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FEDERAL POLICY BRIEF

July 2015

The EITC: A Powerful Savings Program for Low-Wage Workers

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Emergency savings is crucial for financial security

Millions of Americans have little or nothing saved for emergencies. Households without enough liquid savings to subsist for three months at the federal poverty level are considered "liquid asset poor." These Americans are just one lost job or surprise expense away from serious financial hardship. Nearly half of Americans (44%)[1] were liquid asset poor in 2014, with significant variation among states and localities. For instance, just 24% of Minnesota households are liquid asset poor, compared with 64% of Alabama households.

Key Points

1. Emergency savings is crucial for financial security, but millions of Americans lack a rainy day fund.
2. The lump sum EITC at tax-time provides workers a rare opportunity to pay down debt, save and plan for the future.
3. The EITC lump sum is often used up within a few months, leaving workers financially vulnerable later in the year.
4. Congress should keep investing in the EITC while boosting tax-time savings and year-long financial security for workers.

Low-income workers are likely to have unstable budgets and depend on tax-time refunds to make ends meet.[2] A 2015 Pew poll found that 60% of American workers had experienced a significant income drop or expense in the previous twelve months.[3] In another survey of Earned Income Tax Credit (EITC) recipients six months after tax time, more than a third had a household member experience unemployment, and many more had incurred surprise expenses like a major car repair (40%) or hospitalization (33%).

These financial surprises and limited savings mean that workers are at risk of regularly falling behind financially, and they often depend on tax-time to catch up. In interviews with 115 low-income workers, researchers for the book, *It's Not Like I'm Poor*, found that these families often relied on their tax refunds to balance their annual budget.[4]

There is a strong link between savings, financial hardship and economic mobility.[5] Behavioral science researchers have described this precarious financial situation—little savings and unstable income—as a lack of "financial slack."[6] Simply put, when wealthier families experience an income drop or surprise expense, they tap into liquid assets or cut back on non-essential consumption. In contrast, when low-income households lack liquid assets and experience an economic shock, they cut back on essential expenses or take on debt to make ends meet.[7] This financial hardship affects children in the long-term. Children in families with savings are less likely to face hardship, such as food insecurity or forgone doctor visits. And family savings is linked to child academic performance and future economic mobility.[8]

AVERAGE HOUSEHOLD BUDGET:
FALLING BEHIND DURING THE YEAR & CATCHING UP AT TAX TIME

Monthly Income		Monthly Expenses	
Earned Income	$1,887	Housing & Utilities	$690
Government Benefits	$269	Children & Household	$527
Kinship Support	$142	Food	$512
Child Support	$38	Transportation	$388
		Nonessentials	$322
		Debt Payments	$173
		Medical	$72
Monthly Income	**$2,363**	**Monthly Expenses**	**$2,683**
Tax Refund	$4,686		
Annual Resources	**$33,042**	**Annual Expenses**	**$32,198**

Based on interviews with 115 EITC recipients. See Sarah Halpern-Meekin et al., It's Not Like I'm Poor, 2015.

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The EITC is the most impactful savings program for low-income workers

The EITC is structured like a wage subsidy but functions like a savings program. The EITC works by providing an additional boost to workers' wages. For every additional hour worked (up to a point), the EITC benefit increases. This wage subsidy works—research shows that the EITC increases employment rates.[9]

A key feature of the EITC makes it much more valuable than a simple wage subsidy—the lump sum payment. Rather than providing EITC benefits with every paycheck, workers only receive their EITC benefit when they file taxes at the end of the year. This means that the EITC effectively requires low-income workers to use the U.S. Treasury as a savings account to build up savings that is accessible only once per year.[10]

"The EITC not only eases the economic burdens of the working poor but motivates asset building and debt reduction. It does so in a way earnings or other forms of income our families receive usually do not. As a result, the EITC is uniquely positioned to boost parent and child well-being"

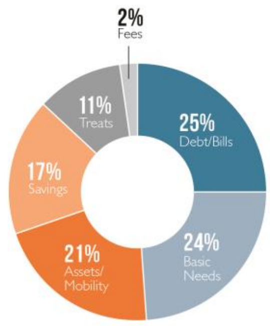
Sarah Halpern-Meekin et al., It's Not Like I'm Poor, 2015.

This savings is significant. The average EITC in 2014 was $2,407.[11] A married couple with two children and income of $21,000 for the year qualified for an EITC of $5,460. That savings is equivalent to more than 25% of the family's income for the entire year. All told, workers received $66 billion in EITC benefits in 2014. In short, when it comes to helping low-income workers build savings, no federal policy is more impactful than the EITC.

Workers prefer the lump sum payment system. Perhaps counterintuitively, for most EITC recipients this forced savings is a valued feature of the program, not a bug. Several studies and reports from the field reveal that the vast majority of EITC recipients *prefer* the forced savings mechanism of the EITC to an alternative monthly wage boost.[12] For low-income families who are unbanked, a zero-interest "savings account" with U.S. Treasury may be the best option they have. In fact, in addition to the EITC, many low-income workers routinely increase the amount of withholdings from their paycheck in order to boost their eventual lump-sum tax refund check.[13]

Tax-time provides a rare opportunity for low-income workers to plan for their financial future. A survey of over 3,000 EITC-eligible tax filers six months after tax time found workers used the majority of their tax refunds for debt management or savings.[14] The Pew Center on State found that one in six payday loan borrowers retires their loan with a tax refund.[15] And the EITC workers interviewed for *It's Not Like I'm Poor* primarily used their tax refunds to save, pay down debt and invest in long-term assets. Researchers for the book concluded that these EITC-eligible families used their tax refund to "build their aspirations for upward mobility."

HOW FAMILIES IN *IT'S NOT LIKE I'M POOR* SPENT THEIR TAX REFUNDS



Based on interviews with 115 EITC recipients. See Sarah Halpern-Meekin et al., It's Not Like I'm Poor, 2015.

The positive impact of the EITC reaches well into adulthood. The unique lump-sum form of tax-time support may be responsible in part for the strongly positive impact that these programs have on workers and their children. Children in families that receive tax-time benefits like the EITC experience improved outcomes from early childhood all the way through retirement. This means better infant health, improved test scores in school, boosted college enrollment, increased earnings as adults and, finally, higher social security benefits in retirement.[16] This long-term impact is quantifiable: children in families that earned an extra $3,000—the size of a typical EITC—worked 135 hours more per year once they reached adulthood.[17]

Congress should strengthen the EITC to boost financial security for more workers

Protect existing EITC provisions. Congress should maintain the EITC improvements that were originally enacted in 2009. If Congress fails to save these EITC provisions before they expire, millions of American workers and their children will be pushed deeper into poverty.[18] Sen. Sherrod Brown and Rep. Richard Neal have introduced legislation to make the important improvements permanent: the Working Families Tax Relief Act (S. 1012) and the Earned Income Tax Credit Improvement and Simplification Act (H.R. 902). As Congress considers other tax proposals in 2015, it should not leave low-wage workers and their families behind.

Plug the gap in the EITC for childless workers. A single childless worker living right at the poverty line in 2014 qualified for an EITC of just $223, boosting the childless worker's income by less than 2%.[19] This meager EITC support means that childless workers are the only class of workers who are taxed *further* into poverty. Members of both parties are leading efforts to fix this. The Working Families Tax Relief Act and the Earned Income Tax Credit Improvement and Simplification Act, referenced above, would expand the EITC to make work pay for these childless workers. The President's 2016 budget and a nearly identical proposal from House Ways and Means Chair Paul Ryan (R-WI) propose lowering the EITC's eligibility age from 25 to 21 for childless workers and raising their maximum credit.

Reform the EITC to boost tax-time savings. While many low-income workers use the EITC as a makeshift savings tool, it was not built to function as one. Congress should make thoughtful reforms to the EITC to help low-income households build savings at tax time. One such reform idea, proposed by the authors of *It's Not Like I'm Poor*, would allow workers to defer a portion of their EITC for future use later in the year. Such a reform would take advantage of the unique "financial slack" afforded at tax time, encouraging workers to build up emergency savings in order to extend financial security beyond tax time.

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