

## **The Earned Income Tax Credit (EITC): Moving Beyond Traditional Safety Nets toward Asset-Building Opportunities**

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For as long as U.S. policymakers have sought to eradicate poverty, largely through safety net programs such as Food Stamps and general cash assistance programs, debate has raged over the relative effectiveness of these programs. At its inception, The Earned Income Tax Credit Program (EITC) was included in this safety net package and received bipartisan support as it rewarded work while providing resources for low-income families.

EITC has proven to be one of the most effective economic policy strategies instituted in the last twenty-five years. Most important, as an anti-poverty program, the EITC is demonstrably effective: In 1999, for example, EITC payments were directly responsible for lifting almost 5 million people—half of them children—above the poverty threshold, according to an analysis of census data by the Center on Budget and Policy Priorities. That's a greater impact than any other government transfer program. This policy has proven effective at encouraging job retention and increasing resources for all low-income families and has provided an imperative economic boost to substantial numbers of qualifying families. Despite these positive effects, millions of EITC dollars go unclaimed each year, often by individuals and families who need the money the most. Much of these unclaimed EITC dollars in general are highest in the areas of greatest poverty, which is where the money is needed the most.

The real advantage of the EITC is in its flexibility and the absence of any requirements about how benefits can be used. With limited resources, poor working people face a multitude of financial challenges, including (but hardly limited to) day care, transportation, nutritional needs and health care. If child care is the most urgent need, then the EITC can help pay for such needs; if not, the money can be spent on other needs, like fixing a car. Many policymakers and others are uncomfortable with cash subsidies, particularly the large, lump-sum payments of the EITC, where the entire credit is paid out at one time rather than tacked on weekly or monthly to a paycheck. Often the perception is that EITC recipients buy stereos or other non-necessities when they “should” be buying better day care for children, or a safer car or more nutritional meals at home.

What recipients actually do with the EITC payments has received more speculation than empirical inquiry. Moreover, those few studies that do examine the effects of the EITC on family incomes have relied mainly on simulation methods to reach their conclusions rather than on direct inquiry. Because much of the literature studying the behavioral influences of anti-poverty policies is contentious, simulation results are likely to be viewed skeptically, especially by those with an alternative point of view regarding the assumptions underlying the simulation.

This study seeks to gain a more complete understanding of how the Earned Income Tax Credit program influences consumer expenditure and savings decisions. Based on survey data collected from 2006 – 2008 from over 10,000 low-income taxpayers participating at Voluntary Income Tax Assistance sites across fourteen states, we find a number of potential economic effects associated with EITC receipt emerged. These effects may occur at the individual, household, and community levels and includes outcomes such as improved economic self-sufficiency, substantial economic relief for low-income families, and increased economic flow in the local community, which

strengthens local businesses. When combined, these effects are likely to build stronger communities. We examine the amount of money flowing to working families and potential uses of EITC income and find that a fairly large proportion of lower-income taxpayers expect to use the majority of their refund for basic living expenses. Even so, 25 percent of these taxpayers reported that they would save a majority of their refund.

## **Preliminary Findings**

### **Planned Use of Tax Refund**

Tax refund dollars are often substantial sums of money entering the household of working families every year. It is important to understand how these dollars are being used by individuals and families and explore ways that these dollars may be leveraged toward asset-building and investment-type financial products. Survey respondents were asked to indicate how they planned to use their tax refund and were allowed to choose multiple answers (See Figure 1). Respondents indicated that their primary planned use of tax return dollars was to cover basic living expenses such as groceries, clothing, and utilities. One could interpret this to mean that many people aren't using this particular extra income to build assets; however, one could also interpret this that respondents are working and using all the money at their disposal to stay out of debt, or prevent themselves from falling deeper in debt or poverty by covering the particular expenses they list. These efforts could be the boost needed to lay a foundation for being able to save modest sums, having them matched, and building assets.

Tax refund dollars also serve as a buffer for emergency expenses such as car repairs and medical bills that exceed insurance co-payments, or are used in lieu of insurance. Another survey question inquired about what portion of their tax return was used for necessities. Of this native sub-sample (n = 1204), over half of respondents indicated that 25% of their refund dollars were used for necessities, 30% of respondents allocated half of their refund for such expenses, 13% of respondents use 75% of their total refund to cover essential expenses and 7% must put all of their refund toward daily living expenses. Refund dollars are also being used to build emergency funds, to cover home and auto repairs and catch up on overdue bills. Each of these strategies can be viewed attempts to ensure greater financial security and as protection from financial shocks.

This data suggests that people are still struggling to deal with energy costs, lack of meaningful and well-paying employment, and enough money for food and health-related costs. These are the basic supports that, when missing, eat away at money that could go for savings. Communities may need to deal with these issues as a piece of their asset-building strategy. Furthermore, these results indicate that following the need for these basic supports and services, individuals are interested in learning more about asset building products and services.

### ***Savings***

Though a majority of respondents indicated that refund dollars are being used to cover basic expenses, results from this study indicate that working families are already engaged in saving. Notably, the results indicate that 23 percent of recipients hope to save at least a portion of their tax return dollars. This suggests a need for greater access to financial institutions, as well as the need for locally institutionalized savings programs. Respondents were asked how much they have in

savings and the average personal savings averaged \$1500. For many, there is a specific savings goal in mind, which include both short term and long term goals. Such goals include auto and home repair, auto and home purchase, and school related expenses.

People seem to want opportunities for saving, and state that they would likely use some of their EITC refund to do so. Linking matched savings programs like IDA and EITC programs could better facilitate these types of asset-building activities. A policy became effective in 2007 that allows EITC money to be direct deposited into more than one account. This means that tax return dollars could go into a structured account like an IDA, educational, and/or retirement account, as well as a checking account. However, the take up on the policy the first year was strikingly low. That means more knowledge and marketing about the potential of using such an opportunity, and encouragement, education, and facilitation towards saving and investment may need to be done in all communities to encourage using at least part of EITC refunds for saving and investment.

### **Future Analyses**

Information gained through this study provides a glimpse into the benefits of VITA sites and the EITC dollars being returned to community members. Future analyses will include an examination of outcomes based on household income levels, receipt of welfare benefits, households with and without children, among others. In addition, we will examine education and outreach efforts implemented by the VITA sites (e.g. financial education, credit counseling, and access to no-cost bank accounts) to see if such services affect how people think about and use the EITC. It will be important to examine whether this policy continues to serve as a safety net or if it may serve as a path toward asset building.

**Figure 1. Intended use of tax refund**

