July 2015

FEDERAL POLICY PROPOSAL

Authors
Kathryn Edin (Johns Hopkins University)
Sara S. Greene (Duke University School of Law)
Sarah Halpern-Meekin (University of Wisconsin-Madison)
Ezra Levin (CFED)

cfed
expanding economic opportunity

The Rainy Day EITC

A Reform to Boost Financial Security by Helping Low-Wage Workers Build Emergency Savings

Working Americans should not face perpetual financial insecurity

Financial stability depends on emergency or "rainy day" savings. Low-wage workers regularly experience large drops in income and unexpected expenses.[1] A household with accessible savings can absorb the impact of these financial shocks,[2] but a near-majority of Americans lack even a modest amount of rainy day savings.[3]

Key Points

1. Financial security depends on accessible emergency savings.
2. Millions of low-wage workers have no emergency savings and so are vulnerable to income drops and unexpected expenses.
3. While a worker's tax refund affords the opportunity to plan for the future, this opportunity comes just once a year.
4. Congress should enact a Rainy Day EITC program to help workers build emergency savings for use later in the year.

Existing policies address emergency savings only indirectly. The Earned Income Tax Credit (EITC) is one of the most impactful programs for low-wage workers.[4] While the EITC was not created to boost savings, it often functions as an imperfect, make-shift savings tool. EITC-eligible workers use the U.S. Treasury as a savings account that is accessible once a year at tax time. This lump sum refund at tax time gives workers a rare moment of financial slack, but many EITC recipients lack emergency reserves later in the year.

A policy solution to boost emergency savings. This paper makes the case for a "Rainy Day EITC," a policy reform to strengthen the EITC as a financial security tool. The program would allow taxpayers to defer 20% of their EITC for six months and receive a modest savings match for doing so. By taking advantage of the "savings moment" made possible by the lump sum refund at tax time, the Rainy Day EITC would empower low-wage workers to build a source of emergency savings for use later in the year. The proposal would increase EITC costs by roughly 1.3%.

This proposal is not the work of CFED alone. The basic structure of this proposal was described in the 2015 book, *It's Not Like I'm Poor*, and a similar proposal was made in the 2013 paper, *The Broken Safety Net*.[5] To develop the proposal further, CFED worked with the authors of the book and article, members of the low-income tax preparation community and both research and policy advocacy partners in the financial security field.[6]

The remainder of this paper is structured as follows:

I. Research on emergency savings and financial insecurity
II. New research on the importance of tax time
III. Evaluations of tax-time savings programs
IV. Existing legislative proposals to boost emergency savings
V. Description of the Rainy Day EITC proposal

I. Research on emergency savings and financial insecurity

A near majority of Americans have little or nothing saved for emergencies. Measures of "liquid asset poverty" illustrate the precarious financial state of millions of Americans. Liquid assets include funds held in liquid accounts like bank accounts, as well as in quasi-liquid accounts like IRAs. It excludes illiquid assets, such as vehicles and homes. A household is "liquid asset poor" if it lacks enough accessible savings to remain above the federal poverty level for three months. With a nationwide liquid asset poverty rate of 44%, lack of liquid savings affects a much larger percentage of the population than income poverty.[7] Other estimates find even higher rates of this type of financial insecurity.[8]

There is significant variation in liquid asset poverty between states and localities. For instance, only 21% of New Hampshire households are liquid asset poor, compared with 64% of Alabama households.[9] And city-level data reveals that there are also dramatic differences between communities within the same state as well.[10]

Income instability and unexpected expenses are common for low-wage workers.[11] The liquid asset poverty data reveals that a large percentage of the population is in a precarious financial situation—one unanticipated car repair or job loss away from true economic hardship. And these income drops and surprise expenses are common. Household incomes are complex and often vary month to month, causing financial distress even for middle class households with adequate annual income.[12] A 2015 Pew poll found that 60% of Americans had experienced a significant income drop or expense in the previous twelve months.[13] There is evidence that income volatility is growing, and we know that the Great Recession ravaged the balance sheets of low-wage Americans.[14]

There is a strong link between savings, financial hardship, and economic mobility.[15] Behavioral science researchers have described this precarious financial situation—little savings and unstable income—as a lack of "financial slack".[16] 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-wage workers lack liquid savings and experience an economic shock, they cut back on essential expenses or take on debt to make ends meet.[17]

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.[18]

LIQUID ASSET POVERTY BY STATE

See CFED, *Assets & Opportunity Scorecard*, 2015.

II. The unique role of tax time in promoting financial security

Tax time represents a unique opportunity to encourage workers to build emergency savings. This section reviews the research of a new book on the complex financial lives of low-wage workers, *It's Not Like I'm Poor*.[19] The book, based on in-depth interviews with 115 low-wage families, illustrates the impact of tax-time programs on financial well-being. The EITC in particular plays an outsized role, helping families save and build assets to achieve upward economic mobility. This section also draws on a new analysis of data from the 2013 Household Financial Survey by the Center for Social Development (CSD), which is composed of surveys of thousands of EITC-eligible workers.[20]

EITC recipients believe in work and the American Dream. It is an "article of faith" among the families interviewed for *It's Not Like I'm Poor* that hard work will lead to upward mobility. All of the families had jobs and significant earned income. Without exception, the families actively sought to avoid the public cash welfare system, and most see work as integral to being a good parent. This is reflected in their balance sheets, where we see that, on average, 80% of monthly income is earned income. The remaining 20% is split between government benefits, kinship support (from family members) and child support.

In short, these are working Americans on the lower end of the pay scale. Administrative and service industry jobs were the most common types of employment for the workers featured—for example, an auto shop receptionist, Head Start staffer, Dunkin Donuts worker, Radio Shack salesperson, housekeeper and nurse assistant, to name a few.

Financial uncertainty is the rule. While all families interviewed for the book worked, most also experienced significant surprise expenses and income drops over the course of a given year, or even a given month. Families cope with surprise emergency expenses and the unpredictability of work schedules. "Few of our families enjoy predictable incomes and expenditures." In CSD's 2015 survey, more than a third of respondents had a household member experience unemployment, and many more had experienced surprise expenses like a major car repair (40%) or hospitalization (33%).

There is no "average" financial month for these families, but rather periods of financial slack punctuated by regular financial shortfalls. When expenses in a given month outweigh available income, families often rely on high-interest credit cards and other forms of debt.

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.

Debt is almost universal. In the past few decades, consumer debt has grown dramatically, and low-wage workers have been especially hard hit. The authors of *It's Not Like I'm Poor* write that "Getting into debt and trying to dig out of it were near-universal experiences" for the families in the book. Of the 115 families interviewed, only five had no debt. The CSD survey found that credit card debt was the highest-interest source of debt among EITC-eligible workers, who held an average of $5,082 in credit card debt. But the debt picture for the families interviewed for *It's Not Like I'm Poor* is more complex than just credit cards. Many families also owed for missed utility payments, car loans, education loans, medical costs, mortgages or loans from family and friends.

Families also often have delinquent debt, causing both financial and psychological stress associated with personal guilt and with the potential pressure of being contacted by creditors seeking repayment. Many of these debts are "accrued by young adults who have little experience with credit and don't know its dangers or rules." For one working mother, a $100 debt owed to the bank for an overdraft charge turned into over $700 after years left untended. This story is typical—about half of all debt carried by families interviewed for the book is long-term debt that has accumulated over the course of years.

Dealing with debt. Paying off debt for the families in *It's Not Like I'm Poor* "is a pressing concern—it often weighs heavily on their minds." Families regularly relied on low-limit, subprime credit cards with high interest rates to make ends meet, juggling multiple cards and paying a little here and there to avoid penalties. While these cards can work well for building credit history and covering expenses in a pinch, they are a double-edged sword. Use of credit often results in the accumulation of additional debt, and missed payments are disastrous for credit scores.

COMMON SOURCES OF SAVINGS, ASSETS AND DEBT

Savings and Assets		Debt	
Asset	**% Who Own**	**Debt**	**% Who Own**
Checking Account	78%	Credit Card	66%
Car	68%	Utilities	43%
Savings Account	66%	Car	36%
Informal Savings	32%	Education	35%
Retirement	23%	Medical	14%
House	10%	Mortgage	12%
Stocks or Bonds	10%	Family/Friends	7%

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

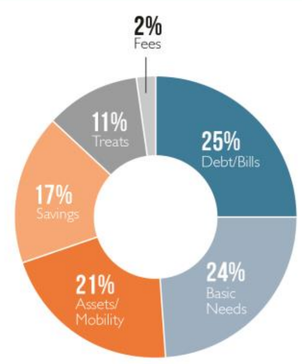
Juggling card payments to cover monthly obligations is not always enough. When families are unable to cover debt payments—a common dilemma—they are forced to prioritize. They rarely prioritize these debt payments based on interest rates or fees, but rather those "with the largest balance or the credit card they use most….This practice seems to offer some psychological benefit but presumably not financial ones."

For many of the families, "tax time is seen as *the* time to pay off outstanding debts," and indeed nearly a quarter of all refund dollars used by families in *It's Not Like I'm Poor* went to this purpose. CSD's survey of EITC-eligible workers found even higher rates debt management—those interviewed used nearly half of their tax refund dollars to pay off debt.

Tax refunds are crucial for financial security. The families in *It's Not Like I'm Poor* report a great deal of financial relief that comes with the EITC. Given the relative size of their tax refunds, this is no surprise. The average tax refund for these families (counting EITC, other credits and any over-withholding) was $4,686—the equivalent of about 20% of their annual earned income. The tax refund provides a much-needed financial boost to families who are typically unable to fully cover expenses every month. The tax refund dollars mean that these families have a balanced budget over the course of the year, if only just barely.

But the tax refund does more than simply help make ends meet. The lump sum structure makes the EITC an economic mobility program. Families in *It's Not Like I'm Poor* spend months planning how to use their tax refund to "build their aspirations for upward mobility." These aspirations are reflected in the way families use their tax refunds. A large majority of these dollars go to improving long-term financial security, whether through managing debt, saving for emergencies or investing in assets. Indeed, the thousands of EITC recipients interviewed by CSD spent only about 20% of their tax refund on new consumption within one month of receiving it. The rest was used to pay day down debt or save for the medium- or long-term.

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 tax-time refund is a valued savings tool. The *It's Not Like I'm Poor* authors write that "it would be difficult to overstate the importance of the tax refund in generating savings and asset building goals and helping families make progress toward achieving them." During the year, families aspire to save, but the pressures of daily budgets often leave them coming up short. These families see the EITC as empowering them to save over the course of the year, even if they are unable to directly save a portion of their regular paycheck. For one working mother, this "forced savings" aspect of the EITC is "the only way to protect her resources from the demands imposed by frequent financial shocks." In fact, many families opt to withhold extra tax from each paycheck in order to boost their future refund. Families are extremely averse to owing the IRS at tax time and so are reluctant to take any steps that could reduce their eventual tax-time refund.[21]

III. Research on tax-time savings programs

Two randomized control trials use the tax system to boost emergency savings. The lump sum tax refund is often the largest payment a household receives. The average 2014 EITC alone was more than $2,400,[22] and the total tax refund is often even higher. With over 140 million households filing tax returns every year, tax-time interventions are scalable and sustainable. Two recent randomized control trials (RCTs) explore the opportunity of using the tax system to promote emergency savings: SaveUSA and Refund2Savings. Evaluations of each of these innovations have found modest but statistically significant and positive impacts on low-wage workers.

The SaveUSA pilot was launched in 2008 in New York as $aveNYC and expanded as SaveUSA to several cities between 2011 and 2013. The program partnered with Volunteer Income Tax Assistance (VITA) sites to boost emergency savings for low-wage tax filers. Tax filers at VITA sites were given the option to participate in a program that entailed: 1) opening a SaveUSA savings account, 2) depositing at least $200 of their refund into the accounts, and 3) pledging to retain a portion of their deposit until the following year. Those who fulfilled the pledge received a 50% savings match of up to $500.[23]

> Key Findings: Participants were significantly more likely to save and to save more than tax filers in the control group. The percentage of individuals with any savings increased 7%; the average total savings increased by $512. No effects were found on debt, material hardship (such as food insecurity) or other aspects of financial security.

Refund2Savings (R2S) is the largest savings experiment conducted in the U.S., with a sample of about 900,000 tax filers.[24] Researchers partnered with Intuit to use TurboTax to overcome the "psychological, behavioral and institutional barriers that limit the accumulation of savings." The intervention was low-cost and low-touch. Low-income TurboTax users were randomly assigned to a control group with no intervention or a treatment group, which was nudged to split their tax refunds. The experiment tested the impact of various defaults and messages on savings behavior.

> Key Findings: The intervention significantly increased the rate of savings, the amount of savings, the rate of splitting refunds between accounts and the likelihood that savings would remain six months later. Though statistically significant, the effect sizes were modest. In the most impactful iteration, the percent depositing their refund into a savings vehicle increased from about 8% to about 10%. The intervention nearly doubled the rate of splitting refunds for savings, but this represents an increase from just 1.3% to 2.5%. Average savings increased from $197 to $224 (among those who chose to save, the increase is more impressive, $387 to $695). Likelihood of retaining some amount of savings six months later increased from 25% to 30%.

IV. Past federal emergency savings proposals

Federal policymakers and researchers have considered several emergency savings proposals. There have been two recent legislative proposals introduced in Congress to create a tax-time credit for emergency savings. Three additional proposals for emergency savings have not yet been introduced.[25] These proposals approach the task of boosting emergency savings with three different strategies:

1) Rewarding workers with a credit *after* they have developed emergency savings

2) Allowing workers to access a portion of their future refund early

3) Encouraging workers to defer a portion of their refund in order to build emergency savings

This section reviews the key features of past and proposed emergency savings policies in detail.

Legislation Introduced in Congress

Saver's Bonus: This proposal, developed by New America Foundation, would have created a refundable tax credit for low- and moderate filers who deposited a portion of their tax refund into an eligible account.[26] These filers would qualify for a 100% match of up to $500 each year for refund dollars saved in retirement and college savings accounts, savings bonds or 6-month CDs. The credit would be deposited directly into the eligible savings vehicle, rather than being combined with the standard tax refund. The Saver's Bonus Act was introduced by Senator Bob Menendez (D-NJ) in 2008, but it did not proceed further than introduction.

Financial Security Credit: This proposal revamped the Saver's Bonus with a few key changes. While the maximum credit size remained at $500, the match was reduced from 100% to 50%. For every dollar saved, the tax filer would qualify for fifty cents of credit. The list of eligible accounts was expanded to include savings accounts. In order to qualify for the tax credit, tax filers would have to hold the savings in the eligible account for at least eight months. Rep. Jose Serrano (D-NY) introduced the Financial Security Act in 2013, and the bill has attracted 31 cosponsors, but Congress has taken no further action on the legislation.

Legislation Proposed but Not Introduced in Congress

Universal Savings Credit: This credit was proposed by the Center for American Progress in 2013. The reform would replace the various employer and employee deductions for retirement, health and education savings accounts with a flat refundable credit. The credit is focused on asset development (savings for retirement, homeownership and education), but it would allow for hardship withdrawals as well.[27]

Early Refund EITC: Until 2011, EITC-eligible workers could opt in to an "Advanced EITC" (AEITC) program that provided monthly payments of EITC benefits. But because of low take-up and high error rates,[28] Congress eliminated the program. The Center for American Progress has proposed a new early payment program, the Early Refund EITC, which aims to improve upon the old AEITC.[29] The Early Refund EITC would allow workers to access up to $500 of their future EITC refund in the second half of the year. The reform's goal is to reduce demand for predatory loan products by providing an alternative source of liquid funds.

Other researchers have explored alternative early refund delivery options. Steve Holt, in a 2008 Brookings Institution paper,[30] called for a broader program providing periodic advance payments of the EITC. The Chicago Earned Income Tax Credit (EITC) Periodic Payment Pilot is currently testing an advanced EITC payment program with promising early results.[31]

Saving and Emergency Fund (SAEF) Accounts: This EITC-based emergency savings reform was proposed by Sara S. Greene, a former student of Sen. Elizabeth Warren (D-MA) and a current law professor at Duke University.[32] The proposal, developed based on interviews with 194 EITC recipients, would automatically defer a portion of the EITC for use in an emergency savings account. Specifically, 20% of the existing EITC would be automatically deposited into an interest-bearing savings account created by the IRS. Workers could choose to withhold additional amounts and would receive a match for doing so. Access to the funds would be provided with a fee-free "emergency" debit card. To discourage non-emergency use of the card, additional savings matches would be available annually based on the amount of savings left in the SAEF account at the end of each year.

V. The Rainy Day EITC Proposal

An EITC reform to increase savings and boost year-long financial security starting at tax time. This section outlines a federal policy reform to strengthen the EITC with a "Rainy Day" component. The program boosts emergency savings using the third strategy described in the previous section: encouraging workers to defer a portion of their EITC at tax time for use in emergencies later in the year. The basic structure of this reform was originally proposed by the authors of *It's Not Like I'm* Poor, and it resembles a modified version of the SAEF Accounts program described above.[33] The final proposal in this paper has been amended and fleshed out with the help of several researchers and practitioners in the low-income tax field.[34]

What problem does the Rainy Day EITC solve?

As described in this paper, low-wage workers often have irregular income, making it difficult to maintain sufficient funds to pay their bills, let alone cope with unexpected expenses or financial emergencies. Without emergency savings to cover these financial shocks, these workers regularly build up costly debt over the course of the year. This financial cycle is expensive, making it difficult for low-wage workers to move beyond living paycheck to paycheck.

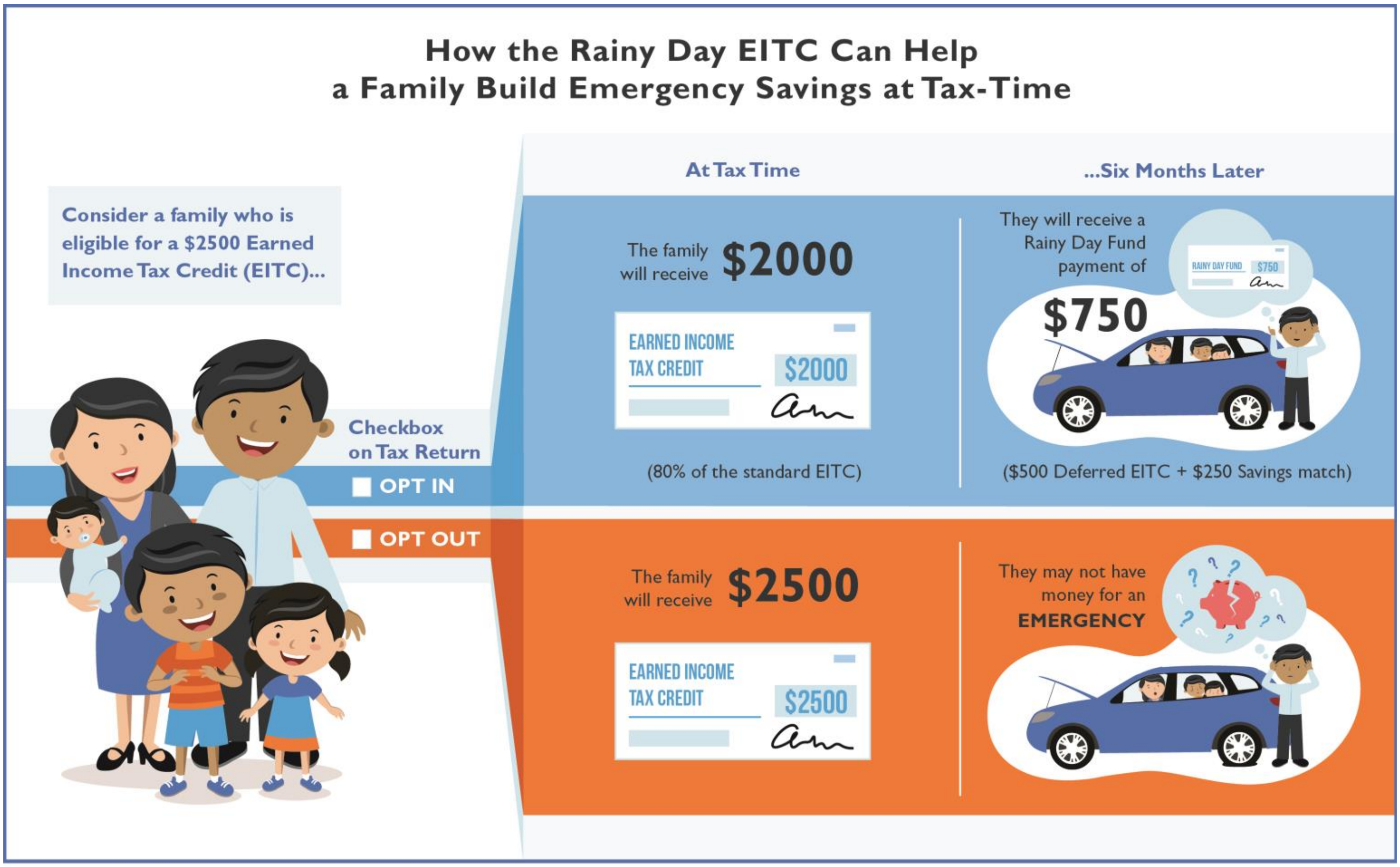
Currently, there is no federal program aimed at boosting emergency savings for these workers. The EITC functions as a make-shift savings tool but an imperfect one. Families use much of their tax refund to pay off debt, invest in long-term assets and build savings. But within a few months of receiving the refund, the majority of families have exhausted any emergency savings they may have built up at tax time. The following months see a familiar pattern of unexpected expenses or income shocks, ballooning debt and missed bill payments. These workers need support to maintain a financial cushion beyond tax-time.

How would the Rainy Day EITC work?

The reform builds on the existing EITC structure, providing an option for families to defer a small portion of their EITC for use later in the year. Below we describe the key features of the Rainy Day EITC, as well as the reasoning behind these key features.

Opt-In: Workers will be given the option to opt into the program on their tax return.

> ***Reasoning:*** While an automatic, opt-out program would achieve higher take-up rates, take-up is not the only determinant of a successful program. Many reviewers of this paper raised serious concerns that an automatic program would take taxpayers by surprise, cause confusion and backlash, and increase the tax-time financial insecurity of some workers. Most reviewers agreed that providing the *option* to defer rather than a *default* was preferable, even at the expense of take-up. In order to increase the rate of take-up, several reviewers emphasized the importance of education and outreach to tax preparers, taxpayers, and tax software companies.



<u>80% at Tax Time and 20% Saved:</u> Those who opt in receive 80% of their EITC at tax time and save 20% of their EITC for a later payment.

> ***Reasoning:*** Two alternatives were considered but rejected: allowing multiple pre-set deferred amounts, or allowing taxpayers to choose their own deferred amount. While these options would increase program flexibility, they would also increase both administrative complexity and difficulty in explaining the program to potential participants. In the interest of simplicity, the final recommendation is to provide a single deferral option. Those who would like to save more can do so, but not through this program.

<u>50% Savings Match:</u> For every dollar of EITC deferred, the taxpayers would receive fifty cents in additional benefit when the Rainy Day payment is provided later in the year.

> ***Reasoning:*** The 50% match is in line with SaveUSA's incentive, and reviewers agreed that this match would be large enough to serve as a modestly effective incentive without unnecessarily inflating program costs.

<u>Single Lump Sum Deferred Payment:</u> Households receive the remaining 20% of their EITC and their 50% savings match as a single payment six months after the tax-time refund is provided.

> ***Reasoning:*** Two alternatives were considered but rejected: providing the Rainy Day payment through monthly payments; and providing it through several "lumpy" payments. Reviewers commented that monthly payments would be too small and would simply be incorporated into monthly budgets. The option of several lumpy payments was rejected in the interest of simplicity. Note that reviewers were not uniform on the issue of *when* the deferred amount should be provided. The six-month deferral was deemed a reasonable time period, splitting the year equally in two for the two EITC payments. Several reviewers also emphasized the importance of ensuring that the Rainy Day payment does not count against public benefit asset limits.

Delivery via Direct Deposit: The Rainy Day payment is deposited into the same account used for the direct deposit of the worker's tax refund.

> ***Reasoning:*** An early iteration of the Rainy Day EITC proposal called for a government-issued pre-paid card, third-party products and other potential options for delivery mechanism. While these may be beneficial features, they were rejected in the interest of simplicity. The simplest delivery mechanism is the direct deposit system currently used to provide tax refunds to taxpayers.

Eligibility: Only EITC-eligible taxpayers with an EITC benefit of sufficient size and who provide direct deposit information are eligible to opt in. Given the limited size of the existing EITC for childless workers, the Rainy Day EITC reform would have additional impact if coupled with bipartisan reforms that have been proposed to improve the EITC for childless workers.[35]

> ***Reasoning:*** While reviewers uniformly agreed that EITC recipients with very small awards should not be allowed to participate in the program, there was not agreement on what that size should be. A $500 requirement, for instance would guarantee that the Rainy Day EITC payment would be at least $150, but policymakers may choose to set the threshold lower or higher.
>
> Requiring direct deposit information was deemed necessary to simplify delivery of the deferred payment, and it may also serve as an incentive for unbanked populations to become banked. To further increase both take-up and bank account ownership, the Rainy Day EITC could be coupled with an option to open an eligible account, such as a Treasury-run myRA or prepaid card, directly on the tax form at tax time.

Escape Hatch: Participants who opt in at tax time but require funds before the Rainy Day EITC payment later in the year may choose to receive their deferred amount early, but they forgo some or all of the 50% match if they do so.[36]

> ***Reasoning:*** Reviewers uniformly agreed that taxpayers should have the option for accessing their deferred refund early if emergency needs arise. An option to exit the program early will reduce potential financial hardship caused by locking participants into a six-month deferral. This feature will also likely increase take-up, as participants will know they can still access their EITC, without penalty, in the event of an emergency.

Benefits of a Rainy Day EITC

- Boosts financial security beyond tax time: The Rainy Day EITC program guarantees that workers will have some emergency savings that lasts beyond their initial tax refund. The deferred portion of the average EITC is $480, and combined with the 50% match, this savings grows into $720 six months after tax time. Given that nearly half of Americans report that they would not have enough liquid savings to cover a $400 emergency expense,[37] this Rainy Day payment represents a sizable emergency fund that can be used to make ends meet later in the year.
- Combats predatory lending: The Rainy Day EITC functions as an emergency fund that can be used as an alternative to costly predatory loans. For an average-sized EITC, the Rainy Day EITC payment will be significantly larger than the average sized payday loan.[38]
- Takes advantage of the tax time moment: Low-income taxpayers view tax time as an opportunity to plan for the future.[39] The Rainy Day EITC takes advantage of this moment by giving households a tool to plan for future unexpected expenses and income fluctuations.

How much would the Rainy Day EITC cost?

Estimates of the program cost depend on take-up rates. Those workers who do not choose to opt into the program would receive no savings match and so would not contribute to the cost of the program.[40] A generous rough estimate of the initial cost, based on reasonable administrative costs and the take-up rate of the comparatively high-touch SaveUSA program would be $867 million per year, roughly 1.3% of the current cost of the EITC.[41]

Conclusion

Financial insecurity is a fact of life for millions of low-wage workers. Jobs are lost or hours are cut; cars break down or kids get sick. Life happens. Millions of working Americans have trouble developing any kind of personal emergency savings fund, so they manage the irregularity of their financial lives by taking on costly debt. As an escape from this perpetual financial insecurity, many of these workers rely on the tax system to function as their savings account—depending on the EITC and over-withholdings to develop some financial cushion once a year.

The Rainy Day EITC can help workers develop year-long financial security. The benefits of these lump sum tax refund payments are well documented, but the EITC was not designed to function as a long-term savings program. A Rainy Day EITC option would change this, empowering workers to develop a personal emergency savings account for use later in the year. On the face of it, this proposal is a relatively modest expansion of the EITC, costing only about 1% of existing EITC expenditures. But this modest expansion would provide workers with a new tool for adding some stability to their often unstable financial lives.

---

[1] See Jonathan Morduch and Rachel Schneider, *Spikes and Dips: How Income Uncertainty Affects Households*, 2013; Anthony Hannagan and Jonathan Morduch, *Income Gains and Month-to-Month Income Volatility: Household evidence from the US Financial Diaries*, 2015.

[2] See Reid Cramer et al., *Flexible Savings: The Missing Foundation for Financial Security and Economic Mobility*, 2015; Leah Gjertson, *Liquid savings patterns and credit usage among the poor* (in *A Fragile Balance: Emergency Savings and Liquid Resources for Low-Income Consumers*), 2014; and Gregory Mills and Joe Amick, *Can Savings Help Overcome Income Instability?*, 2010.

[3] Jennifer Brooks et al., *Excluded from the Financial Mainstream: How the Economic Recovery is Bypassing Millions of Americans*, 2015.

[4] Chuck Marr et al., *EITC and Child Tax Credit Promote Work, Reduce Poverty, and Support Children's Development, Research Finds*, 2015.

[5] See Sarah Halpern-Meekin et al., *It's Not Like I'm Poor*, 2015; and Sara S. Greene, *The Broken Safety Net: A Study of Earned Income Tax Credit Recipients and Proposal for Repair*, 2013.

[6] CFED benefited from the input of Miren Beitia (Community Tax Aid), Michal Grinstein-Weiss, Janie Oliphant, and Phillip Poirier (Center for Social Development), Steve Holt (HoltSolutions), Chye-Ching Huang (Center on Budget and Policy Priorities), Clint Key (Pew Charitable Trusts), Justin King and Rachel Black (New America), Yuri Kim (United Way of King County), David Marzahl and Dylan Bellisle (Center for Economic Progress), Robin McKinney (Maryland CASH Campaign), and David Sieminski (Consumer Financial Protection Bureau). Note that the recommendations made in this paper are CFED's and the authors' alone and do not necessarily reflect the recommendations of these reviewers.

[7] CFED, *Assets & Opportunity Scorecard, Liquid Asset Poverty Rate*, 2015.

[8] See Jonathan Morduch et al., *Emergency Savings*, 2015; Pew Charitable Trusts, *The Precarious State of Family Balance Sheets*, 2015; Michal Grinstein-Weiss et al., *Lack of Emergency Savings Puts American Households at Risk: Evidence from the Refund to Savings Initiative*, 2014; and Financial Industry Regulatory Authority, *Financial Capability in the United States: Report from the 2012 National Financial Capability Study*, 2013.

[9] CFED, *Assets & Opportunity Scorecard, State Data*, 2015.

[10] CFED, *Assets & Opportunity Scorecard, Local Data Center*, 2014.

[11] For a more comprehensive review of eighty academic papers on various aspects of emergency savings, see Stephanie Chase et al., *Coming Up with Cash in a Pinch: Emergency Savings and Its Alternatives*, 2011.

[12] See Jonathan Morduch and Rachel Schneider, *Spikes and Dips: How Income Uncertainty Affects Households*, 2013; and Anthony Hannagan and Jonathan Morduch, *Income Gains and Month-to-Month Income Volatility: Household evidence from the US Financial Diaries*, 2015.

[13] Pew Charitable Trusts, *Americans' Financial Security: Perception and Reality*, 2015.

[14] See Jacob Hacker, *Universal Insurance: Enhancing Economic Security to Promote Opportunity*, 2006; Austin Nichols and Seth Zimmerman, *Measuring Trends in Income Variability*, 2008; and Fabian Pfeiffer et al., *Wealth Levels, Wealth Inequality, and the Great Recession*, 2014.

[15] For an overview of the importance of savings for financial security and economic mobility, see Reid Cramer et al., *Flexible Savings: The Missing Foundation for Financial Security and Economic Mobility*, 2015.

[16] Sendhil Mullainathan and Eldar Shafir, *Financially Fragile Households: Evidence and Implications*, 2009.

[17] For a review of behavioral science perspectives on programs and policies to encourage savings for low-income populations, see Piyush Tantia et al., *A Behavioral Economics Perspective on Innovations in Savings Programs* (in *The Assets Perspective: The Rise of Asset Building and Its Impact on Social Policy*), 2014.

[18] See Elizabeth Gershoff et al. *Income Is Not Enough: Incorporating Material Hardship Into Models of Income Associations With Parenting and Child Development*, 2007; and Leah Gjertson, *Liquid savings patterns and credit usage among the poor* (in *A Fragile Balance: Emergency Savings and Liquid Resources for Low-Income Consumers*), 2015; and Ezra Levin, *Savings Up, Moving Up? Children, Savings & Opportunity*, 2014.

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

[20] Mathieu Despard et al., *Do EITC recipients use their tax refunds to get ahead? Evidence from the Refund to Savings Initiative*, 2015.

[21] Note that while families clearly prefer the lump sum benefit structure of the EITC, there is some evidence that this structure leads to greater debt accumulation over the course of the year. See Katherine Michelmore and Lauren Jones, *Timing is Money: Does Lump-Sum Payment of Tax Credits Induce High-Cost Borrowing?*, 2015 (not yet published).

[22] Internal Revenue Service, *Statistics for Tax Returns with EITC*, 2014.
[23] See Gilda Azurdia et al., *Encouraging Low- and Moderate-Income Tax Filers to Save*, 2014; and Clint Key et al., *Tax-Time Savings among Low-Income Households in the $aveNYC Program*, 2015.
[24] Michal Grinstein-Weiss et al. *Refund to Savings: Evidence of Tax-Time Saving in a National Randomized Control Trial*, 2014.
[25] Not included in this list are proposals to reform the Saver's Credit. The Saver's Credit is aimed at retirement savings, but Roth IRAs also qualify for the credit and can be used for more flexible purposes. There have been no proposals to expand the Saver's Credit to more explicitly support emergency savings.
[26] Rachel Black and Reid Cramer, *Incentivizing Savings at Tax Time: $aveNYC and The Saver's Bonus*, 2011.
[27] Christian Weller and Sam Unger, *The Universal Savings Credit*, 2013.
[28] U.S. Government Accountability Office, *ADVANCE EARNED INCOME TAX CREDIT: Low Use and Small Dollars Paid Impede IRS's Efforts to Reduce High Noncompliance*, 2007.
[29] Rebecca Vallas et al., *Harnessing the EITC and Other Tax Credits to Promote Financial Stability and Economic Mobility*, 2014.
[30] Steve Holt, *Beyond Lump Sum: Periodic Payment of the Earned Income Tax Credit*, 2008.
[31] See David Marzahl and Dylan Bellisle, *Chicago Earned Income Tax Credit (EITC) Periodic Payment Pilot*, 2014; and David Marzahl and Dylan Bellisle, *Chicago Earned Income Tax Credit (EITC) Periodic Payment Pilot Interim Report*, 2015.
[32] Sara S. Greene, *The Broken Safety Net: A Study of Earned Income Tax Credit Recipients and Proposal for Repair*, 2013.
[33] See Sarah Halpern-Meekin et al., *It's Not Like I'm Poor*, 2015; and Sara S. Greene, *The Broken Safety Net: A Study of Earned Income Tax Credit Recipients and Proposal for Repair*, 2013.
[34] See endnote #6 above for a list of reviewers.
[35] Ezra Levin, *The EITC, A Powerful Savings Program for Low-Wage Workers*, 2015.
[36] In order to avoid creating benefit cliffs, policymakers may want to ensure that the amount of match forfeited is proportional to the amount of time it has been deferred. For instance, if a worker opts out of the program three months after tax time—halfway through the six-month deferral—she would receive half of the full match amount.
[37] Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2013*, 2014.
[38] Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products*, 2015.
[39] Sarah Halpern-Meekin et al., *It's Not Like I'm Poor*, 2015.
[40] SaveUSA has found an upper-end take-up rate of 13%, though the program is structured to incentivize somewhat less liquid savings, which likely reduces take-up.
[41] This rough estimate is based on the following calculation: $66 billion cost of the existing EITC (2014 expenditures); 13% Rainy Day EITC take-up rate; 10% additional EITC benefit for each beneficiary (50% match of 20% deferred); administrative costs equal to 1% of total Rainy Day EITC payments.