DESIGN CHANGES CAN STRENGTHEN THE EITC DURING RECESSIONS

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We examine how proposals to modify and expand the EITC would change its impacts during economic downturns. Using components from the Economic Security Project's Cost-of-Living Refund, we identify three main effects. First, accelerating the credit phase-in (or eliminating it entirely) would reduce instances in which credit amounts decline during downturns. That would make the credit a more effective automatic stabilizer. Second, increasing the size of the credit and expanding eligibility would provide one-time stimulus when first enacted. That stimulus would be better targeted to people with low incomes than some other proposals such as payroll tax holidays. If an EITC expansion were made permanent, it would provide less stimulus in future downturns but would provide more consistent economic assistance. If the expansion included childless workers (many of whom do not file taxes today), it would make it easier for policymakers to deliver special payments in future recessions (much as the initial round of CARES Act rebates is doing today). Finally, advancing credit payments could provide faster financial assistance to beneficiaries in a downturn. Unless the advance was structured as an additional payment, that gain would be offset by a reduction in financial assistance at some point in the future when the remaining credit was computed.

During a recession, many economically vulnerable families lose jobs or earn lower wages. This exacerbates already difficult economic circumstances. Before the economic blow from the novel coronavirus, 40 percent of people in a recent Gallup poll reported either running into debt or barely making ends meet.[1] Many people do not have sufficient savings on hand to deal with an emergency (Kavanaugh 2019). Six in 10 adults in families with children who had incomes below 200 percent of the federal poverty level (about $50,000 for a family of four) reported trouble securing a basic

[1] V. Lance. Tarrance, "Despite U.S. Economic Success, Financial Anxiety Remains," *Polling Matters* (Gallup blog), July 12, 2019.

need such as housing, food, health care, or utilities (Karpman, Zuckerman, and Gonzalez 2019). In other words, even without a recession, many families' financial lives are precarious.

Policies that help stabilize families before a recession can help families weather one when it occurs. In some cases, they also help stabilize the overall economy. Unemployment Insurance, for example, helps covered workers manage the financial shocks of a job loss in good times and in bad. It is an especially valuable policy tool in bad times because it expands automatically and thus supports the overall economy. A universal basic income (UBI), in contrast, provides some income stability, but it does not expand during bad times or contract during good times. A UBI can help families get through recessions, but it does not expand to fight recessions when they happen.

The EITC provides income support through good and bad economic times. During economic downturns, it also acts as a modest automatic stabilizer. In past recessions, more workers have seen their EITC benefits rise than have seen them fall. Workers received larger credits if their income had previously exceeded EITC limits but earnings loss made them eligible for a credit. Workers received smaller credits if their income had previously qualified them for the EITC but earnings loss reduced (or eliminated) the credit. The stabilizing effect of the EITC is important, but it is modest relative to other automatic stabilizers such as Unemployment Insurance and Supplemental Nutrition Assistance Program benefits.[2]

In recent years, many policymakers, advocates, and analysts have proposed expanding the EITC, sometimes dramatically. In this brief, we examine how redesigning the EITC would change its effects during economic downturns. As an example of reform options, we focus on elements from the Economic Security Project's proposal for the Cost-of-Living Refund (Maag, Marron, and Huffer 2019). We consider extending eligibility for the EITC to more low- and middle-income workers, increasing the maximum benefit, accelerating the phase-in of benefits, considering being a student or caregiver on par with paid work sufficient to receive the maximum credit, and delivering the payment throughout the year.

Accelerating the credit phase-in (and eliminating it entirely for caregivers and students) would increase the credit's value as an automatic stabilizer. Paid workers would face less risk of having their credit decline as a result of earnings losses. People who become caregivers or students upon job loss would be eligible for a credit at least as large as what they received when working. In the recession we are facing now, with many schools closed and the elderly appearing particularly vulnerable to COVID-19, many people previously in the paid labor force may need to fulfill caregiving responsibilities for children or elderly people. In any recession there is a risk that some lost jobs will not return. Supporting students can allow people to gain new skills that will hopefully be needed for the jobs that replace those lost ones.

Expanding the credit to people with higher incomes and lengthening the phase-out would help offset recession losses for middle-income people. People with earnings too high to receive an expanded credit (such as the Cost-of-Living Refund) in a normal year may become eligible for a credit due to a recession caused earnings drop. People with earnings in the phase-out range of the credit could become eligible for a larger credit amount during a recession as their earnings drop. The Cost-of-Living Refund proposal broadens the reach of the credit up the income scale and

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[2] Between 2007 and 2008, the number of families claiming the EITC increased from 24.6 million to 24.8 million, despite no significant program changes. EITC dollars claimed increased by about $2 billion, from $48 billion to $50 billion (Internal Revenue Service 2009, 2010.) For scale, Supplemental Nutrition Assistance Program (SNAP, formerly known as food stamps) benefits went to about 12 million households in 2007, rising to 13 million in 2008 and 16 million in 2009 (Population Reference Bureau 2009). Increases in SNAP participation were largely driven by increases in eligibility from unemployment and changes in the law (Liebman 2018). SNAP benefits increased from $30 billion in 2007 to $35 billion in 2008, jumping to about $50 billion in 2009. These increases stemmed from increased participation and benefit increases (Congressional Budget Office 2012). In general, about half of SNAP beneficiaries also receive EITC benefits. Those that do not receive EITC benefits tend to be childless or have no earnings (Maag et. al 2015). Similarly, legislators expanded Unemployment Insurance over this period and claims also went up. In 2007, Unemployment Insurance benefits were about $32 billion, increasing to $51 billion in 2008 and $129 billion in 2009 (DOL 2020.) In 2009, that included $50 billion in extended benefits and federal emergency benefits.

provides insurance for people with incomes up to about $50,000 if single and up to $90,000 if married. A similar, countercyclical effect happens under the current EITC at lower income levels.

Increasing the size of the EITC and expanding eligibility would provide a one-time stimulus when first enacted. Under the Cost-of-Living Refund, that stimulus would be better targeted to people with low- and moderate-incomes than some other proposals. A payroll tax holiday, for example, would benefit up to 75 percent of households with over 70 percent of the benefits going to households in the top 40 percent of the income distribution (Steuerle, Quakenbush, and Maag 2018). The rebate payments authorized by the CARES Act had no minimum earning requirement (i.e., even people with no earnings could receive the maximum credit). This provided larger benefits to very low-income people than increasing the maximum EITC would provide. However, the rebates reached much higher up the income distribution than an expanded EITC likely would. The CARES Act rebates are expected to benefit over 90 percent of households. This means the rebates were more targeted to low- and moderate-income families than a payroll tax holiday (providing much larger benefits, particularly for people who did not work) but were less targeted to moderate-income families than an EITC expansion since more people further up the income scale benefit from the CARES Act rebates. Allowing a temporary credit expansion to remain in place during a recession and then turn off once the economy has sufficiently recovered would allow the expansion to be used as stimulus again in a subsequent downturn. If the credit expansion were made permanent, however, it would provide only limited stimulus in future downturns, reflecting its modest counter-cyclical nature. A permanent credit expansion would primarily provide persistent income support to beneficiaries rather than countercyclical support.

Finally, advancing credit payments could provide faster financial assistance to beneficiaries in a downturn by providing cash resources prior to the taxpayer filing an income tax return. That gain would be offset by a reduction in financial assistance in the future, and taxpayers who believe that they may become ineligible should be provided a way to opt out of the advance credit payments. Paying the credit regularly throughout the year would require the Internal Revenue Service to have up-to-date bank account information for beneficiaries. This would make it easier to distribute special tax rebates, as was done in the CARES Act. Once payments from the CARES Act are established, they may provide a similar avenue for additional payments.

HOW THE EITC OPERATES TODAY

EITC Targets Benefits to Low- and Moderate-Income Workers

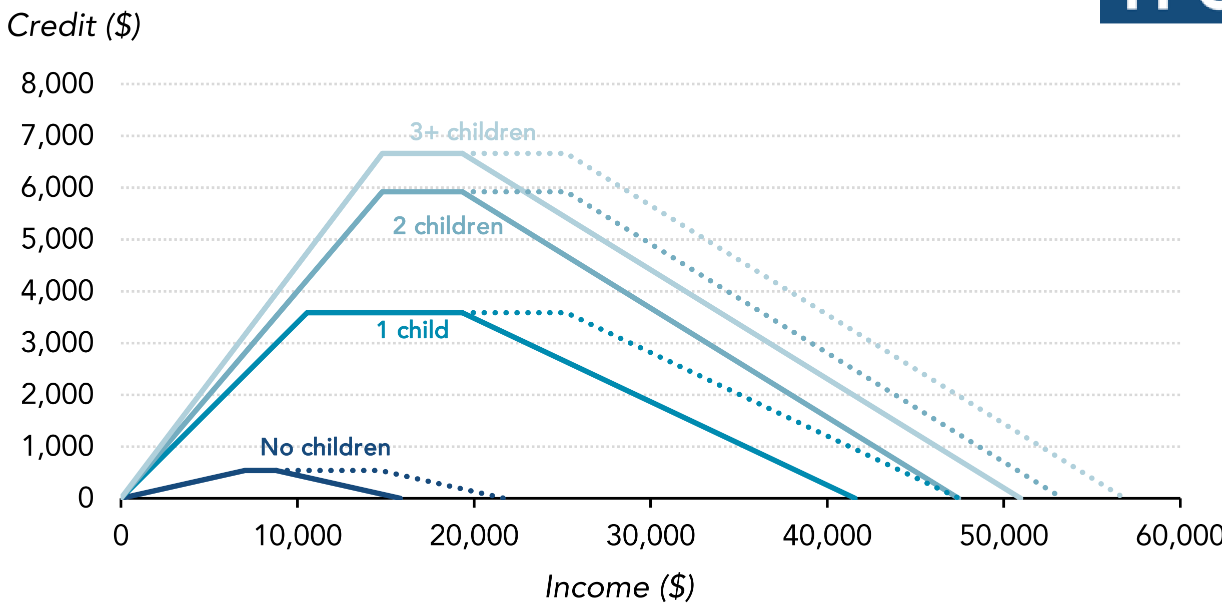
The EITC is the most widely received cash assistance program for low- and moderate-income working families. In 2019, the Tax Policy Center estimated that over 27 million households received a total benefit of almost $67 billion in reduced taxes and payments, almost completely delivered in 2020 after 2019 tax returns are filed. In 2018, the program lifted roughly 5.6 million people out of poverty and reduced poverty for 16.5 million more (Center on Budget and Policy Priorities 2019).

The credit subsidizes wages. It rises by a fixed percentage of earnings from the first dollar of earnings until the credit reaches a maximum. The credit then stays flat until earnings hit a phaseout range. From that point, the credit falls with each additional dollar of income until it disappears entirely. All else equal, families with more children qualify for larger credits than families with fewer children, and “childless families,” meaning those without custodial children, qualify for the smallest credits (figure 1).

The EITC goes to relatively few elderly people. Not only are they less likely to work and have children at home, benefits for childless people extend only to taxpayers under age 65.

FIGURE 1

Earned Income Tax Credit, 2019

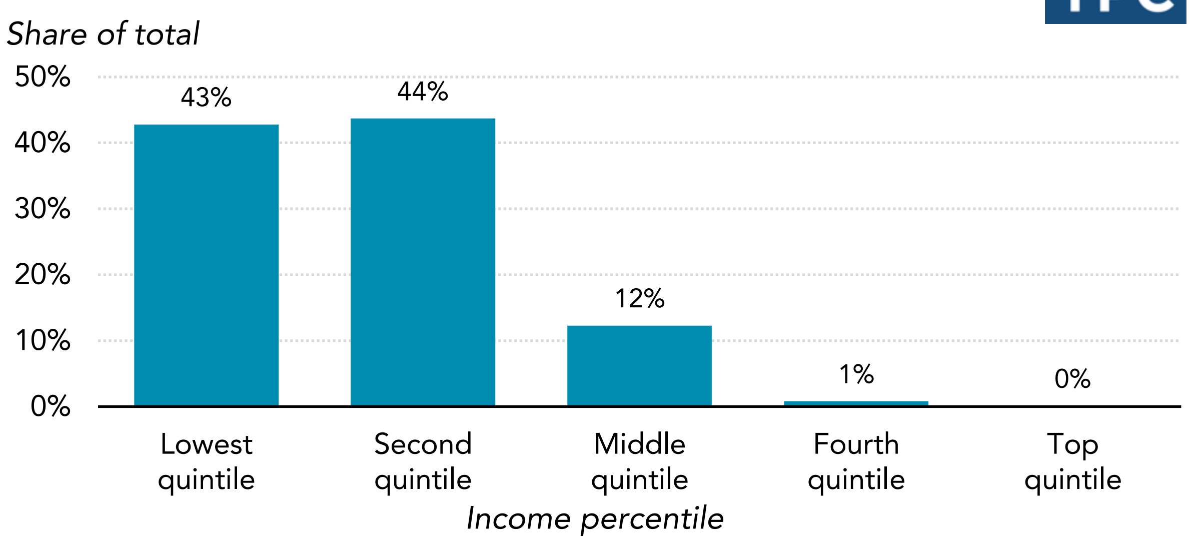


Source: Urban-Brookings Tax Policy Center.
Note: Assumes all income comes from earnings. Dotted lines represented married couples.

The structure of the credit means that benefits are well-targeted to those with low incomes. About 43 percent of all benefits go to families in the bottom one-fifth of the income distribution (bottom income quintile), and another 44 percent go to families in the second income quintile (figure 2).

FIGURE 2

Distribution of EITC Benefits in 2019



Source: Urban-Brookings Tax Policy Center Microsimulation Model version 0319-2.
Note: EITC = earned income tax credit.

Among families with children, the credit benefits a relatively large share of those in the bottom two income quintiles: 80 percent of families in the lowest income quintile receive the EITC as do 78 percent of families in the second income quintile. EITC benefits are thus well-targeted to improve income security for many low- and moderate-income workers who live with children.

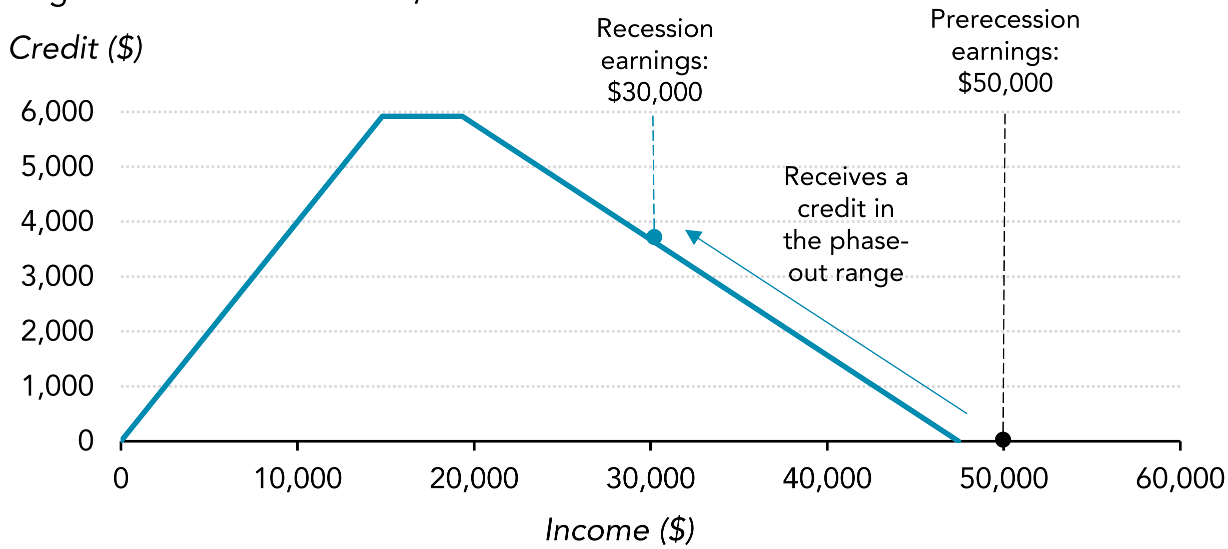
Benefits Offset Earnings Losses for Some Workers but Accentuate Them for Others

Credit amounts depend on a family's earnings. As a result, those amounts can rise or fall when a worker loses a job, works fewer hours, or otherwise sees their pay cut. In the case of a recession, the impact depends in part on whether people lose jobs for the entire year or experience reduced earnings over the year (Williams and Maag 2008). If people who would have earnings either in the phaseout range of the credit or just beyond the phaseout range of the credit lose a job for part of the year (or have their earnings reduced), they will likely qualify for a larger benefit (either moving from no benefit to some benefit or from a limited benefit to a larger benefit or even the maximum benefit; figure 3A). If, on the other hand, a people who would have had earnings that qualified them for the maximum benefit lose earnings, their credit could move into the phase-in portion, meaning they would qualify for less (Figure 3B). Worse, if a person loses his or her job entirely for the entire year (or both people, in the case of a married couple), he or she would move out of credit eligibility altogether (figure 3C).

FIGURE 3A

An Earnings Loss Can Increase the EITC

Regular earnings above the phase-out, recession earnings in the phase-out
Single filer with two children, 2020

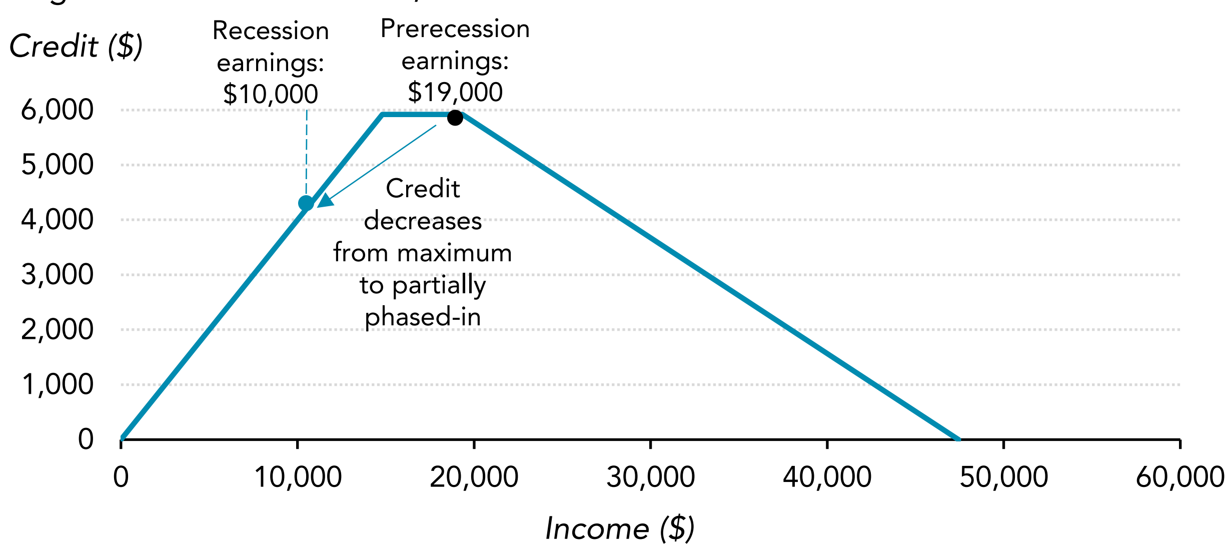


Source: Urban-Brookings Tax Policy Center.
Note: EITC = earned income tax credit. Assumes all income comes from earnings.

FIGURE 3B

An Earnings Loss Can Reduce the EITC

Regular earnings gave full credit, recession earnings in phase-in
Single filer with two children, 2020

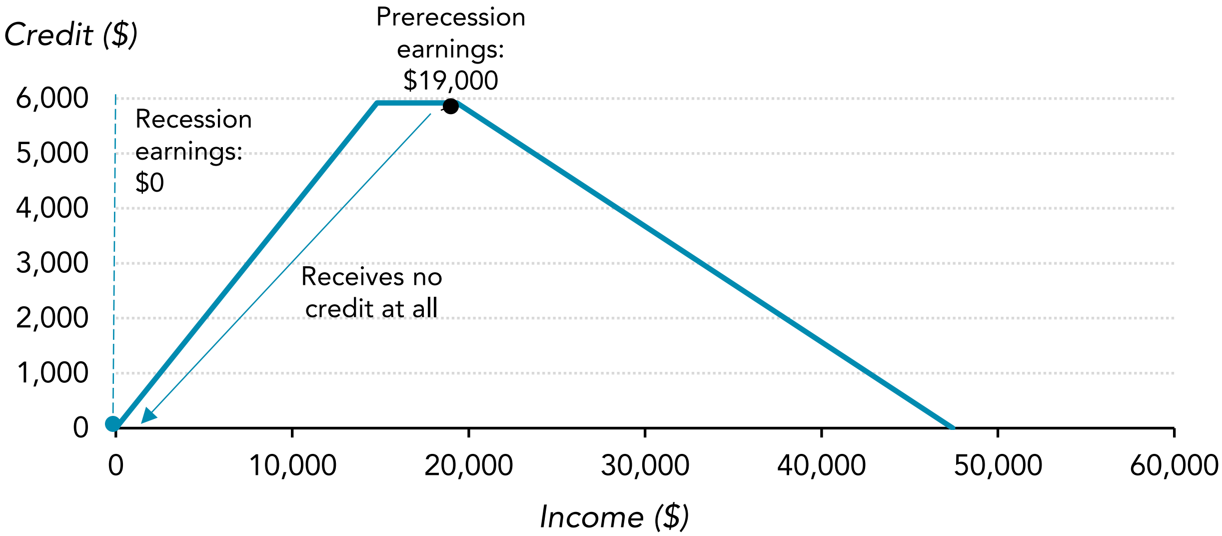


Source: Urban-Brookings Tax Policy Center.
Note: EITC = earned income tax credit. Assumes all income comes from earnings.

FIGURE 3C

An Earnings Loss Can Eliminate the

Regular earnings gave full credit, zero earnings give no credit
Single filer with two children, 2020



Source: Urban-Brookings Tax Policy Center.
Note: EITC = earned income tax credit. Assumes all income comes from earnings.

During the early 1990s recession, the EITC played an important role in supplementing low-income families' wages, particularly in areas of the country hardest hit by the economic downturn (Kneebone 2007). The same was true in the more recent recession that started at the end of 2007, when EITC beneficiaries increased even as the number of total income tax filers declined.[3] The EITC was particularly insulating for married couples. One spouse could lose earnings, making the couple eligible for a higher EITC than if both spouses had continued earning at prerecession levels. The EITC was also insulating for better-educated single parents who were more likely to see their earnings fall than lose earnings altogether (Bitler, Hoynes, and Kuka 2017). Single parents with low education were most likely to lose their jobs. To the extent that job losses or hours reductions were significant enough to move someone into the phase-in range of the credit, and they had received an EITC in the previous year, the loss of EITC benefits compounded their earnings loss. However, on net, the countercyclical nature of the EITC was larger than any procyclical effect the credit had. More people became eligible for a larger credit than lost the credit (Moffitt 2012).

EITC Targets Benefits to Low- and Middle-Income Workers Differently Than Other Antirecession Policies

In the aftermath of recessions, policymakers often try to stimulate the economy by distributing money to households that they will then spend. On average, households with lower incomes are more likely to spend (Keightley 2019), so targeting them can make a stimulus more effective. Increased EITC benefits are better targeted at people with low and moderate incomes than are expansions in Unemployment Insurance or payroll tax cuts (Steuerle, Quakenbush, and Maag 2018). A recent analysis showed similar effects for the CARES Act rebates: a larger share of the total payments went to higher-income households than do EITC benefits. However, rebate payments also went to households with very little or no labor earnings, who are largely missed by the EITC. (In any event, though, the rebate payments were better targeted than payroll tax cuts).[4] Two factors likely account for the EITC being more targeted than other programs. First,

[3] Elizabeth Kneebone, "How Well Did the EITC Work During the Recession?" *New Republic*, July 27, 2011.

[4] "Table T20-0101, Distribution of Federal Payroll and Income Taxes by Expanded Cash Income Percentile, 2018," Urban Brookings Tax Policy Center, March 17, 2020.

unlike an extension of Unemployment Insurance benefits or a payroll tax cut, benefits from the EITC are tied to household (not individual) income, and benefits phase out beyond a certain threshold. Higher-income families, even those who experience job loss during a recession, will be left out of EITC benefits if they continue to be high-income households. Unemployment Insurance benefits are delivered based on an individual's employment. If one worker in a married couple loses a job, he or she might qualify for Unemployment Insurance benefits even if a spouse retains a high-income job. With the EITC, one high earner can prevent the household from receiving benefits. CARES Act rebates did not begin to phase out until income reached $75,000 if single, $112,500 if single with children, or $150,000 if married. About 90 percent of households qualified for some payment, including those with little or no labor income. That means that overall, benefits from the rebates were both less targeted to those likely to spend than are EITC benefits (due to the higher income phaseout) and more targeted because tax units with little or no earnings received the full rebate payment.

EITC benefits are also better targeted than payroll tax cuts. Payroll taxes apply to earnings up to a given threshold. Thus, everyone with earnings benefits from a cut to the payroll tax—even those with very high incomes. About 75 percent of households pay payroll taxes each year.[5] Second, eligibility for the EITC is determined on an annual basis. Families add up their earnings over the entire calendar year and then calculate their benefit based on those earnings as well as other qualifying characteristics (e.g., how many children can be included in the tax unit and marital status). This annual eligibility period directs EITC benefits to people who remain vulnerable rather than people who might experience a single dip and then a recovery in income during the year.

EITC DESIGN CHOICES THAT COULD BE USEFUL DURING A RECESSION

In recent years, policymakers, advocates, and analysts have put forward many proposals to expand the EITC, sometimes dramatically.[6] As an example, we consider the changes proposed by the Economic Security Project. Its Cost-of-Living Refund would accelerate the phase-in of benefits, increase the maximum credit, extend eligibility to more low- and moderate-income workers, include caregivers and students as eligible credit recipients, and deliver the payment throughout the year (figure 4).[7]

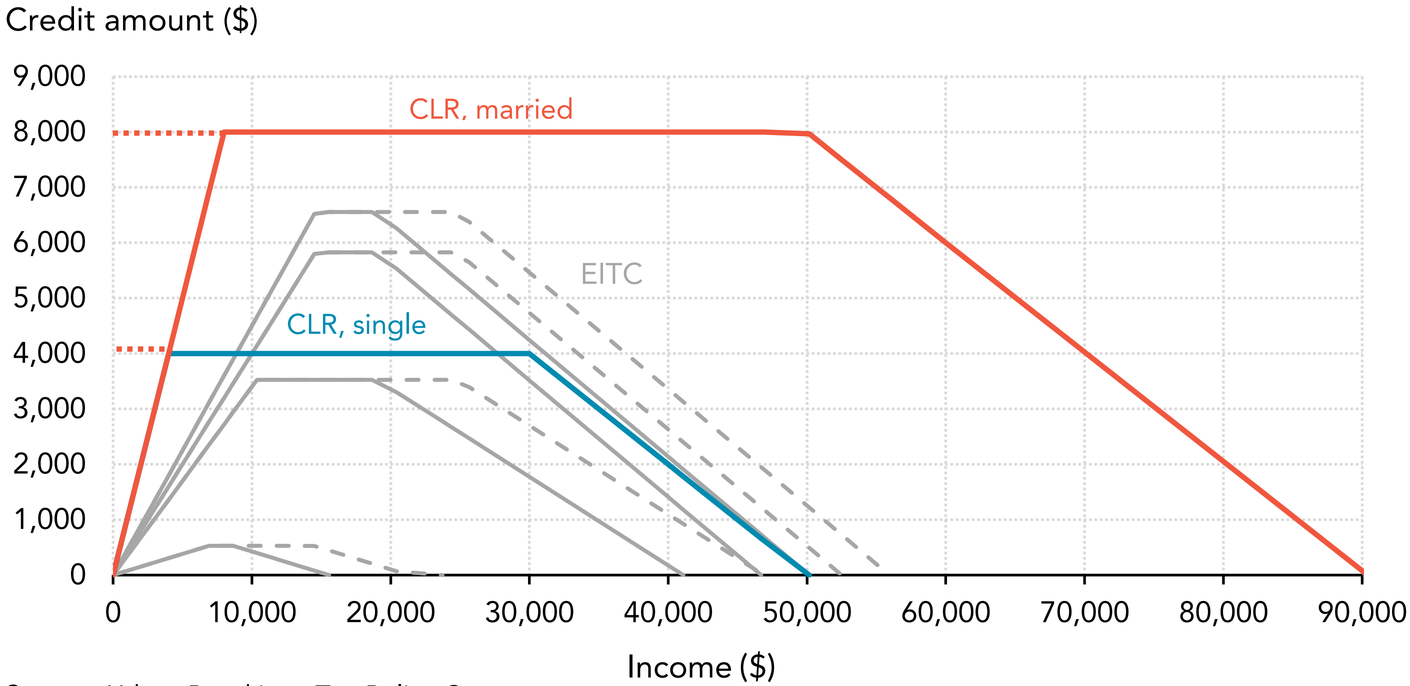
[5] "Table T20-0118, Senate Republican Recovery Rebate in H.R.748 for which Motion to Invoke Cloture Failed on March 22, 2020: Distribution of Federal Tax Change by Expanded Cash Income Percentile," Urban Brookings Tax Policy Center, March 23, 2020.

[6] Recent proposals include the Cost-of-Living Refund (proposed by Sen. Brown [D-OH] and Rep. Khanna [D-CA]), the Livable Incomes for Families Today (LIFT) Act (Sen. Harris [D-CA]), the Working Families Tax Relief Act (Senators Brown, Bennet [D-CO] Durbin [D-IL] and Wyden [D-OR]), and the BOOST Act (Rep. Tlaib [D-MI]).

[7] The Cost-of-Living Refund would provide an additional credit to single parents with children to maintain at least existing benefits levels. For further details of the proposal, see Maag, Marron, and Huffer (2019).

FIGURE 4

Earned Income Tax Credit and Cost-of-Living Refund, 2019



Source: Urban-Brookings Tax Policy Center.
Note: EITC = earned income tax credit; CLR = cost-of-living refund. Assumes all income comes from earnings. Dashed EITC lines represent married couples. Dotted CLR lines signify that students and caregivers would not be subject to the phase-in range.

Accelerating or Removing the Benefit Phase-in

Accelerating the credit phase-in range or eliminating it entirely would increase the credit's value as an automatic stabilizer, meaning as earnings go down, people would be more likely to get higher (or equivalent) credits and be at less risk of receiving smaller credits if their incomes dropped them into the phase-in range. Eliminating the phase-in would eliminate the risk of workers losing their credits when they experience a job loss or drop in pay during a recession.

The Cost-of-Living Refund, an expansion to the EITC promoted by the Economic Security Project, would not automatically eliminate the phase-in range of the credit for all people; rather, it eliminates the phase-in range for some caregivers and low-income independent students (Maag, Marron, and Huffer 2019). People who provide care for a child or spouse or who extend their education during a recession (possibly as preparation for jobs expected to be available after the recession subsides) would not be at risk of any EITC countercyclical effects during a recession (Ryan 2014) because the credit is a fixed amount for these recipients.

Increasing the Maximum Benefit

Increasing the maximum benefit for "childless" workers or for all workers could be done either in times of particular economic need or permanently. A temporary increase would provide stimulus during an economic downturn and could be repeated in subsequent recessions. A permanent increase would provide stimulus when first enacted and then become part of people's regular income. It could help some people develop a financial cushion in preparation for a future recession, but it would not provide a new stimulus in a subsequent downturn (except to the extent that it increases the existing countercyclical aspects of the credit). An expansion of the maximum benefit would allow people to better meet their needs and better prepare for economic downturns.

Increasing the benefit for childless workers would also draw additional people into the tax system, making them easier to find and deliver payments to during recessions. These workers receive relatively small benefits from today's EITC. A prior analysis examined boosting the federal EITC for childless workers to make it more on par with the credit for workers with one child; that research found that in half of the states, the majority of benefits would go to workers in retail and hospitality, two industries particularly prone to economic downturns and hit very hard in the current coronavirus-driven recession (Table 1) (Maag, Werner, and Wheaton 2019).

TABLE 1

Industries with Workers Most Likely To Benefit from a Childless EITC Expansion

Industry
Retail Trade
Accommodation and food services
Health care
Other services
Administrative services
Construction
Education
Manufacturing
Transportation
Professional services

Source: Maag, Werner, and Wheaton 2019, and Urban Institute's Analysis of Transfers, Taxes, and Income Security model, using data from the 2016 American Community Survey.

Note: EITC = earned income tax credit. Married couples are classified by the characteristics of the higher-earning spouse.

Extending Eligibility to Workers with Higher Earnings

Extending the credit to workers with higher incomes would have mixed effects on the credit's behavior in recessions. The credit's automatic stabilization effects would now occur in a higher income range. Whether that provides more or less overall stimulus (and stability) to the economy will depend on the particular pattern and magnitude of income losses. Two changes to the EITC can increase benefits to more middle-income workers: Extending the point at which the credit begins to phase out, all else equal, will deliver the credit to more middle-income workers. And increasing the maximum benefit, all else equal, will also extend benefits to more middle-income workers because the credit will phase out over a wider income range.

Delivering Payments throughout the Year

Because EITC eligibility is determined annually, the EITC does not respond to job losses as quickly as programs specifically targeting people who have lost their job. A person must wait until the upcoming tax season to assess eligibility for the credit and receive the benefit. Because the EITC is a refundable tax credit, most people receive benefits from the credit as a tax refund after filing their income tax return. And when vulnerable people receive the EITC, it provides an annual payment that, once issued, can provide a cushion during lean economic times. Analysis of how a group of low-income EITC recipients spent their benefits shows that EITC benefits often are used to pay off debt and viewed as a springboard for upward mobility (Sykes et. al 2014).

Delivering the EITC contemporaneous with need could improve its efficacy during a recession. No mechanism currently exists to provide EITC benefits ahead of income tax filing. However, if the federal government were already using the Internal Revenue Service to provide ongoing support to people (similar to the one-time economic impact payments distributed through the CARES Act), concerns about outdated direct-deposit information on tax returns could be mitigated, and payments could be made with improved accuracy and speed.

Between 1979 and 2009, an option existed for people to receive EITC benefits ahead of tax filing. Each year, employees who thought they would be eligible for the EITC could submit a form to their employers to deliver the benefit as an advance payment added to their paychecks. Employers would then calculate a credit amount for the employee and pay it out in even increments throughout the year. The employer would report those payments to the Internal Revenue Service, and they would be counted against what the employer owed in withheld income and payroll taxes. Very few people, probably significantly fewer than 3 percent of eligible recipients, participated in this program (Government Accountability Office 2007). In part, this was because employers were used as intermediaries to deliver the payments, which added administrative complexity and employee concerns about sharing personal information with their employer, and may have created workplace stigma. That use of employers to deliver the advance payments also necessarily meant that self-employed workers were excluded.

The credit could be changed to respond more quickly to income drops. A key element of a successful advance payment would be to have the Internal Revenue Service, rather than an employer, administer the advance. This would allow even people without jobs, or people who are self-employed, to potentially receive the credit. Of course, this would require that the IRS have something like real-time access to individual earnings profiles.

Advancing the credit would likely have benefits to individual households that go beyond boosting the economy. For example, paying the credit in advance could help stave off the need for expensive, short-term credit or loans.

Importantly, an advance payment is a one-time fix. Advancing a credit changes when a person will receive payment, not the total amount of payment for a year. This could be critical for solving an immediate financial problem. If advance payments were already part of the EITC, the mechanism could be used to quickly deliver additional payments during a recession as well.

CONCLUSION

The primary purpose of the EITC is to boost incomes for low- and moderate-income workers. The credit can play a secondary role, however, in softening economic downturns. As currently designed, the credit is modestly countercyclical, providing somewhat more assistance in economic downturns. Lawmakers could provide additional stimulus to a weak economy by expanding the credit temporarily. Those benefit increases would be more targeted to low- and moderate-income workers than expansions in Unemployment Insurance or a payroll tax cut. The CARES Act rebates provided the maximum benefit even to people not working, benefiting very low income people. However, the benefits extended up the income scale more than the EITC does, making the rebates' total benefits somewhat less targeted than an EITC expansion. Proposals to permanently expand the EITC could increase its role as an automatic stabilizer. An expansion could also allow people to be more prepared for a recession and could encourage more people to file tax returns, making it easier for the Internal Revenue Service to deliver payments, such as the CARES Act rebates being delivered now. The most effective EITC expansion for stimulating the economy during a recession would be phasing in the credit more rapidly (or eliminating the phase-in entirely either for all workers or for targeted populations such as caregivers and low-income students). Doing so would reduce or eliminate instances in which some workers receive smaller credits when their income falls (such as during a recession).

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