The Impact of the Earned Income Tax Credit on Young Adults' Educational Outcomes and Student Debt

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Objective

This study uses the Panel Study of Income Dynamics and the Transition to Adulthood data from 1999 to 2019 to explore the relationship between young adult parents' exposure to Earned Income Tax Credit (EITC) before and during college and educational and student debt outcomes (such as college attendance, college completion, GPA, and student debt load).

Significance

We analyze the role of parental resources and fiscal policies (federal and state tax credits) on children's college attendance, college performance, and the college financing decisions such as student debt acquisition among income-poor families. The share of undergraduate college students from low-income families has increased in recent years (Fry and Cilluffo, 2019). However, low income is still a significant barrier to obtaining higher education. Although low-income families do not hold the most student debt, the burden of loan repayment inflicts more hardship on such families (Nichols, 2015). Therefore, the precise knowledge of the impact of income and fiscal policy on college attendance and student debt acquisition/repayment could have wide implications for policymakers and consumer educators.

The findings of this study are expected to contribute to two distinct lines of research. First, the paper will add to the literature on the determinants of educational outcomes such as college attendance, college completion, GPA, and student loan level. Second, the study will shed light on the potential (unintended) effects of redistributive and fiscal public policies. The EITC is a federal government program designed to offset the costs of raising children and to encourage parents (especially single parents) to join the labor force (IRS, 2023). However, by providing material financial aid in the years leading to and during college, the EITC might exert positive effects on the educational outcomes of young adults.

To the best of the authors' knowledge, this study will be the first to examine the effect of EITC exposure before and during college on educational success. This study will contribute to the evaluation of the benefits of EITC in higher education and the effects of youth exposure to safety-net programs on educational outcomes.

Method

The econometric models employed in this study exploit the exogenous variation in the EITC program's generosity brought about by adjustments to eligibility and amount of tax credit at both the federal and state levels for families of various sizes and compositions. We calculate the average annual maximum tax credit parents could have received during their child's high school and college years. We model the impact of EITC exposure on young adults' college outcomes as follows:

$$Y_i^* = \gamma + \beta_1\, MaxEITC_{i(HS)} + \beta_2 X_i + \beta_3 \delta_i + u_{it}$$

where Y_i is the outcome variable, such as college attendance, completion, GPA, and student loan acquisition. $MaxEITC_{i(HS)}$ is the average annual exposure to EITC four years before reaching the first year

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in college. Vector X_i represents personal demographic and socio-economic characteristics, including state, year of birth, gender, and race. In addition, we interact race and gender indicators with state and birth year. We also include controls for a child's parental characteristics before age 18 such as the mother's and father's educational attainment and the fraction of childhood years in which the parents were married. Vector δ_i consists of policy and economic contextual variables averaged at the state level between birth and age 18: per capita gross domestic product, unemployment rate, highest marginal income tax rate, and minimum wage. Finally, u_{it} is the model's error term.

The empirical analysis draws data from the 1999-2019 waves of the Panel Study of Income Dynamics (PSID) and the 2005-2019 waves of the Transition to Adulthood (TAS) datasets. The PSID collects data covering employment, income, wealth, expenditures, health, marriage, childbearing, child development, philanthropy, education, and numerous other topics from a nationally-representative sample of over 18,000 individuals living in 5,000 families in the United States. TAS is part of PSID that conducts more in-depth interviews with children of PSID respondents when these children are 18-28 years old. The equations presented above are estimated with observations of child-parent(s) pairs where parents are eligible for EITC based on their labor income.

Results and Implications

We expect that young adult parents' EITC exposure before college is positively and significantly associated with educational attainment and school performance. On the other hand, EITC exposure negatively affects student loan amounts acquired by young adults.This redistributive policy results in benefits that aren't usually considered when policymakers make decisions about the program's parameters. Thus, our findings should be considered in discussions of the program's social costs and benefits to make better-informed decisions. College graduates are more likely to be in the workforce and less likely to rely on public assistance programs. Overall, our findings will indicate that programs that provide income support for the poor or near-poor, such as EITC, are likely to result in far-reaching educational benefits for young adults exposed to the program.

References

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