserve distributional neutrality as part of a larger tax-reform bill;[280] President George H.W. Bush's EITC expansions, which prioritized families with children under the age of one, arose out of an intensely profamily political environment;[281] President Clinton's expansion provided benefits to childless individuals in order to offset the effects of an energy tax that was never enacted, but puzzlingly excluded such individuals from receiving significant antipoverty benefits;[282] President George W. Bush's EITC expansion was currency for political quid pro quo and a blunt instrument for ameliorating the marriage penalty;[283] and President Obama's EITC expansions originated as part of a bill designed to stimulate the economy in the wake of the financial crisis.[284] With these disparate purposes being incrementally

275. Zelenak, *supra* note 2, at 301; *see also* Bird-Pollan, *supra* note 40, at 284 ("While the EITC has continued to enjoy strong political support, it has also continued to suffer from an absence of any clearly articulated purpose.").

276. *See generally* Zelenak, *supra* note 2 (proposing to redesign the EITC to function as a minimum-wage supplement that provides a benefit that adjusts for family size).

277. *See supra* Part IV.

278. *See* Caballero, *supra* note 224, at 435 (noting that the underlying structure of the EITC has generally remained unchanged since it was enacted).

279. *See supra* Part III.

280. *See supra* note 209 and accompanying text.

281. *See supra* Part III.C.3.

282. *See supra* Part III.C.4.

283. *See supra* Part III.C.5.

284. *See supra* Part III.C.3–6.

manifest into the EITC, and with path dependence preventing foundational modernization, it is no wonder the EITC has evolved into an ambiguous jumble of a policy.

B. Why the EITC's Undertheorization Is an Advantage, Not a Hindrance

Of course, not all of the various purposes upon which the EITC is built are obsolete, and the EITC remains extraordinarily useful despite its enigmatical structure. For example, the EITC has played a significant role in alleviating poverty. In the past, the income- and payroll-tax systems increased the number of those in poverty.[285] Today, primarily due to the EITC's enactment and expansion, those systems *reduce* the number of people in poverty, particularly children.[286] In 2009, for example, the EITC "lifted 6.5 million working families, including 3.3 million children, out of poverty."[287] Moreover, the EITC also helps to reduce economic inequality. Progressive tax systems tend to reduce inequality,[288] and no tax provision contributes more to the federal income tax's progressivity than the EITC.[289]

Given its utility—and despite its imperfections—policymakers contemplating comprehensive EITC reform should proceed with caution. Given that its structure is a manifestation of diverse purposes, the EITC is a policy Rorschach test, providing both conservatives and liberals plenty to admire. Conservatives can applaud the EITC for its conservative origins;[290] its status as an alternative to welfare;[291] and the role it plays in lowering marginal tax rates,[292] supporting families,[293] and mitigating the marriage penalty.[294] Progressives, on the other hand, can admire the EITC's extraordinary

285. David Kamin, *Reducing Poverty, Not Inequality: What Changes in the Tax System Can Achieve*, 66 TAX L. REV. 593, 633–34 (2013).

286. *Id.*

287. NICOLAS JOHNSON & ERICA WILLIAMS, CTR. ON BUDGET & POL'Y PRIORITIES, A HAND UP: HOW STATE EARNED INCOME TAX CREDITS HELP WORKING FAMILIES ESCAPE POVERTY IN 2011, at 3 (2011), http://www.cbpp.org/files/4-18-11sfp.pdf [http://www.perma.cc/BPS9-UNJQ].

288. *See* Leonard E. Burman, *Taxes and Inequality*, 66 TAX L. REV. 563, 569 (2013) (explaining that the progressivity of the federal tax system reduces economic inequality).

289. *See supra* note 271 and accompanying text.

290. *See supra* Part III.

291. *See supra* note 94 and accompanying text.

292. *See supra* note 97 and accompanying text.

293. *See supra* notes 221–25 and accompanying text.

294. *See supra* notes 243–51 and accompanying text.

progressivity[295] and its efficacy in reducing poverty and income inequality.[296] Though endowing the EITC with a single unified purpose may very well improve the EITC as a policy matter, such improvements must be carefully weighed against the risk of destroying the EITC's politically valuable ambiguity.[297] If policymakers convert ink blots into a more vivid picture, everyone might not like what they see any more.

CONCLUSION

The EITC is special. Path-dependence analysis typically leads to a diagnosis of policy *problems*. For example, Professors Steven L. Schwarcz and Ori Sharon recently used a path-dependence lens to diagnose inefficiencies in the treatment of derivatives transactions under bankruptcy law.[298] Though path-dependence analysis, in this case, did uncover policy shortcomings,[299] it also helped identify an unconventional strength: ambiguity that has largely neutralized political opposition. Theorizing the EITC—eliminating its ambiguity—risks endangering a member of the rarest of all policy species: one on which both parties can agree.

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295. *See supra* note 271 and accompanying text.

296. *See supra* notes 285–89 and accompanying text.

297. For example, conservatives may not like the EITC as much if it became, as Professor Zelenak proposed, closely tied to the minimum wage, a policy many conservatives already oppose. *See* William Finnegan, *Demonizing the Minimum Wage*, THE NEW YORKER: DAILY COMMENT (Sept. 17, 2014), http://www.newyorker.com/news/daily-comment/demonizing-minimum-wage [http://www.perma.cc/CM8L-B2AH] (detailing opposition to the minimum wage among Republicans in Congress).

298. *See generally* Steven L. Schwarcz & Ori Sharon, *The Bankruptcy-Law Safe Harbor for Derivatives: A Path-Dependence Analysis*, 71 WASH. & LEE L. REV. 1715 (2014) (examining how the rights and immunities of creditors in bankruptcy actions result from path dependence and explaining the problems that such path dependence can cause).

299. *See supra* Part V.A.