



**Our Fair Share:
The Earned
Income Tax
Credit's Crucial
Role During
a Recession**

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Executive Summary

This report lays out how the Earned Income Tax Credit (EITC) functions as an economic stimulus in California and the United States; how the EITC was counteracting the growing inequality in our country prior to the novel coronavirus outbreak; what role this credit can play in stabilizing individuals and families in the months and years ahead; and how having a robust state-level EITC program maximizes the federal EITC's impact.

Finally, this report contains several policy recommendations that will make the EITC a more effective tool during a recession. It also demonstrates the urgency of continued state funding for California's EITC program, which includes outreach, education and free tax filing services that help low-income workers claim their refund.



Key Findings

-  In 2019, state and federal EITC refunds created or sustained 74,000 jobs in California, which is equivalent to nearly 25% of the total jobs created in California that year.
-  Robust education, outreach, and free tax prep funding helps California draw down more federal money. In the four years California has invested in outreach, we have claimed \$400 million more in federal EITC dollars.
-  The increase in EITC claims and refunds has a gross impact on the state's general fund of \$219 million.
-  California is not receiving its fair share of federal EITC dollars. We represent 12% of the US population and 15% of the United States GDP¹, yet only receive 10% of federal EITC refunds. Outreach funding is critical to ensuring that Californians receive their fair share.
-  Reduced hours, lost income, and lost jobs due to the COVID-19 recession means many more workers will be newly eligible for the state and federal EITC in 2020. If these workers and others who were already struggling don't claim an EITC refund, many will fall into poverty or experience greater hardship.
-  Maintaining the \$10 million in state grants that currently pay for EITC outreach and free tax preparation services is a cost effective way to ensure California maximizes federal support and safeguards its most vulnerable workers from economic ruin.

EITC in the United States and California

As the largest cash transfer program in the country, the EITC is responsible for a tremendous amount of economic activity in the United States and California. A new analysis by economists at Andrew Chang & Co, LLC, reveals the full magnitude of this critical program's impact.

Using economic multipliers from the US Bureau of Economic Analysis, which measure the economic impact of money as it moves through the economy of a specified region, their analysis found that the \$69 billion in federal EITC refunds from 2019 were responsible for creating or sustaining 1.1 million jobs, \$52 billion in earnings, and \$188 billion in total economic activity throughout the United States.

	GROSS ECONOMIC IMPACT
JOBS	1,129,000 Jobs
EARNINGS (\$Million)	\$52,000
OUTPUT (\$Million)	\$188,000

In California alone, the combined impact of federal and state EITC refunds created or sustained 74,000 jobs, which is equivalent to nearly 25% of the 310,300² total new jobs California created in 2019. These tax credits were also responsible for almost \$4 billion in earnings and \$14 billion in total economic activity -- or nearly two times the amount of EITC dollars claimed by low-income workers in the state.

	US EITC	CALIFORNIA EITC	TOTAL
JOBS	70,000 Jobs	4,000 Jobs	74,000 Jobs
EARNINGS (\$Million)	\$3,762	\$221	\$3,983
OUTPUT (\$Million)	\$13,266	\$780	\$14,046

Finally, their analysis found that state and federal EITC refunds were responsible for \$219 million in tax revenue collected by California's General Fund, based on the fund's effective tax rate.

	US EITC	CALIFORNIA EITC	TOTAL
Gross impact on State General Fund Taxes (\$Million)	\$207	\$12	\$219

Were California workers to claim less money in EITC refunds, the ripple effect on the state's economy would be subject to the same economic multipliers, leading to less job growth, less earnings, less economic activity and less revenue for the state's General Fund.

EITC Drives Economic Activity and Improves Wellbeing

Created in the 1970s to encourage work, the Earned Income Tax Credit is now a critical piece of our social safety net. Research shows that not only does the EITC encourage work by helping low-wage workers advance in their careers, it's a potent mechanism for combating generational poverty.

The EITC is a major driver of economic activity, especially in high-poverty areas where workers' tax refunds are likely to be the largest cash infusion they receive in a given year.

Studies have found that every \$1 in EITC refunds generates between \$1.58 and \$2 of local economic activity. One study conducted in San Antonio found that for every \$37,000 in EITC returned to that city one additional permanent job was created³.



In 2018, the federal EITC lifted 5.6 million Americans out of poverty, including 3 million children. The credit also reduced the severity of poverty for another 16.5 million, including 6 million children⁴. Childhood is a critical time for development, and research shows that the deprivations of poverty are linked to a host of health and wellness complications in adulthood.

At the same time, children whose parents receive an EITC boost have better health, perform better in school, are more likely to attend college, and go on to have higher earnings as adults, compared to similarly situated children in families that don't receive the EITC⁵.

The EITC is even linked to fewer suicides. A recent study found that a 10% increase in EITC refunds corresponds to a 5.5% drop in suicide rates for workers without a college degree⁶. Financial stability and mental health are often inextricably linked.

EITC and the COVID-19 Recession

Even before the COVID-19 pandemic sparked a global recession, workers in the United States faced a high-level of financial precarity as wages stagnated and the cost of living ballooned.

A widely cited 2017 survey found that nearly 80% of workers report living paycheck-to-paycheck, and a 2019 Federal Reserve report found that 40% of Americans don't have the savings to cover an unexpected \$400 expense⁷. In California between 2006 and 2018, inflation adjusted wages for the bottom 20% of workers actually shrunk, according to an analysis by the California Budget & Policy Center⁸.

Since much of the country went into lockdown in mid-March, more than 33 million Americans have applied for unemployment benefits, with more than 10% of those claims coming from California alone. In total, nearly 20% of California's workforce sought unemployment during the first six weeks of this crisis, leaving no doubt that there is urgent need for cash assistance to help people who were already struggling to meet their basic needs⁹.



The EITC is the most used cash assistance program in United States and will return an estimated \$69 billion to 27 million low-income households in 2020, so it stands to reason that it has a crucial role to play in our economic recovery from the COVID-19 pandemic in both the short- and long-term¹⁰.

Due to its annual nature, people who lost their jobs in the unprecedented wave of layoffs in mid-March with coronavirus lockdown orders will still receive the EITC when they file a tax return next year, even if they're unable to find new work for the rest of 2020.

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Continued: EITC and the COVID-19 Recession

While some who were employed before the pandemic may find themselves out of work for all of 2021 and in need of another form of direct cash assistance, many more workers will become newly eligible for an EITC refund as their hours are cut, their spouse loses a job or they're only able to find work for part of the year. These newly precarious workers are currently America's middle class and without the EITC they will likely fall into poverty.

As Elaine Maag with the Tax Policy Center noted in a recent article, unlike a payroll tax cut or extending unemployment benefits -- two other oft cited counter-recessionary policy levers -- the EITC is targeted specifically to low-income workers who are likely struggling now, and therefore more likely to spend rather than save the money they receive. "That means expanding the EITC could have a bigger effect--per dollar spent" than other broader measures intended to stimulate the economy, Maag writes.

The industries most immediately impacted by COVID-19 are retail, leisure, and hospitality¹¹. The EITC will do a great deal to boost retail sales by increasing the purchasing power of low-income households who will spend that money in the local economy.

Once the virus can be held at bay, the EITC will help bring leisure and hospitality back to life, providing a source of cash for discretionary spending to families that would otherwise forgo vacations or day trips.

The EITC will continue to be the largest cash transfer program in the United States, even during a recession, and it will provide a critical safety net for millions of newly underemployed workers and their families, while also helping the hardest hit industries to recover.

State EITCs Bring More Federal EITC Dollars Home

Having a robust state-level EITC is creating value for California. The state implemented the CalEITC in 2016, and in each subsequent year state leaders have expanded the program to include more workers.

The state's concurrent investments in outreach and education for the CalEITC helps draw down a greater amount of federal EITC dollars. In 2015, the year before the CalEITC was implemented, low-income Californians left nearly \$2 billion in federal EITC unclaimed. In 2019, that figure was \$1.5 billion, meaning California workers drew down roughly \$400 million more in EITC refunds than they did prior to implementation of an outreach program for the CalEITC¹². That \$400 million goes directly to low-income workers, helping lift people out of poverty and providing a boost to local economies.

Despite that progress, California still isn't getting its fair share of federal EITC dollars. With roughly 12% of the United States population and accounting for 15% of its GDP, California received only 10% of federal EITC money in 2019. If California can increase the amount of federal EITC its residents claim, so that it's proportional to its population, it would bring close to an additional \$2 billion into the state -- an increase of roughly 30%.

During a recession, it's crucial for states to draw down as much federal support as possible to reduce the impacts of an economic downturn. Having a highly visible state-level EITC program that has raised public awareness will help California maximize federal support during the COVID-19 recession.

This investment will pay for itself in multiple ways. First, it will help California bring in additional federal EITC dollars. Second, increasing the amount of state and federal EITC dollars returned to low-income workers will boost purchasing power, leading to between \$1.58 and \$2 in economic activity -- including higher tax receipts for struggling local governments. That impact is captured in the ripple effect demonstrated in the new analysis presented above.

Policy Changes Could Make EITC an Even More Effective Anti-Recessionary Tool

The EITC also provides a massive infrastructure that the state and federal government can use to identify low-income workers and provide them critical support. There are several policy options that could bolster the EITC and make it an even more effective tool against the looming recession.

First, as noted above, having a potent state-level EITC program maximizes what California receives in federal EITC dollars, while also providing additional support to the very lowest income workers in our state. To counteract the damage these workers face in the months ahead, California should continue to allocate \$1 billion for CalEITC refunds in 2021.



The state should also continue supporting the CalEITC Outreach and Education and Free Tax Preparation Assistance grants as part of the workload and COVID-19 2020-2021 budget package. Maintaining funding at \$10 million and allocating it for two years will more than pay for itself, providing a substantial return on the state's investment.

Another option to make the EITC a stronger counterrecessionary force would be for the state or federal government to continue providing EITC benefits to workers based on their 2019 income. This would prevent workers laid off due to COVID-19 from seeing a smaller refund in 2020 and could be continued until the economy stabilizes.

This option would ensure the EITC continues to help the most vulnerable. In a study of how the EITC performed during the 2008 financial collapse and resulting recession, economist Maggie Jones with the U.S. Census Bureau, found that “less-educated, unmarried women experienced a greater hazard of [EITC refund] loss due a yearlong lack of earnings compared with other labor-market groups.”

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Continued: EITC and the COVID-19 Recession

Historically, the EITC has helped women, especially single mothers, earn more and advance in the workplace by allowing entry-level low-wage workers to bring home more of their paycheck. Other studies have found it helps single mothers move their families out of shared living situations with other adults and into apartments or houses where they are on the lease or mortgage.



Being named on the lease or mortgage is a key indicator of safe and stable living arrangements, according to researchers at the University of Michigan. They found that an additional \$1,000 in EITC refunds reduced the share of single mothers living in someone else's home by roughly 6% and increased the likelihood they would be named on their own lease or mortgage by close to 10%.

Temporarily extending EITC refunds to workers based on their 2019 income would ensure that this critical safety net program continues to help people with the greatest risk of spiraling into destitution, while also fueling demand for goods and services in high-poverty areas hardest hit by COVID-19. Such a policy could be phased out once workers and the economy recover.

Finally, California and the federal government should extend EITC refunds to workers with Individual Taxpayer Identification Numbers (ITINs) who are often paid very low wages, even as they continue to perform essential jobs -- placing themselves at greater risk for COVID-19. These workers are excluded from unemployment benefits and other federal relief programs, making an EITC refund even more critical for them and their families.

Extending the CalEITC to ITIN filers would boost 600,000 households representing 244,000 children in our state. Those refunds would also provide a greater cash infusion to the local economies where immigrant workers live, creating jobs and further increasing municipal tax receipts.

Conclusion/Recommendations

This new analysis and a review of the available research and scholarship leaves no doubt that the EITC is a proven, effective tool for reducing poverty and improving the health and wellbeing of low-income workers.

There are several policy changes at the state and federal level that would increase its impact and ensure that the EITC remains a potent mechanism for reducing inequality, even in the face of the looming COVID-19 recession:

- Continue to allocate \$1 billion for CalEITC refunds in 2020 and continue supporting the CalEITC outreach and education grants at \$10 million, as well as free tax preparation services, so that newly eligible workers are aware of the program and of how to claim their refund and California continues to draw down more federal EITC dollars
- Temporarily extend EITC refunds to workers based on their 2019 income in order to ensure that this critical safety net program continues to uplift the most vulnerable low-income workers during the current recession
- Extend EITC eligibility to immigrant workers who pay taxes with an ITIN to support a group of mostly essential workers excluded from other COVID-19 relief programs



As COVID-19 continues to exacerbate economic inequality in America, it's crucial we explore how effective programs can be rethought and tailored to meet the moment. This will allow us to best mitigate the impact of this recession for the millions of workers who were already struggling to stay afloat and for those experiencing financial insecurity for the first time.

Footnotes

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- 7 California Budget & Policy Center, 2019 <https://calbudgetcenter.org/resources/income-inequality-significantly-increased-for-californians-in-2018/>
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<http://fordschool.umich.edu/news/2019/pilkauskas-finds-earned-income-tax-credit-helps-low-income-moms-live-their-own>