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How a Redesigned Earned Income Tax Credit Can Limit the Contribution of the College Wage Premium to U.S. Income Inequality

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Income inequality is often described in the dispassionate, soulless language of statistics. For example, according to the Congressional Budget Office, from 1979 to 2021, the average income of the richest 0.01% of U.S. households grew nearly 27 times as fast as the income of the bottom 20% of households.[1] In 2021, the CBO found that the richest 1% of American households averaged 139 times as much income as the bottom 20%.[1] But the reality of income inequality has much more acute consequences. For the growing number of Americans left behind by our powerful economic system, inequality means food insecurity, uncertain housing, rationed healthcare, inaccessible education, and unsteady employment. We are all better off when each of us is better off. Yet in a country with about $90k of GDP per capita, almost 40% of Americans cannot afford a $400 emergency expense.[2, 3]

In this tale of two economic cities, college has been both protagonist and villain. For those privileged enough to attend, college offers skills, networks, and access. On the other hand, the absence of a college degree can limit wages or prevent employment altogether. This so-called "college wage premium" is exacerbating U.S. inequality and two structural factors are amplifying the premium:

First, technology (including computers, artificial intelligence and robotics) is automating previously routine or manual tasks, thus enabling those with more advanced skills to work more productively. This skill-biased technological change increases demand for those who can manage, interpret, and work alongside technology – often those taught to do so in college. As demand for physical or repetitive tasks diminishes, the wage premium on higher-order talents increases.

Second, the decline in the number of U.S. manufacturing jobs, and the concurrent decline in union membership, have reduced job opportunities and wage leverage for those without a college degree. According to the U.S. Bureau of Labor Statistics, at its peak in June 1979, U.S. manufacturing employment represented 22% of total nonfarm employment (19.6 million employees).[4] That share had fallen to 9% (12.8 million employees) by June 2019.[4] Similarly, union membership peaked at 21 million in 1979 and declined to 14.7 million in 2025.[5, 6] From the end of World War II through 1980, a factory job with union membership was a viable path to a

decent life. Despite recent efforts to re-energize domestic manufacturing, that path no longer seems viable or sustainable.

The tax code, interestingly, contains a tool with the potential to reduce inequality by addressing these educational disparities. That tool is the Earned Income Tax Credit, or EITC. However, the impact of the EITC is limited by its current design. The EITC requires fundamental changes that, if implemented, would collectively yield a new and uniquely effective policy to combat inequality.

As it exists today, the EITC is a refundable tax credit that supplements the wages of lower-income workers. In 2024, 24 million taxpayers each making an average of $30,000 received EITC payments averaging $2,900.[7, 8] That is, the IRS gave one-time payments of about 10% of income to about 7% of the U.S. population.[9] EITC payments to eligible workers decrease as wages increase, but with no disincentive effect: an increase in wages always produces an overall gain in income. The EITC phases out at $68,675 of adjusted gross income for a married couple filing jointly with three children.[7]

Three key changes would better enable the EITC to mitigate the college wage premium's impact on inequality:

- First, greater awareness and ease of claiming the credit would increase uptake. According to the IRS, 20% of eligible taxpayers do not claim the EITC.[10, 11] This means that almost 6 million working taxpayers are leaving almost $17 billion of refundable tax credits on the table.
- Second, coupling the EITC with financial literacy training can make the credit amount more durable and lasting. For example, volunteers preparing lower-income tax returns under the IRS' Volunteer Income Tax Assistance program can spend half an hour discussing savings, spending, investment and related topics with EITC recipients.
- Third, well-crafted timing and default rules can enlarge the impact of the EITC. For example, distributing the credit in monthly installments versus one annual lump sum would slow spending and encourage saving and investment. Monthly distributions would reduce the need for high-interest loans often used to bridge the three-week gap between tax filing and refund receipt. Additionally, cash transfers can default into Individual Retirement Accounts, Health Savings Accounts, 529 College Savings Plans, and debt reduction plans. Recipients can opt out of these defaults but would benefit from them, as would become clear via the financial literacy component.

This new EITC policy could go a long way toward mitigating the inequality induced by asymmetric education access. However, even well-intentioned policies involve trade-offs or can

yield unintended consequences. Acknowledging and addressing at least three such possible drawbacks could enhance the likelihood of success of the proposed EITC redesign:

- First, this proposal aims to mitigate existing and entrenched inequality ex post rather than addressing the root causes of that inequality ex ante. Expanding education opportunities, increasing the minimum wage or implementing a universal basic income could directly impact the root causes of inequality. However, changing the education system has proven quite difficult, increasing the minimum wage can reduce employment, and a universal basic income would be politically and culturally challenging to implement.
- Second, the Earned Income Tax Credit, as the name implies, only helps those earning reported income, so is of little use to the unemployed, workers in the "informal economy," or undocumented immigrants. In short, even an expanded EITC with simplified access would exclude the most precarious populations.
- Third, just as college confers a wage premium, race and gender can also contribute to wage inequity, and this EITC-related policy proposal would be of limited effect in mitigating these other long-standing inequities.

College appears to be a prerequisite to participation in an economy that is increasingly uneven. Economic rewards flow to those equipped to accommodate high-skill tasks, with college serving as both the selection mechanism and signal of this capacity. Yet, fewer than half of American adults have a four-year degree.[12] How can we reconcile the opportunity of our college system with the income inequality enhanced by the college wage premium? Redesigning the EITC is one tool, albeit at an imperfect one, in a toolkit that will have to expand if we are to deliver on the promise of opportunity to the majority of Americans.

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