MIDDLECLASS TASK FORCE
THE VICE PRESIDENT of the UNITED STATES

STAFF REPORT

The American Recovery and Reinvestment Act: Helping Middle-Class Families

Introduction

One of the central goals of the Middle Class Taskforce is to identify public policies that will help middle class families by improving their living standards. This taskforce goal is an especially important one, because even in normal times of economic growth in recent years, the middle class has not gotten very far ahead. In fact, even during the economic expansion of the 2000s, as we show below, the real income of working-age, middle-class households actually *fell* by about $2,000.

In this current period of widespread economic hardship, a key tool for helping these families is the American Recovery and Reinvestment Act, or ARRA. The ARRA is the $787 billion package supported by the Obama/Biden administration, which was passed by Congress and signed into law on February 17, 2009. This staff report focuses on how the ARRA helps middle-income families.

The ARRA helps struggling families in a variety of ways. First, by creating and saving jobs — 3.5 million by the end of next year, according to estimates by the Council of Economic Advisers — the ARRA gives a crucial boost to family incomes, which we quantify below. Second, the ARRA creates and expands a number of provisions that raise family income, directly and indirectly. Tax cuts and programs targeted both at middle- and lower-income families give a direct boost to after-tax income. Expansions to safety net programs, like the Supplemental Nutrition Assistance Program (SNAP, formerly food stamps), help lower-income, vulnerable families deal with hardships. And expansions to unemployment insurance and healthcare programs in the ARRA help families across the income spectrum who are suffering from the loss of jobs, health coverage, and income.

In this staff report to the Middle Class Taskforce, we examine the impact of these various parts of the ARRA on the incomes of different types of families at different parts in the income scale. Some of our key findings are:

- Jobs created by the ARRA are predicted to lower the unemployment rate by almost two percentage points. We expect this change to increase average middle-class incomes by over $1,300, or 2.3%.
- Depending on family type and circumstances, the tax benefits from the ARRA provisions can add $2,000 or more to after-tax family income.
- Combining job and tax effects, the ARRA will lift incomes by around $3,000 for many middle-class families, significantly offsetting their income losses over the recession.
- For middle-class families hit with spells of unemployment, tax credits and safety net expansion in the ARRA, combined with existing unemployment insurance programs, can replace much of the income loss that occurs when a wage-earner in the family loses his or her job.

Our staff report begins with a historical look at middle-class incomes, focusing on the income/productivity split that has become so pronounced and problematic in recent years. Next, we discuss the boost to family incomes provided by reduced unemployment, and we provide an estimate of this effect for different types of families. Finally, we look at other ways the ARRA lifts incomes, through the tax and safety net systems.

The Obama/Biden administration is committed to addressing the economic challenges facing the American middle class, and the American Recovery and Reinvestment Act is one of the first, critical steps to fulfilling that commitment. By creating jobs and boosting the incomes of working families, the American Recovery and Reinvestment Act will help to support the broad middle class while putting the economy as a whole on the path to recovery.

Middle-Class Incomes and Productivity Growth

Economic theory broadly states that as an economy becomes more productive, the living standards of its families rise. On average, this is certainly true. If productivity, or output per hour of work, goes up two percent, that means we can enjoy two percent more economic output without working more hours to create it.

However, this theory is too simplistic to capture important changes to the dynamics of the economy that have made life much tougher for middle-class families over the years. One critical change has to do with the increase in economic inequality. The theory above is stated in terms of averages, but if much of the economy's growth is flowing to the top of the income scale while bypassing the middle, the society will be getting richer on average even though middle-class families are being left behind. As the figures below reveal, this is precisely what has been occurring in recent years.

Figure 1 takes a long-term view, plotting the growth of productivity against the real income growth of the median family—the family right in the middle of the income scale—from 1947 through 2007 (most recent data).

Note that between 1947 and 1979, both productivity and middle-class income more than doubled, and that their growth rates were about the same. But since the 1980s, middle incomes have grown only 25% as fast as productivity, as the wedge of inequality has funneled most of the growth to higher income groups.

Figure 1. Median family income and productivity, 1947-2007

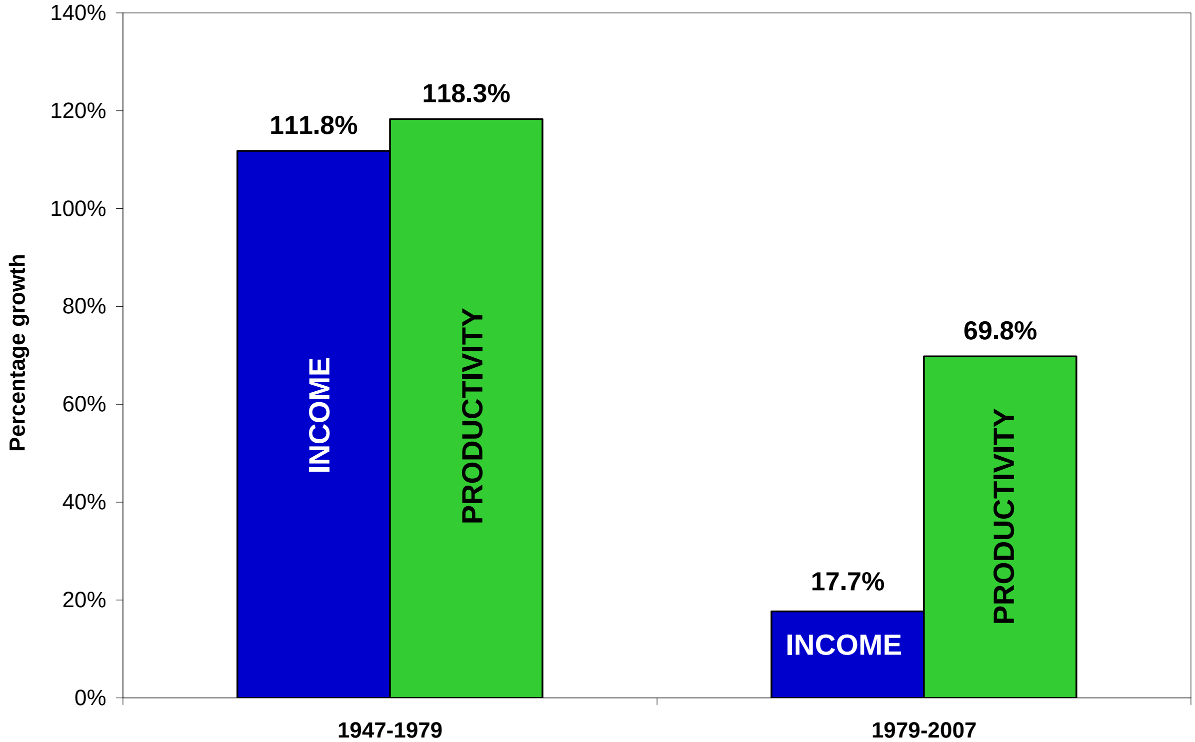
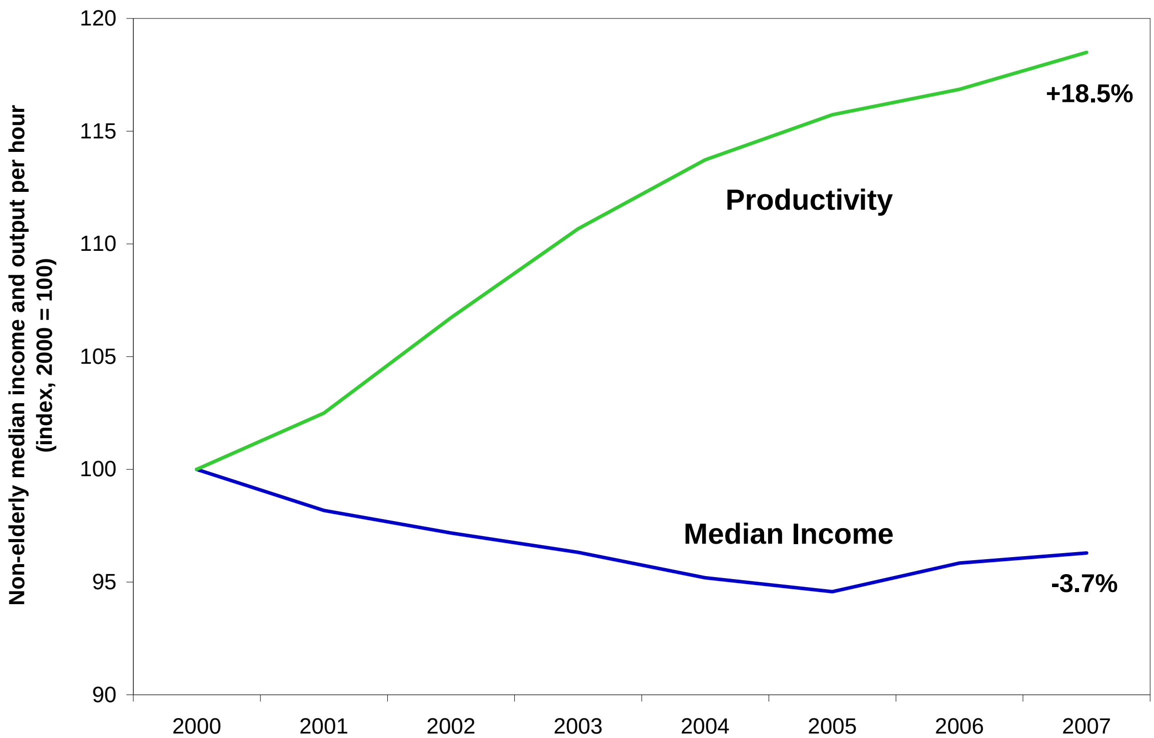


Figure 2, below, takes a closer look at working-age families in the recent past, when productivity and the income of working families sharply diverged. The figure plots the real median income of working-age households, those headed by someone less than 65 years old, since retirement-aged families are less likely to be connected to the workforce. Over this period, while productivity rose by a solid 18.5%, the real income of these middle class families fell almost 4%, as they lost over $2,000 dollars (in 2007 dollars).

Figure 2. Productivity outpaces median income for working-age households



Note that the income dynamics shown in Figure 2 occurred when the economy was expanding, over a period when jobs were growing and unemployment was falling. Since the recession officially began in December 2007, employment is down by over four million and the unemployment rate has climbed from about five to about eight percent. As we quantify below, this rise in joblessness is putting further downward pressure on the real incomes of middle-class families.

These facts and figures present the challenge we face: our policies must create the glue to reconnect the living standards of middle-class families to the economic growth they themselves are creating, and that is one of the main reasons for the creation of the Middle Class Taskforce. But first, of course, we must deal with the challenge of a deep recession and its impact on families that were already facing a tough climb, even in relatively good economic times. This is the challenge we are addressing through the American Recovery and Reinvestment Act.[1]

[1] To learn more about the policy components of the ARRA, see www.recovery.gov.

Job Creation, Unemployment, and Family Incomes

The primary goal of the American Recovery and Reinvestment Act is job creation. Estimates by administration economists predict that the ARRA will create or save 3.5 million jobs by the end of 2010 and will lower the unemployment rate by 1.8 percentage points compared to what would happen with no stimulus.

Most working-age, middle-class families depend on their paychecks, so creating more jobs and lowering the unemployment rate will have a direct, positive effect on their incomes. Economists have studied this effect, in which a lower unemployment rate is associated with increased income. Such studies imply that every 1 percentage point decrease in the unemployment rate raises family incomes by 1-2%.

Interestingly, this effect varies with income levels. The incomes of lower-income families tend to be more responsive to changes in unemployment than higher-income families. One reason for this increased sensitivity is that their unemployment rates tend to move more than the overall rate, such that a one point drop in the overall jobless rate might mean a two percentage point drop for, say, a low-income family.[2] Applying this relationship to the 1.8-point decline in unemployment we expect from the ARRA, ***we predict an increase of over $1,300 in the incomes of middle income families***.[3] This 2.3% boost in their income, which is around $60,000, represents a sizable benefit for families in the core of the middle class, partially offsetting the effects of the increase in unemployment over the recession and easing the pressure on family budgets during these tough economic times.

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[2] This is a well-known relationship in the case of minority unemployment. Thus far in the current recession, overall unemployment is up 3.2 points, while that of African-Americans is up 4.5 points.

[3] Estimated using elasticity estimates from: Blank, Rebecca and David Card. 1993. "Poverty, Income Distribution and Growth: Are They Still Related?" Brookings Papers on Economic Activity, 2. The estimated increase in income applies to a family making, $60,989 in early 2009. We derive this value by adjusting the average income (in 2008 dollars) of the middle fifth of families from 2007 for the increase in unemployment since then, using the elasticity in the Blank and Card paper.

Table 1, below, illustrates the estimated impact of reduced unemployment on family incomes for the second and third (or middle) fifths of the income distribution:

Table 1. Effects of unemployment on family income, by income quintile

Family income quintile	Estimated average income	Effects of reduced unemployment	Percentage change in income
Second Fifth	$37,380	$1,157	3.1%
Middle Fifth	$60,989	$1,383	2.3%

Source: US Bureau of the Census, family income by fifth, adjusted as stated in footnote #3

As a result, all the job-creation measures in the American Recovery and Reinvestment Act give a two-for-one deal to middle-class workers and families. Not only will the ARRA provide much-needed job opportunities to middle-class workers who have been laid off in this recession, but it will make life easier for struggling families across America by lowering unemployment and lifting the wages on which they depend.

Tax Benefits in the American Recovery and Reinvestment Act

While the central focus of the American Recovery and Reinvestment Act is on job creation, the ARRA will also put $232 billion of tax cuts and expanded credits for individuals into the directly into the hands of lower and middle-income families. These tax benefits will not only help families whose well-being has been diminished by lost jobs, declining home values, and falling stock prices, but will stimulate the economy by boosting spending, taking advantage of the so-called multiplier effect.[4]

The tax provisions of the ARRA (see box) are targeted to families who need help the most, including families with dependent children and parents putting their kids through college.

[4] This is the effect that occurs when increased spending creates a chain of economic activity throughout different parts of the economy. For example, when the ARRA raises a family's income due to a tax cut, and they spend the extra income on more food or clothes, that means more shelves need to be restocked and more inventory has to be ordered and delivered, etc. Thus, "downstream" spending creates more "upstream" demand.

The cornerstone of this part of the ARRA is the Making Work Pay tax credit, which will reach 129 million working households, or about ***95% of all working households*** – the largest number of people ever to benefit from a tax cut. The Making Work Pay credit will give up to $400 to individual tax filers and $800 to married couples filing joint returns, and is fully refundable so that low-income workers can benefit from the credit. Most employers will handle this tax credit using updated withholding formulas, which means that most workers will receive the Making Work Pay tax credit directly in the form of increased take-home pay starting by April 1.

TAX CREDITS AND OTHER KEY SUPPORTS IN THE AMERICAN RECOVERY AND REINVESTMENT ACT

- The Making Work Pay (MWP) tax credit, a refundable credit that will give $400 for individuals and $800 for married couples to 95% of American workers.
- Expansions to the Earned Income Tax Credit (EITC) that will help low- and middle-income married couples and families with children.
- Expansions to the Child Tax Credit (CTC) that will enable lower-income families to take advantage of the credit.
- The American Opportunity Tax Credit (AOTC), which expands tax credits for college education, and offers the credits to a wider range of families.
- Temporary tax cuts designed to boost the economy and help middle-class families, including a tax credit for first-time homebuyers and a deduction for car purchases.
- Expansions to the unemployment insurance program, which will increase the weekly benefit by $25 and extend benefits so that middle-class workers can better replace their lost income if they lose their jobs, as well as a provision to exclude UI benefits from taxable income.
- Expansions to the Supplemental Nutrition Assistance Program (SNAP, formerly food stamps) that will help some of those hit hardest by the recession to provide healthy food for their families and help protect their family budgets.

The Making Work Pay tax credit is complemented by significant expansions to the Earned Income Tax Credit and the Child Tax Credit, which will ensure that lower-income families who work full-time can raise their children above the poverty line. The expansions to these tax credits are targeted to low-income married couples and families with children, and they reflect the Obama/Biden administration's commitment to the principle that no American working full-time should be faced to raise his or her children in poverty.

At the same time, the expansion of these two credits will help middle-class families who, due to their lower-middle income status, or due to job loss, fall into the eligibility zone for these credits, a point we stress below in various examples.

The ARRA also reflects the administration's commitment to keeping the American dream within reach for middle-class families, which means providing every family with the opportunity to send their children to college. The American Opportunity Tax Credit aims to give families that chance to make sure their children have the education they need to succeed. The American Opportunity Tax Credit increases the maximum tax credit for higher education from $1,800 to $2,500 and extends the duration of the credit from two to four years. Just as importantly, the ARRA makes the credit partially refundable, which allows lower income families to take advantage of the credit. Making higher education available to the children of low-income families will help to make sure disadvantaged children can one day *reach* the middle class, and will help build the foundation of a strong middle class for years to come.[5]

These tax initiatives put money directly into the hands of working- and middle-class families across America, offering much-needed support to many different types of families. **Table 2**, below, illustrates the potential benefits of these tax initiatives to two example families:

- The first family is married with three children, and makes $40,000 a year. This family receives the Making Work Pay tax credit and benefits significantly from the expansion of the Earned Income Tax Credit.

- The second family is married with two children, one of whom is in college, and makes $70,000 a year. This family's income is too high to qualify for the Earned Income Tax Credit or benefit from expansions to the Child Tax Credit, but they still receive the Making Work Pay tax credit. In addition, this family benefits from the American Opportunity Tax Credit, which gives them an extra $700 a year compared to prior law to help put their child through school.

Table 2. Benefits of selected tax credits for sample families

	Income	Making Work Pay Tax Credit	Expanded Earned Income Tax Credit	American Opportunity Tax Credit	TOTAL
Family 1: Married, with three children					
	$40,000	$800	$1,025	$0	$1,825
Family 2: Married, with two children, one in college					
	$70,000	$800	$0	$700	$1,500

Furthermore, the tax credits in the ARRA work together with the effects of the reduced unemployment rate as a result of jobs created by the ARRA (discussed in the previous section) to significantly increase the incomes of working- and middle-class families. **Table 3**, below, illustrates the *combined* impact of the tax credits and job-creation measures in the American Recovery and Reinvestment Act, for the same two sample families described above:

Table 3. Total estimated effect of the ARRA on family income for sample families

	Income	Effects of tax credits	Effects of reduced unemployment	TOTAL
Family 1: Married, with three children				
	$40,000	$1,825	$1,238	$3,063
Family 2: Married, with two children, one in college				
	$70,000	$1,500	$1,588	$3,088

As this table shows, the tax credits in the ARRA, along with the effects of job creation, can mean thousands of dollars of income for middle-class families. This boost to the income of families across the country will help middle-class Americans make it through these difficult economic times while starting to put the economy as a whole on the road to recovery.

[5] The ARRA also boosts college affordability by increasing Pell Grant funding by $17 billion. As noted at www.recovery.gov, this change is expected to reach seven million students by funding the shortfall in the current

Yet while the examples above demonstrate ARRA's sizable benefits for family incomes, they *understate* the importance of the ARRA to middle-class families because they focus on families with incomes too high to benefit from expansions to other programs like the Child Tax Credit. The ARRA significantly expands several programs, including the Child Tax Credit, the unemployment insurance program, and the Supplemental Nutrition Assistance Program, that help to strengthen the safety-net for working Americans.

This system of supports is invaluable during hard economic times such as the current recession; with the unemployment rate at 8.1% in February and over 12 million people jobless, many middle-class families will face spells without work. In these situations, the ARRA, in tandem with existing unemployment insurance benefits, will help deliver significant relief. As an example, consider a married couple with two children, with one spouse earning $30,000 and the other earning $20,000. Now, imagine that the higher-earning spouse loses his or her job and is out of work for three months of the year. According to an analysis by the Center on Budget and Policy Priorities (CBPP), various elements of the ARRA would lift their income by about $1,670.[6] This increase comes on top of existing unemployment insurance benefits—assuming the worker qualifies—which in a typical state might contribute about $3,750 to this family's income, at least for a limited time period.[7] Putting these benefits together, this family could get back 70% of their lost earnings.

CBPP does a similar simulation for a lower-income couple with two children, in which the sole wage-earner has a $30,000 per year job. Because of their lower income, this family ends up with more income from the expanded EITC and a boost from the ARRA's significant expansion of the CTC. Here again, ARRA expansions, together with unemployment insurance, replace much

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program and by adding $500 to the maximum grant.

[6] These elements include increased unemployment insurance (UI) benefits ($325), the exclusion of UI income from taxes ($311), expanded EITC ($236), and the Making Work Pay tax cut for periods in the job market ($800).

[7] In practice, not every unemployed family receives UI benefits, and not every state benefit is equal. ARRA provides incentives to encourage states to change their eligibility rules in order to make UI benefits more accessible, particularly to part-time or low-wage workers and workers with family responsibilities. UI benefits last for 26 weeks, but various extensions related to the recession and the ARRA grant extra months of receipt to states with high unemployment (see http://www.nelp.org/page/-/UI/extended.benefits.feb.09.pdf?nocdn=1 for an explanation of these extensions).

of the family's lost earnings.[8] By expanding programs that support lower-income households, the ARRA helps to ensure that even if middle-class Americans lose their jobs, they will be able to keep providing for themselves and their families until they can get back on their feet.

Conclusion

There are, of course, many other ways that ARRA helps to offset the economic stress that so many families are experiencing today. Some of these are hard to quantify. For example, the expansion of broadband technology into areas that currently lack internet access could have many positive benefits, ranging from greater access to information and entertainment to the ability to job hunt across greater areas. Folks who take advantage of ARRA's weatherization subsidies to better insulate their homes could save hundreds of dollars per year on energy costs. Someone who loses his or her job and at the same time loses his or her health insurance coverage can benefit from a 65% subsidy to COBRA, a program that allows former employees to keep their health coverage for a period of time after they are laid off.[9] Thanks to the ARRA expansion of Trade Adjustment Assistance, a *service* worker laid off due to trade competition will soon receive help that was previously reserved for manufacturing workers.[10] And state fiscal relief is already helping to prevent teachers from being laid off in public schools, a benefit that means a lot to families with kids in these classrooms.[11]

In other words, there are many ways this comprehensive legislation will help middle-class families as they struggle to deal with a period of great economic turmoil. Yet the President and Vice President recognize that helping families make it through these hard times is just one part of their agenda for lifting up the middle class. They also are acutely aware of the disconnect between growth and middle-class incomes that persisted even in good times. They know,

[8] In this case, the simulation includes increased UI benefits ($325), a smaller amount from the exclusion of UI income from taxes ($25), expanded CTC ($483), expanded EITC ($833), the Making Work Pay tax cut for periods in the job market ($800), and the Supplemental Nutritional Assistance Program ($129).

[9] According to the Kaiser Family Foundation, the average premium for an individual plan was about $4,700 for an individual and $12,700 for a family in 2007. A 65% subsidy would thus save laid off workers between $250 and $700 for up to nine months (after which time the subsidy would terminate).

[10] According to the Department of Labor, workers eligible for this type of assistance "may be eligible for training, job search and relocation allowances, income support and other reemployment services."

therefore, that an economic recovery is necessary, but not wholly sufficient to lift the fortunes of the middle class and to correct the economic imbalances that held them back in recent years.

In this regard, future meetings of the Middle Class Taskforce will tackle those policy matters that taskforce members believe will help create the policy "glue" to reconnect growth and middle-class prosperity. In April, for example, we plan to tackle an issue of pressing concern to so many middle-income families with children: college affordability.

[11] See http://www.ed.gov/policy/gen/leg/recovery/factsheet/stabilization-fund.html for a discussion of this aspect of the ARRA.