Recession and Recovery

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The Recession and the Earned Income Tax Credit

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No cash assistance program for low-income working families is as widely received as the earned income tax credit (EITC).[1] In 2006 (the last year for which data are available), 23 million households received a total of $44.4 billion in reduced taxes and payments (figure 1). The share of eligible families receiving EITC benefits is far higher than for public assistance programs like Temporary Assistance for Needy Families and food stamps (now called the Supplemental Nutrition Assistance Program), presumably because EITC is provided through the tax system and does not require application through a separate agency.[2] But the EITC is an unreliable safety net for low-income families during a recession, particularly as unemployment rates climb.

How It Works

The EITC 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 (figure 2).

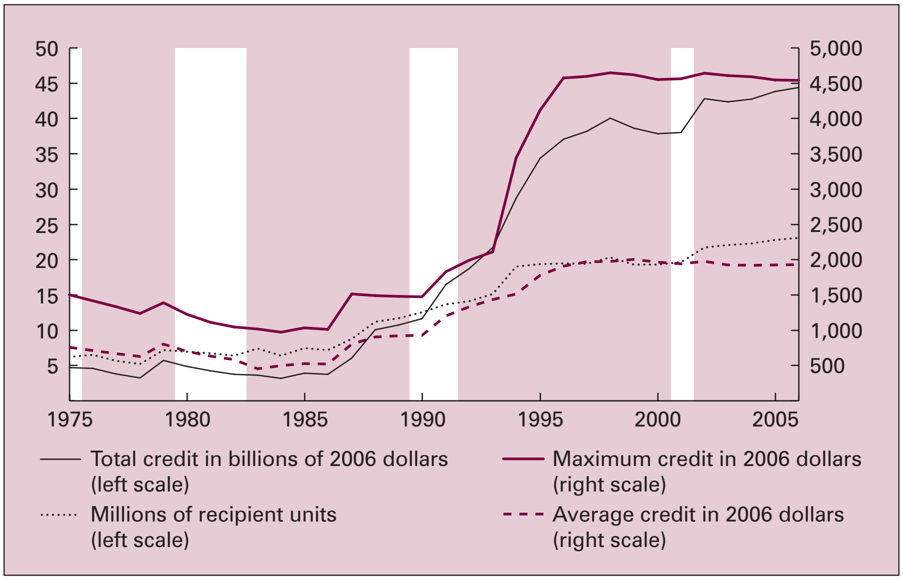
The EITC varies by a taxpayer's filing status and number of children. Families with two or more children may receive a credit of up to $5,028 in 2009. The maximum credit is $3,043 for families with one child and just $457 for childless workers. The credit is fully refundable: any excess beyond a family's income tax liability becomes a payment.

The real value of the maximum federal credit tripled between 1975 and 1995 but stabilized after Congress indexed it in 1996 (figure 1). Twenty-four states also had their own EITCs in 2008; most were set as a percentage of the federal credit, effectively indexing the state credits for inflation, too (Levitis and Koulish 2008).

Who Receives It?

The number of families receiving the EITC—and federal expenditures on the program—have climbed since the credit's inception in 1975 (figure 1). The number of recipient families nearly quadrupled from 6.2 million in 1975 to 23 million in 2006, while the credit's total value increased almost tenfold in real terms from $4.7 billion to $44.4 billion (in 2006 dollars). The real average credit per recipient family has changed fitfully over time, falling over its first 10 years as inflation took its bite and then rising and eventually stabilizing as Congress raised both income limits and the credit percentage and indexed dollar values for inflation.

FIGURE 1. EITC Recipients and Total Credit, 1975–2006

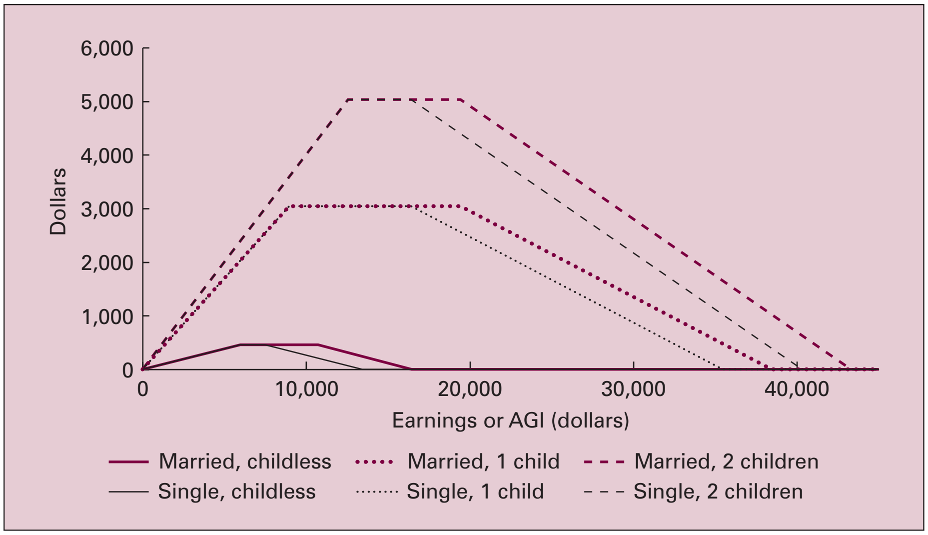


Source: Tax Policy Center based on data from the Internal Revenue Service, Statistics of Income Division, and the Bureau of Labor Statistics.

Does It Help during a Recession?

Although the EITC successfully encourages employment, particularly for single mothers (Eissa and Nichols 2005), it is unlikely to help low-income

FIGURE 2. 2009 Earned Income Tax Credit by Filing Status and Number of Children



Source: EITC parameters taken from http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=36.

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workers during an economic downturn. Historically, the EITC has come too late to help recipients during recessions (figure 1). Participation fell slightly during the 1980–82 recession and ticked up in 1983 only after the recession ended. Participation rose during the 1990 recession, continuing a six-year trend. The average benefit jumped nearly a third, mainly because Congress raised the credit rate more than 20 percent. Participation rose more than 10 percent in the year following the 2001 recession, after dipping during the downturn itself.

The EITC offers little immediate assistance when unemployment reduces family incomes because families generally collect it only when they file their tax returns. Low-income workers may ask their employers to provide Advance EITC (AEITC) in their paychecks, but employers do not have to comply. Further, less than 2 percent of eligible workers choose that option, largely because they prefer to get larger lump-sum tax refunds when they file their tax returns and because they fear having to repay excess AEITC. Because only workers can receive AEITC, it cannot help those who lose their jobs. That said, the advance payments could provide moderate economic stimulus if more workers asked for them. Since the maximum payment is just $35 a week in 2009—$1,826 for a full year—doling it out in small chunks may prompt recipients to spend the extra funds instead of saving them.

Notes

1. This description of the EITC draws heavily on Maag and Carasso (2008).
2. In 1999, 86 percent of eligible families with children received the EITC, while 52 percent and 67 percent received Temporary Assistance for Needy Families and food stamps, respectively (Burman and Kobes 2003).

References

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