

# The Role of Earned Income Tax Credit in the Budgets of Low-income Families

Ruby Mendenhall  
*University of Illinois*

Kathryn Edin, Susan Crowley Jennifer Sykes and Laura Tach  
*Harvard University*

Jeffrey Kling  
*CBO & NBER*

Katrin Kriz  
*Emmanuel College*

# Investing in Enduring Resources

## ***PIs***

Jeffrey Kling (Congressional Budget Office & NBER)

Kathryn Edin (Harvard)

Ruby Mendenhall (UI Champaign/Urbana)

## ***Project Direction***

Gretchen Wright (Penn)

Jennifer Sykes (Harvard)

## ***Funder***

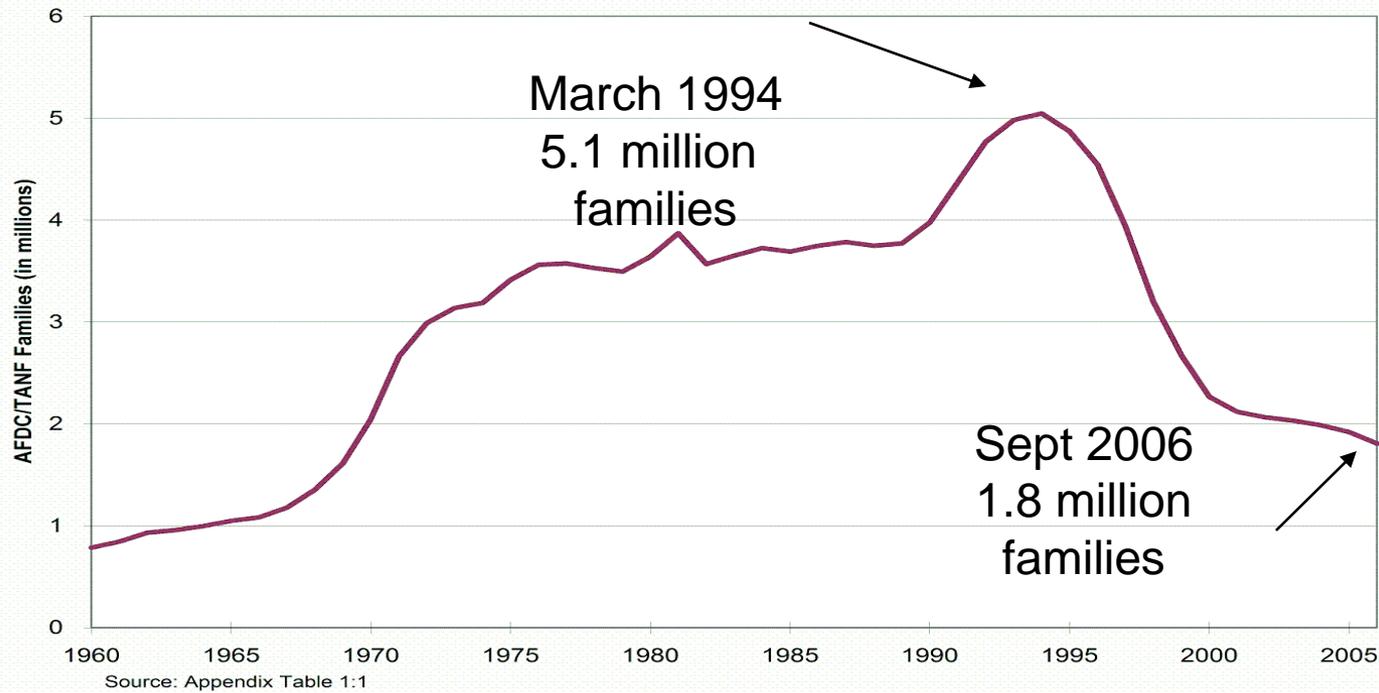
Ford Foundation

# Background

- Welfare Reform
  - Cash welfare and based on non-work
- EITC as the New “Welfare” System
  - Currie (2006) “stealth welfare reform” because benefits are larger than the old or new welfare program
- H&R Block & other agencies viewed as the New “Welfare Office” (70%)
  - For-profit: fees and refund advance loans cost EITC recipients an estimated \$1.75 billion (Spader et al. 2005).

# The Old Safety Net

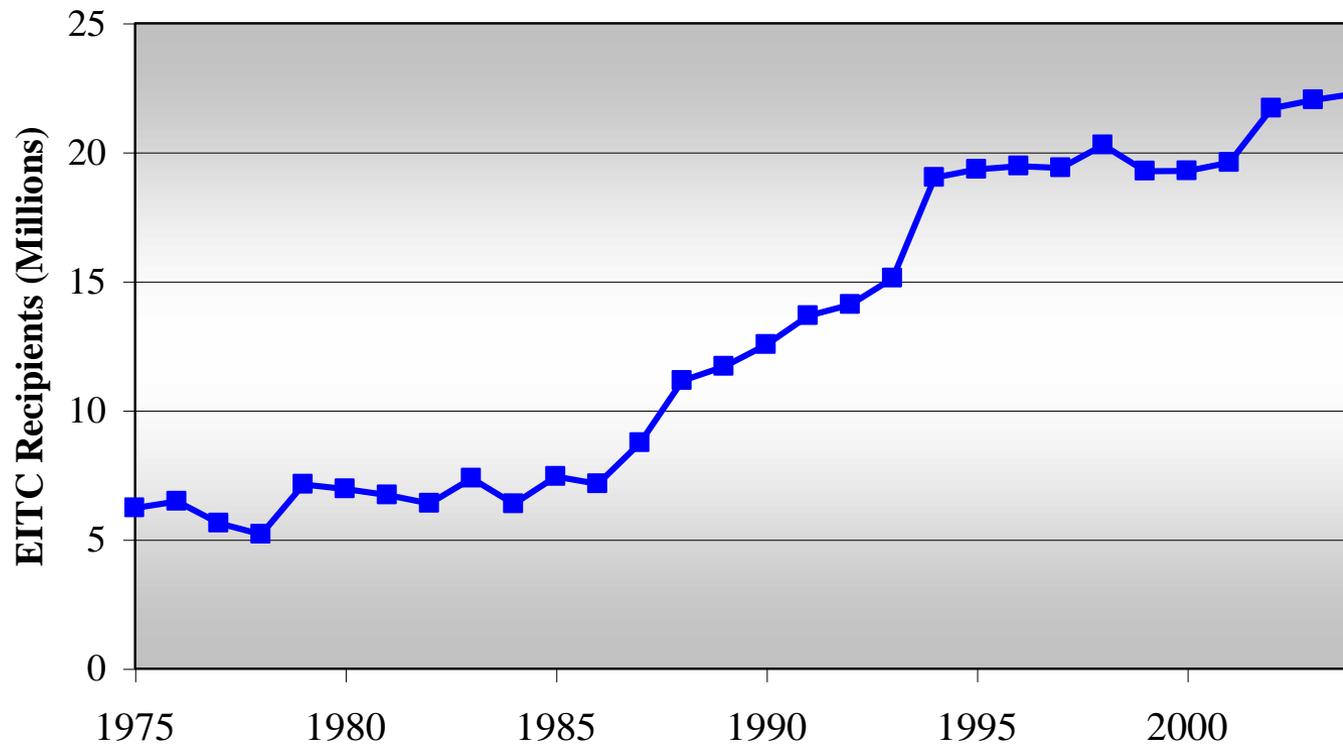
**Figure A**  
**AFDC/TANF Families**  
**FY 1960 - FY 2006**



Source: TANF 8<sup>th</sup> Annual Report to Congress

# The New Safety Net

EITC Recipients, 1975-2004 from Hoynes and Eissa 2007



Source: For 1975-2001 *Green Book*, 2004; for 2002-2004 published SOI tables.

# EITC & The American Recovery and Reinvestment Act of 2009 (ARRA)

- EITC Expansions
  - Third tier – for families with 3 or more children, receive \$629 more
  - Decreased marriage penalty - married couples can now receive more benefits
- Expansions benefited over 7 million families

# ETIC & Poverty

- In 2009, the EITC lifted roughly 6.6 million people out of poverty, including 3.3 million children.
- More children now exit poverty through the EITC than through any other form of government assistance.

# How is the EITC Structured?

- Varies by income and by number of children. In 2009, maximum credit was...

- 1 child \$3,043

- 2 children \$5,028

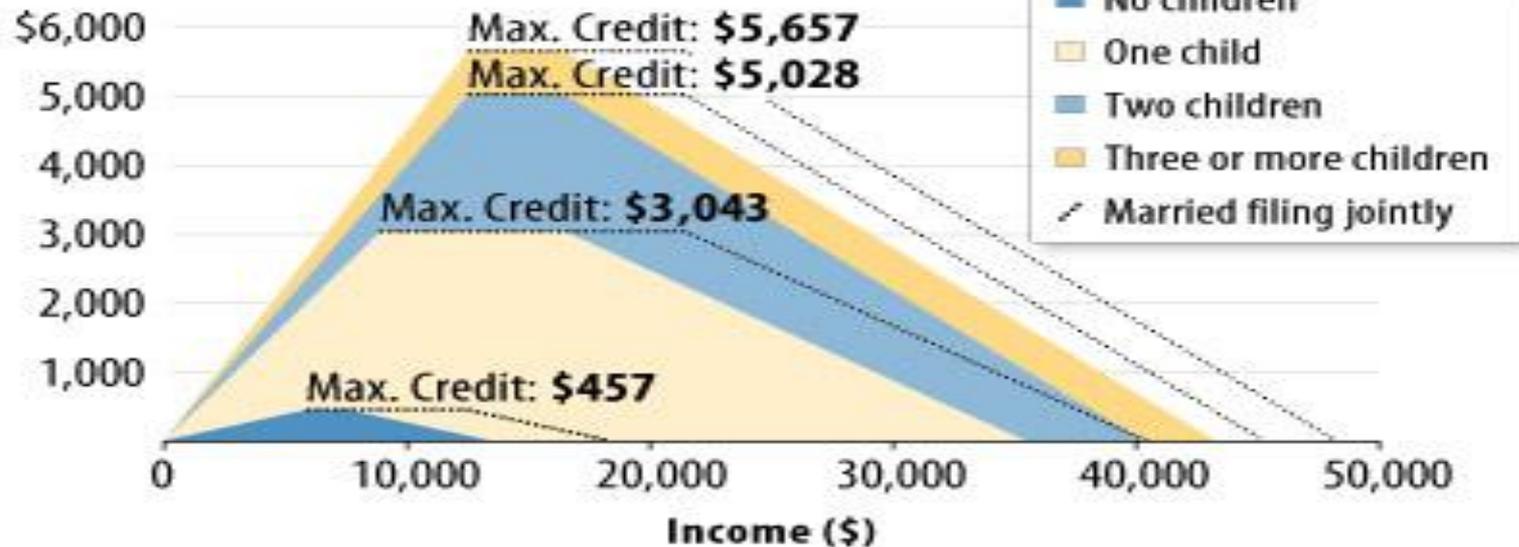
(Often exceeds max 12 month TANF benefit for mother with 2 children)

- 3 or more children \$5,657

# EITC Structure cont. (2009)

## The Federal Earned Income Tax Credit in Tax Year 2009

### EITC Credit Amount



Note: Married couples with income in the phaseout range qualify for a higher credit than singles—shown by dashed lines.

Source: Center on Budget and Policy Priorities

# Two Hypotheses about EITC Expenditures and Family Well-being

- Families may blow the lump sum of money.
- They will accumulate assets and save.

# Our Contributions

- Our study is significant because it looks at how 194 families planned to use their refund as well as how they actually allocated the money.
- We obtained detailed information about the amount of each item purchased and families' decision-making processes.
- We also stratified our sample by race and ethnicity, marital status, tax preparation site, and geographical location.

# Our Study: Investing in Enduring Resources

- Tax Season 2007
- Two sites,
  - 1 high living costs (Boston)
  - 1 low living costs (Urbana)
- 194 Households, all EITC recipients, all with minor children, all with large refunds (\$1,000 or more)

# Sampling Strategy

- For-Profit Tax Preparation (62% of sample)
  - Visited 3 for-profit tax preparation sites, 2 in Boston and 1 in Central Illinois, at random sampling intervals
  - Conducted short survey of planned uses of EITC, and gathered permission to contact again for later study
- Other (38% of sample)
  - Surveyed at Head Start Centers
  - Volunteered at 3 VITA sites between February 1 and April 15, surveying all filers who qualified for study
  - For married couple families, relied on referrals from other respondents.

# Demographics

- **Children**

- Number: 2

- **Housing**

- Own: 10 - 20% (u)
- Subsidized: 18 - 60% (b)

- **Employment**

- Full-time: 47 - 49% (u)
- Combined Full-time: 17 - 25% (u)

# Demographics cont.

- **Education**

- HS or less: 26-28% (u)
- Some College: 30-35% (b)
- Associate Degree: 25-35% (u)

- **Governmental Assistance**

- Ever: 29-63% (b)

- **Banking Status**

- Current: 82-86% (b)
- Ever: 98-100% (u)

# Interviews

- Interviews averaged two and one-half hours in length.
  - Audio-recorded, transcribed, and coded
- Open-ended questions explored themes of:
  - Income, savings, and assets
  - Home and work life
  - Housing and neighborhoods
  - Expenditures (monthly and after the refund)

# Two Questions of Interest

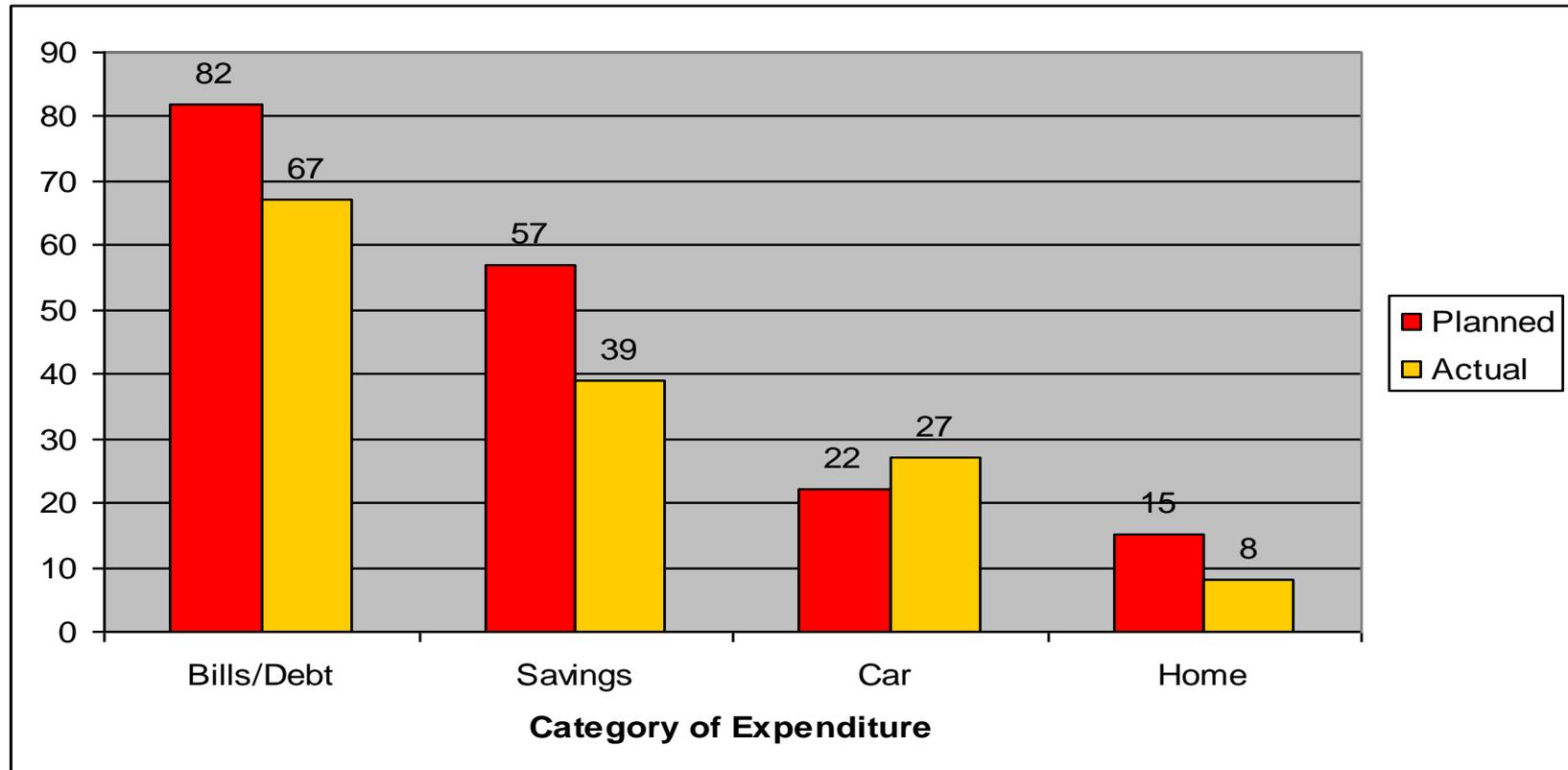
- How do families allocate their refund?
- What are their financial hopes and dreams with regard to assets and savings, and to what extent does the EITC help them realize these dreams?

# Findings

- Planned & Actual Uses of the Refund
- Saving Behaviors Using the Refund
- Motivations to Save
- Pathways to Savings

# Planned & Actual Tax Refund Expenditures

Percent of Families



# Qualitative Insights

- **Catching Up** — on both debt accumulated in the past (great deal of worry about credit ratings) and debt accumulated while the IRS is holding the money.

“Well what I was excited about, I was like okay I calculated everything. I’m like I can pay my bill. I can pay. I was behind on my cell phone. I can pay my cell phone. I can pay my electricity. I can pay little things. I owe money on my son’s insurance. I can pay that. Just little things you know.”

# Qualitative Insights cont.

**Multi-year Asset Plans** - striking evidence that the anticipation of receiving the refund in the future lead to three-stage plans: paying down debt, increasing credit scores, buying a home

“When I tried to buy a house last time, my back debts were impacting me like right then and there. Another credit card bill was [a problem] and then probably the older [debts I owe]. Because at the time I thought to use my [refund] money for a down payment on a house. But I had to pay those things off in order to be evaluated [for a loan].”

# Qualitative Insights cont.

- I have to fix my credit. [That will] take me a few years. So I have to get that nice and clean and pretty. My whole purpose [i]s to put [my refund] in a bank and... just stack [more] money on top of it [each month]. Let me just [pay off my debt]. If I had good credit, then I would use the money towards a house; like get a loan--put that together--and then get a house.

# Refund Saving Behaviors

- 57 percent of families saved part of their refund
  - Range: \$300 - \$5,000
  - Mean: \$858
  - Median: \$300
  - ~43 families saved over \$1,000

# Refund Saving Behaviors cont.

- Six months later, allocations to savings declined by about half for families
  - 75% of initial savings was used for unexpected shortfalls in monthly income or unanticipated monthly expenses.
  - Other initial savings was used for
    - Assets (car, education, etc.)
    - Typical expenses (bills, fees, etc.)
    - Atypical expenses (treats, money to family, etc.)

# Motivations to Save

- Families with long-term refund savings
  - Emergencies – cover unexpected events
  - Insurance - make sure kids are taken care of if something happens to them
  - Smooth Income – seasonal jobs
  - Home – multi-year asset plan

# Motivations to Save - Messages

- Father says a “real woman has a car” and mother says, “if you want something in life, you have to plan.”
- Grandmother tells her all the time, “You might want to start saving. You might want to save money.”
- “Like growing up she (her mom) always told me being responsible, always have a couple of dollars in your bank, you know. If you have an account or [something] to the side, always keep a couple of dollars on you because you never know when you may need it for an emergency. You know, try to budget, you know what I’m saying. If it’s something you don’t need, don’t get it.

# Pathways to Savings

- Direct deposit
- Separate accounts
- “Don’t touch the money”
  - “I always make sure that I have money and never touch it.”
  - “[I’m] saving money for the house, a down payment for a house. So that just stays in the bank, not to be touched.”
- Let family members keep the money

# Pathways to Savings cont.

- Take EITC in lump form
  - “They [IRS/government] beat down the blue collar guy more than they should. [The EITC is an exception.] It’s a nice little bank account to me. And I, I put in the maximum money so that I have the maximum return versus [getting more] during the year.”

# Neither Prediction is Quite Right

- Some asset accumulation but a lot of spending on bills and non-regular necessities. However, the palpable relief these families face might be of considerable value.
- No evidence that they “blow” the lump sum of money.
- The issue of asset accumulation and social mobility for families in low-wage jobs is complex.
  - “I just think I could save better. Like I can stretch a dollar but I need to learn how to save.”

# Bottom Line.....

- “Makes work pay more than it otherwise would” (Currie 2006).
- For those in the “struggling” group, a visceral sense of relief from the regular financial grind – keeping the wolves at bay.
- For those stably employed at relatively good wages, a strong vehicle for social mobility. Just the leg up they need to get ahead. It allows them hope that they can clean up their credit and move forward.
- Forced savings feature greatly valued, many intentionally try to maximize forced savings by claiming 0 exemptions.



**THANK YOU**

