
NEW MEXICO ADVOCATES FOR CHILDREN AND FAMILIES

Campaign to Reduce Child Poverty

Policy Brief #1

Expanding the Low Income Comprehensive Tax Rebate (LICTR): A Cost-Effective Strategy to Lift Children Out of Poverty in New Mexico¹

New Mexico has the nation's highest child poverty rate.

Childhood Poverty in New Mexico

One third of New Mexico's children live in poverty: sixty **thousand** children under the age of six. Childhood poverty not only damages the child, it continues to limit and damage the adult the child becomes.

Poor children have:

- Greater risk for serious and chronic health problems
- Greater exposure to violence at home and in the neighborhood
- Reduced school readiness due to cognitive and developmental delays
- Higher risk of dropping out of school

The long-term consequences of growing up in a poor household are sobering: adults with limited education confined to low wage jobs; high rates of unemployment; substance abuse, homelessness, and more. And the cost of poverty is public, as well as private. Poor people rely on public benefits such as indigent care or cash assistance to survive.

Children under the age of 6 are particularly vulnerable to the effects of poverty.

First, this age group is particularly vulnerable to the negative health effects of poverty, and alleviating those effects would yield long-term benefits. *Second*, the poverty rate is particularly high among families with pre-school children. *Third*, reduced reliance on welfare benefits leaves poor families particularly vulnerable. Supplementing their income through the tax system is a non-stigmatizing way to deliver needed assistance, and to help families exit welfare successfully.

Unique Aspects of Poverty in New Mexico

Striking differences exist in the rates of poverty among the states in the U.S. New Mexico has one of the highest rates of poverty in the nation. Poverty is not only more prevalent in New Mexico than in most other states; it is also different in at least

three important ways. First, nationally poverty is largely an urban phenomenon, while in New Mexico it is not concentrated in urban areas (in 1997 the Census Bureau estimated that only 23% of people living in poverty lived outside of metropolitan areas; in New Mexico more than half of those living in poverty live outside a metropolitan area). Many poor New Mexicans live in remote rural locations, far from jobs and social service offices, making access to both employment and income support and social service programs more difficult. Second, the income distribution in New Mexico is more unequal than in most other states. While New Mexico is home to many very poor families, it is also home to some very wealthy ones. Studies show that this disparity between rich and poor negatively affects health, including child health and infant mortality. Third, in *New Mexico almost half of poor people* are severely poor (defined as having an income less than half the applicable poverty threshold), compared to the national rate of 41%. Generalized calculations of the number of families living below the poverty line do not distinguish between families living near the poverty line, from those living far below it.

One of the most cost-effective approaches to reducing poverty is through tax-based policy.

Tax Policy: An Effective Approach to Alleviating Poverty in New Mexico

Poverty reflects systemic issues that are part of national, and international, economic and political structures. But part of the difference in child poverty rates among states is due to differences in policies and programs at the state level. If those differences were understood in terms of specific programs that reduce poverty, individual states, including New Mexico, could knowledgeable implement programs that addressed this serious problem.

At the national level, the Earned Income Tax Credit (EITC) has been particularly effective at raising families from poverty. According to the Washington D.C.-based Center on Budget and Policy Priorities, the EITC lifts more children out of poverty than any other government program. The EITC also encourages families to remain employed as the tax credit is only applicable to earned income. However, the extremely poor, who face worse consequences than those living just below the threshold, are less likely to be lifted from poverty by existing programs like the EITC.²

Financial assistance provided through the tax system avoids some of the pitfalls associated with other poverty relief programs. Eligibility is determined and benefits delivered by mail, which makes it easy for residents in remote parts of the state to obtain the benefits for which they are eligible. Assistance delivered through the tax system is less stigmatizing than that which requires a visit to an Income Support Division office. And expanding existing tax-based programs entails much lower administrative costs than expanding conventional entitlements.

New Mexico's Existing Tax Policy: A Step in the Right Direction

Fortunately, several aspects of New Mexican tax policy lend themselves to tax-based programs that alleviate poverty. New Mexico already has a unique tax-based policy in place, the Low Income Comprehensive Tax Rebate (LICTR), that allows a rebate to all households with modified gross income of \$22,000 or less (counted as all earned and unearned income, including public benefit income). Virtually all poor New Mexicans qualify for this tax rebate, even if they have no earned income, because LICTR is not an income-based credit. Rather, it rebates a portion of the gross receipts tax on necessities. This tax disproportionately impacts the poor who have no choice but to spend virtually all of their income on gross receipts taxable commodities such as food.

LICTR has been in place for almost thirty years. Three factors - availability of a rebate absent any earned income, the longevity of the program, and the virtually anonymous non-stigmatizing delivery mechanism - contribute to the high number of poor families who apply for the credit. Estimates are that 90-95% of New Mexicans living in poverty file for LICTR rebates.

The Most Cost-Effective Tax-based Strategy To Alleviate Childhood Poverty in New Mexico

A study conducted by New Mexico Advocates for Children and Families, "State Tax Policy and Child Poverty in New Mexico", concludes that the most cost-effective tax-based strategy to alleviate child poverty in the state is a two-tiered one that would combine restructuring LICTR to increase allowable exemptions for dependent children, with a tax rebate administered as part of LICTR, targeted at children aged six and younger. More than 100,000 New Mexican families would benefit from this two tiered approach.

- **Revision of LICTR To Increase the Rebate and Make the Exemption Status of Children Equal to the Exemption Status of the Elderly and the Blind:** LICTR amounts are based on household size. Each member of the household is an "exemption" for purposes of LICTR. If LICTR were revised to allow poor families with children **two extra exemptions per dependent child**, the exemption status of children would be equivalent to that currently allowed the elderly and the blind (i.e., currently the elderly and blind are allowed a total of three exemptions, while children are allowed only one). In addition, the LICTR rebate would be increased by 20% for filers having more than one exemption, and more than \$3,500 in modified gross income.
- **The Early Childhood Advantage Tax Rebate:** This rebate would provide an additional credit to families

with children ages six years and younger, thereby addressing the problem of poverty among the youngest children in the state. The amount of the credit would depend on the family's modified gross income, and the number of young children in the household.

More than 6,000 children would be lifted completely out of poverty by these policies...at a cost of \$2,500 per child.

The cost of reducing poverty by one percentage point is \$1.7 million, far less than other tax based policy options.

Cost / Benefit Analysis

The average cost of lifting a child out of poverty through these policies is approximately \$2,500 per child. The combined cost for these policies is \$29 million. The average depth, or severity, of poverty would be reduced by 9%.

For example, changing the standard deduction allowed to head-of-household would not affect child poverty because households below the poverty threshold have no tax liability in New Mexico.

Other tax credit options aimed at alleviating poverty in families with children either cost more than the two-tiered LICTR restructuring and rebate approach, or benefit fewer families, or both.

- A tax credit of \$300 per child in families below the poverty level would cost \$45.6 million; increasing the credit to \$400 would cost \$60.8 million. The \$400 credit lifts 11,827 children from poverty but costs twice the LICTR proposal.



- A graduated tax credit, for families in extreme poverty, would also cost \$60.5 million and would lift fewer families from poverty than the \$400 credit.
- An income tax credit similar to Arizona's Family Income Tax Credit, would cost about as much as the LICTR restructuring (\$23 million) but would only lift 1,803 children from poverty, compared to the more than 6,000 who would be lifted through LICTR restructuring combined with the Early Childhood Advantage Tax Rebate.

The LICTR revisions proposed here, combined with the Early Childhood Advantage credits, are by far the most cost-effective tax-based policy to alleviate childhood poverty in New Mexico. LICTR revisions alone would not be as cost-effective as the combined policy proposed. The cost of the LICTR component is \$13.6 million. This component alone would lift only 446 families from poverty, including 734 children, at an average cost per child lifted of \$14,387 (the highest average among all policies considered). Adding the Early Childhood Advantage components adds \$15.3 million in tax expenditures, but increases the number of families lifted from poverty by more than six-fold, and the number of children lifted by more than eight-fold.

The cost of this policy would be partially offset by tax revenues gained. Virtually every dollar returned to poor New Mexicans will be spent on goods and services that yield gross receipts tax revenue. As a result, roughly \$1.3 million of the program's estimated \$29 million annual cost would be returned to the state each year.³

Positive Action by New Mexico Policy Makers

While poverty and inequality in New Mexico are particularly severe, there are also unique opportunities within the state tax system to address these problems. Policies

that specifically target families with young children address the poorest and most vulnerable segment of the population. The benefits associated with reducing poverty extend beyond the numbers. By investing in policies that reduce childhood poverty the state invests in the future.

Legislators and the Governor have a unique opportunity to take a significant step towards alleviating the problem of childhood poverty in New Mexico. Lift 6,000 children out of poverty by enacting the proposed revision of LICTR, and the Early Childhood Advantage Tax Rebate in the next legislative session.

A complete version of this report is available on-line at www.nmadvocates.org

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² Use of the EITC by residents of New Mexico will be the focus of another policy brief.

³ Data for this analysis was obtained from 1998 state tax returns. The data set, obtained from the New Mexico Taxation and Revenue Department, includes approximately 95% of the low-income population in New Mexico, allowing accurate inferences about the revenue implications of specific changes in tax policy. For the full analysis, see "State Tax Policy and Child Poverty in New Mexico" available from New Mexico Advocates for Children and Families.