Investing in Enduring Resources with the Earned Income Tax Credit: Barriers and Pathways to Social Mobility

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Investing in Enduring Resources

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Talk Overview

- Background on EITC
- Tax Refund Expenditures
- Social Mobility
  - Pathways
  - Barriers
- Housing Cost Burdens and Neighborhood Resources

Background

- 1996 Safety Net Changed - Welfare Reform
  - Old - Cash welfare was based on non-work
  - More you worked, the less benefits received
- EITC as the New “Welfare” System
  - New – based on work
  - The more you work, the more benefits until phase out
  - Janet Currie (2006) “stealth welfare reform” because EITC benefits are larger than the old or new welfare program

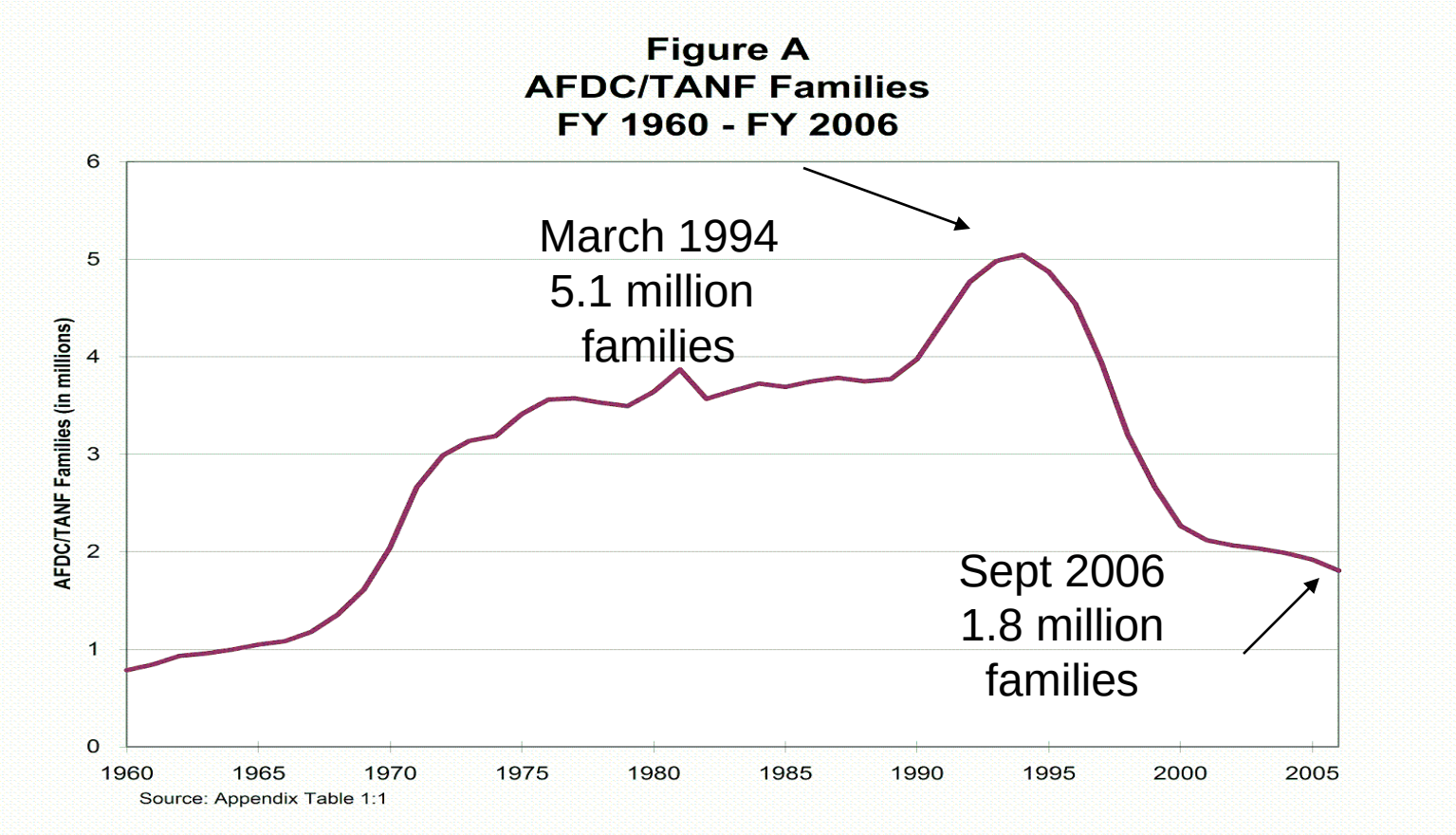
Background cont.

- 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).

Estimated that 20-25% of eligible families do not claim the EITC

The transformation from the old system to the new created big losers—roughly 30 percent of all former welfare recipients have no source of household income at any given time.

The Old Safety Net

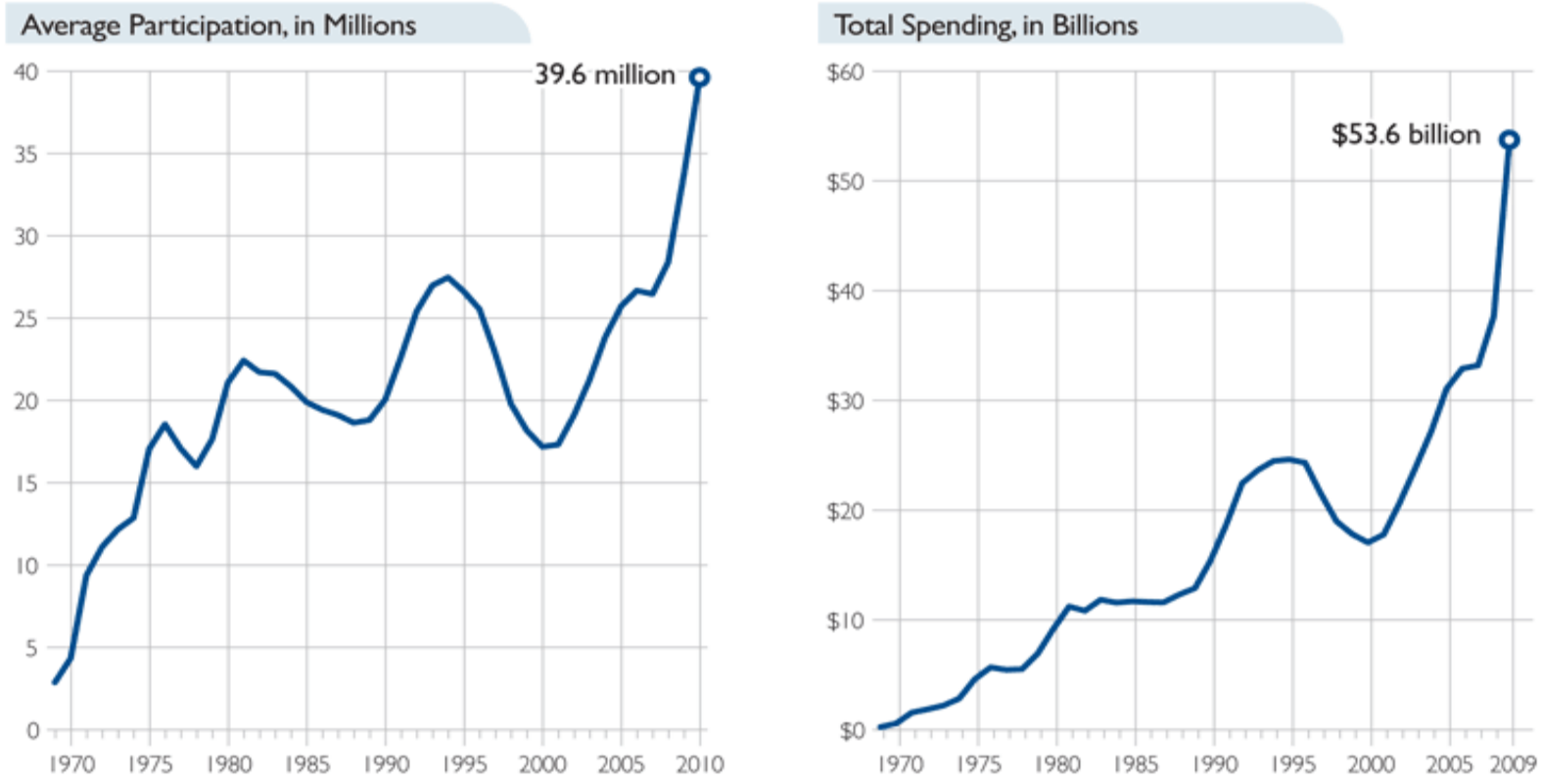


Source: TANF 8th Annual Report to Congress

Supplemental Nutrition Assistance Program (SNAP)

Food Stamp Use on the Rise

Participation and Spending in the Supplemental Nutrition Assistance Program, 1969–2010

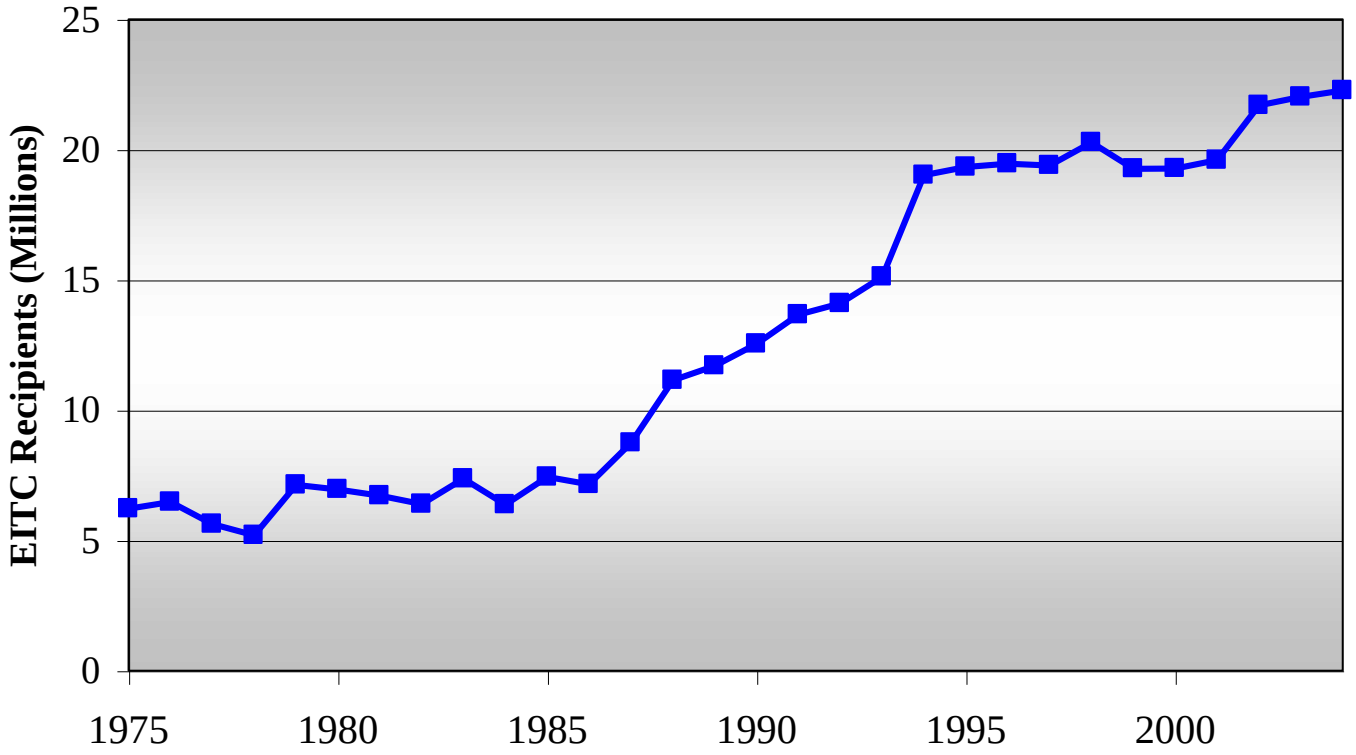


Source: U.S. Department of Agriculture, Food and Nutrition Service, Supplemental Nutrition Assitance Program Participation and Costs, May 3, 2010, at *http://www.fns.usda.gov/pd/SNAPsummary.htm* (May 28, 2010).

Chart 5 • B 2427 heritage.org

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

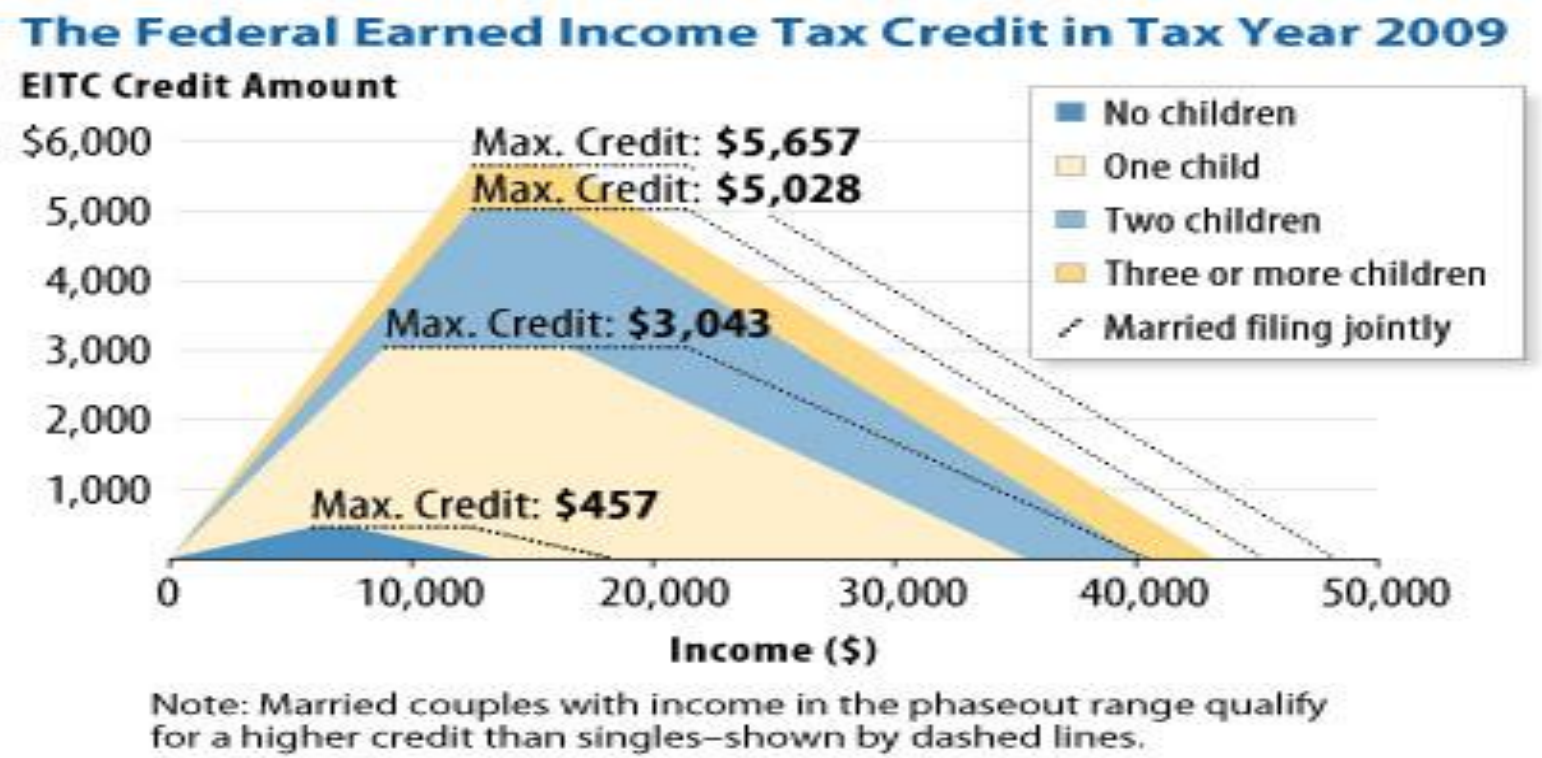
- In 2009, the EITC lifted roughly 6.6 million people out of poverty, including 3.3 million children.
- More children now exit poverty through the EITC than through any other form of government assistance.

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)



Source: Center on Budget and Policy Priorities

Two Hypotheses about EITC Expenditures and Family Well-being

- Families may blow the lump sum of money.
- The lump sum may allow them to accumulate assets.

Limitations of Previous Research

- **No reliable measure of actual EITC allocations, only plans. As Spader et al. (2005) showed, plans and behaviors, though related, vary significantly.**
- **Surveys did not ask about what *proportion* of the refund was spent for various uses. (ex. top 3 uses)**
- **Small number of households had substantial refunds ($1,000 or more) and participated in the follow-up study.**
- **Several studies' sampling relied on non-profit tax preparers, while only a small portion of EITC recipients use such services.**
- **Surveys cannot illuminate in much detail the micro-level decision-making processes and contextual constraints that may underlie allocation behavior.**

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

- 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 (60% 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 (40% of sample)
  - Surveyed at Head Start Centers
  - Volunteered at 3 VITA sites, between February 1 and April 15, 2007, surveying all filers who qualified for study
  - For married couple families, relied on referrals from other respondents.

Detailed Budget Information

- Monthly Income
  - Formal and informal jobs
  - Contributions from family and friends
  - Public assistance
- Monthly Expenditures
  - Housing and utilities
  - Transportation
  - Credit cards and other bills
- Added these up during the interview and discussed any discrepancies

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 asset accumulation, and to what extent does the EITC help them realize these dreams?

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)
- **Average Refund**
  - $3,640 - $4,686 (b)

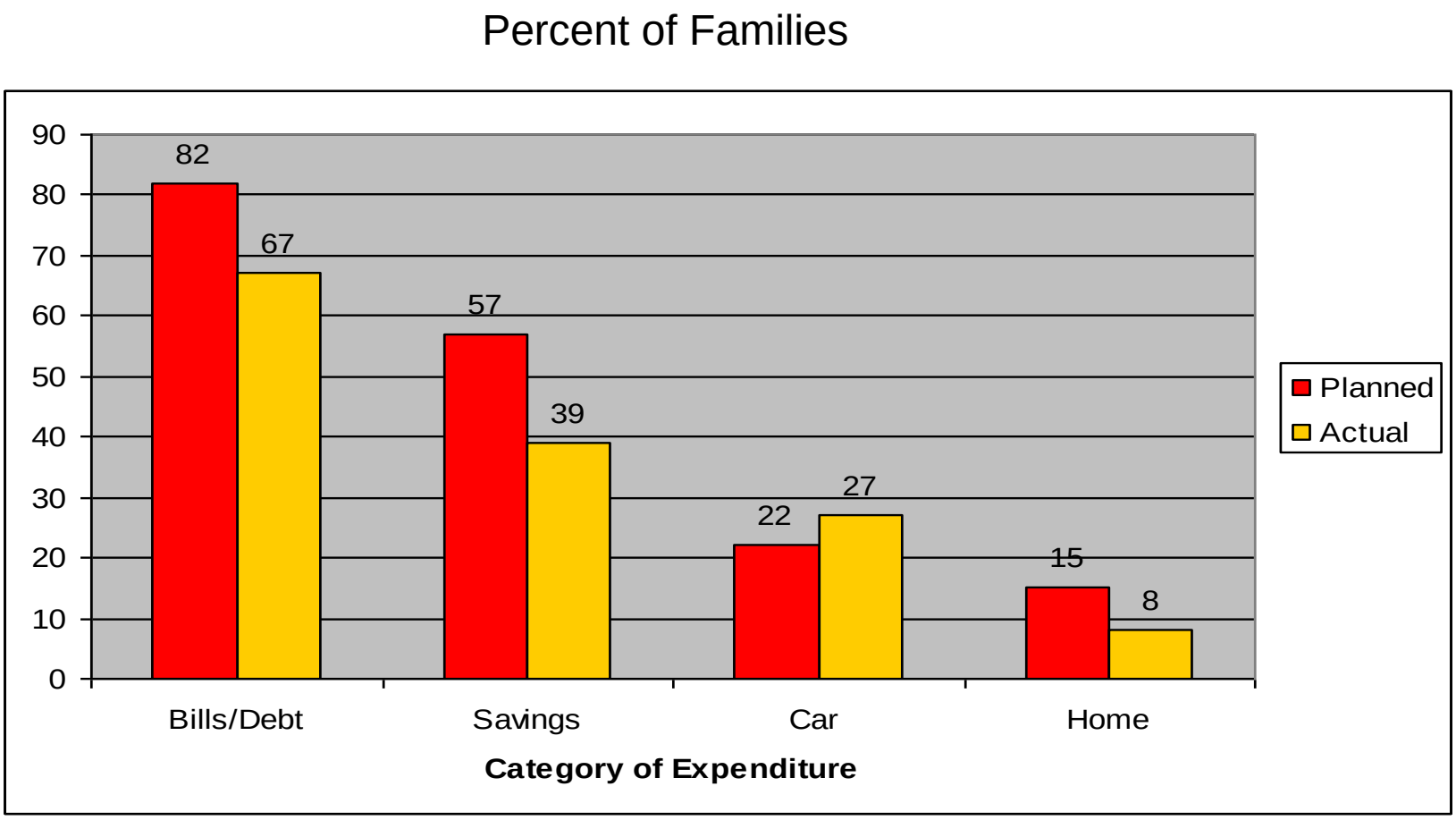
Demographics cont.

- **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)

Findings

- Planned & Actual Uses of the Refund
- Tax Refund Expenditures
- Social Mobility
- Housing Cost Burdens and Neighborhood Resources

Planned & Actual Tax Refund Expenditures



Credit Card Debt

- Ten percent of total refund dollars went toward paying old debts, including medical and credit card debt, educational debt, and personal loans.
- Sixty-four percent (n=124) with credit card debt
  - 70% of these families used some of the refund to pay down their credit.

Credit Card Debt cont.

- The average known debt on all of the cards was $3,698 (with a median of $1,000)
- Range of debt was $0 to $52,000.
  - Families paid on average 22% of their debt (median of $0).

Interest Rates on Credit Cards

- Of the families that we asked to tell us the interest rate on their credit cards, about 42 percent of them cited specific rates.
  - Range: 0% to 30% interest rates
  - Average rate: 14%
  - Median rate 16.5%

Paying Down Credit Card Debt

- Families spent an average of $394 paying off back debt (with a median of $0).
- Range: $0 - $4,000.
- Around 17 families paid off all of their credit card debt with their tax refunds and six of those families closed their accounts.

Quote: Paying Credit Card Debt

- Families who paid off their credit cards describe an extreme sense of relief. One respondent talked about having “this stupid a__ bill that I’m so f__ing tired of people calling [me to pay it].
- Often respondents cited debt as a barrier to asset accumulation, and prioritized debt payment over asset building.

Quote: Catching Up

- Families catch 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."

Quote: Multi-year Asset Plans

For some families, the anticipation of receiving the refund in the future leads to three-stage plans: paying down debt, increasing credit scores, and buying a home.

Helen, a 30 year-old Black single mother with 3 children

"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 that 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]."

Quote: Fixing Credit

Lucy, 26 year old Puerto Rican with 2 children

"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."

Expenditures: 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 feel is 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.”

Social Mobility

- Savings
  - Saved part of EITC refund (n=76, 39%)
  - Savings from all sources, over $25 (n= 80, 59%)
- Homeownership (n = 27, 14%)
- Concrete plans to buy a house (n = 23, 12%)
- In School (n = 56, 29%)
- Good Neighborhood (n = 114, 59%)
  - Safety, resources, and if respondent reported it was a good neighborhood

Social Mobility and Housing Cost Burden

- Initially, looked at if low housing cost burden (less than 30% of housing costs) was correlated with social mobility
- No relationship
  - Low HCB with total savings above median (n=50)
  - Low HCB no savings (n=45)
  - Severe HCB with total savings above median (n = 41)
- Unpack the nuances of social mobility, especially savings

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

Savings Motives

- Browning and Lusardi (1996) – 9 motives
  - Precautionary motive
    - “To build up a reserve against unforeseen contingencies“
  - Life-cycle motive
    - "To provide for an anticipated future relationship between the income and the needs of the individual . . ."
    - Add behavioral aspects (Shefrin and Thaler) self control, mental accounting, and framing
  - Down payment motive
    - “To accumulate deposits to buy houses, cars, and other durables”

Motives - Socialization Messages

- We may add socialization messages. LT savers mostly talked about this
- 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.

General 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

General Pathways to Savings cont.

- Take EITC in lump form
  - Ross, a white 40 year-old engaged father of two responding to the question about what he would change about EITC or taxes in general.
  - “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.”

Pathways for Families with Low HCB and above Median Savings

- Increase Sources of Income (n=38, 76%)
  - Borrow money from family and friends without a set date of repayment (n=11, 22%)
  - Obtain gifts and services: clothing for kids, car, cell phone, groceries, and child care (n=21, 42%)
  - Work multiple jobs (n=7, 14%)
- Planning (n=32, 66%)
  - Set money aside for upcoming bills
  - Sometimes pay bills in advance to prevent spending the money
  - Do not have credit cards
  - Do not look at bank balances

Pathways for Low HCB above Median Savings cont.

- Limit Expenses (n=21, 42%)
  - Try not to buy unnecessary items (toys, landline, cable, gifts or vacations)
  - Bargain shop for many of their regular expenses (store where you can fill your bag with food for $1)
  - Full-day Head Start
  - Housing assistance (program where does not have to pay rent for 2 yrs)

Unable to Save Group
Barriers to Saving

- Bills - “I can’t save; I can’t save. I don’t make enough to save. I try to but every time I try to save some there – this bill is needed and this bill is needed so I got to go and take from that....”
- Back Debt
- Owe money to friends and relatives

Tax Refund Savers & Barriers

- Families (39%) who saved part of their tax refund
  - Range: $300 - $5,000
  - Mean: $858
  - Median: $300
  - ~43 families saved over $1,000
- Six months later, savings declined by about half for families

Tax Refund Savers: Barriers to Long-term Saving

- 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.)

Pathways to Homeownership

Twenty-seven families own their homes

- Home program for first-time buyers (33%)
- Family (19%)
- Savings (19%)
- Tax Refund (11%)
- Other (22%)
- Note: Some families used multiple pathways.

Pathways to Homeownership
Savings & First-Time Buyers Program

- Carol, a 46 year old Black female with two children received help from the Urban League in Champaign. She initally saved $1,000 of her money and the program matched it. She also received free legal advice.
- She eventually put $6,000 down on her house, with half of the money coming from the Urban League.

Savings & First-Time Buyers Program cont.

- Carol: “I got a U of I student lawyer who helped me with the financing. I was connected first with a company that he ultimately said…there are too many fees associated with what they are trying to do. You need to find somebody else to finance you. Inevitably I got financed locally [with an agency] that they hooked me up with. It was just all a blessing and then the day that I was supposed to close – a week before my closing, I got a call from [the program] telling me that if I could come up with another thousand dollars, they would give me another thousand dollars. I was like I’m borrowing a thousand dollars from somebody. Somebody is going to give me a thousand. Well my husband gave me a thousand dollars.”

Pathways to Homeownership Family, Savings & Tax Refund

- Mary, a white single female living in Boston with her boyfriend and two children. They used about $2,000 from their tax refund and $1,200 from savings. They also received a significant amount of money from family and friends.

- “Everybody was willing to, like instead of giving us money for a wedding or anything because we’re not married. So instead of saying, okay, we’ll get married in five years, why wait? They gave us that money that they would have given us towards a wedding [gift]…I want to say like July, that [they] gave us [the money]. That helped pay for me to pay for our closing costs. That was like, you know, thirty-two hundred or something, and that’s what I used.”

Home Ownership: Other Pathways

- Zero percent down loans
- Selling one house and using the money for a down payment
- Connections in the mortgage industry

Barriers to Homeownership cont.

- High housing cost burden that ate into the families' ability to accumulate savings. These families often reported paying down debt to improve credit scores.
- Outstanding debt, namely credit card debt. This debt limited the families' ability to save and made applying for a home loan more difficult.
- Another barrier is lack of home affordability in "good" areas. Some families were able to save money for a down payment and get a loan from the bank. However, when they searched for homes, they were not able to afford a home in what they describe as a "good" neighborhood.

Homeowners in Trouble

- Three black families struggling and on the verge of losing their homes.
- Another black family had a housing cost burden of 1.05 after the husband suffered a stroke and was unable to work part of the year.

In Trouble: Zero Percent Down

- The Reneauxs are Haitian American immigrants who have lived in the U.S. for 16 years. They have three children. The family purchased the home with no money down and appeared not to need much for closing costs. When asked how the family is managing with a zero percent down loan with a high interest rate, he responds…

Quote Homeowner in Trouble

- Right now it's zero, zero in the bank because the bank take the whole money we have. The whole money we work for the bank takes all. We pay the bank all right now, we don't have none…Now we don't have none [money]. Now we shut down completely, completely, completely – completely shut down…Five hundred thousand something, five hundred thousand something, yes. And we pay like three thousand, almost three thousand dollars every month.

Good Neighborhood

- Rationale for good neighborhood as social mobility
- Definition of good hood: good schools, safe, close to work, close to stores and other amenities, and families identify it as a good neighborhood

Pathways to a Good Neighborhood

- Push Factors
  - Drugs and Crime (effect on children)
  - Not enough space
- Pull Factors
  - Safety
  - Good schools
  - More space
  - Quiet, good place for kids can “run and jump”
  - Close to relatives or friends who can help with children
  - Cheap rent – often had arrangements with relatives

Push: Area not good for son

- White single female in Boston.
- It's just that when I see I'm not getting ahead somewhere I end up leaving it. I'm always looking for a better way. You know I'm always trying to show, because my son is the oldest, I'm always trying to show him a difference in life. But I moved up around from that area. I mean it's just, well the area was no good. You know my son was just being lured into the streets, and I find myself at ten o'clock at night with my little daughter looking for him. I'm just like you know what it's time to move. It wasn't a big difference. It was only up the street, but it really is a big difference.

Push: Other Factors

- Things to Avoid: pedophiles/child molesters, sexual predators, gang activity, small and cramped, noisy neighbors with loud music, people coming in and leaving all day and night indicating possible drug selling, breaking into friend's garage 3x and he need to install security bars, neighbors drinking and leaving bottles, heroine addicts, 3 children and 2 adult sleeping in same room of a house, police harass entire block

Pull: Safety and Schools

- Black married male
- It wasn't easy because I couldn't find anything in Hyde Park where I used to live but I didn't want to buy a house in Hyde Park because my kids. I wanted them to be raised in a safe neighborhood and have a good education, you know.

Pull: Other Factors

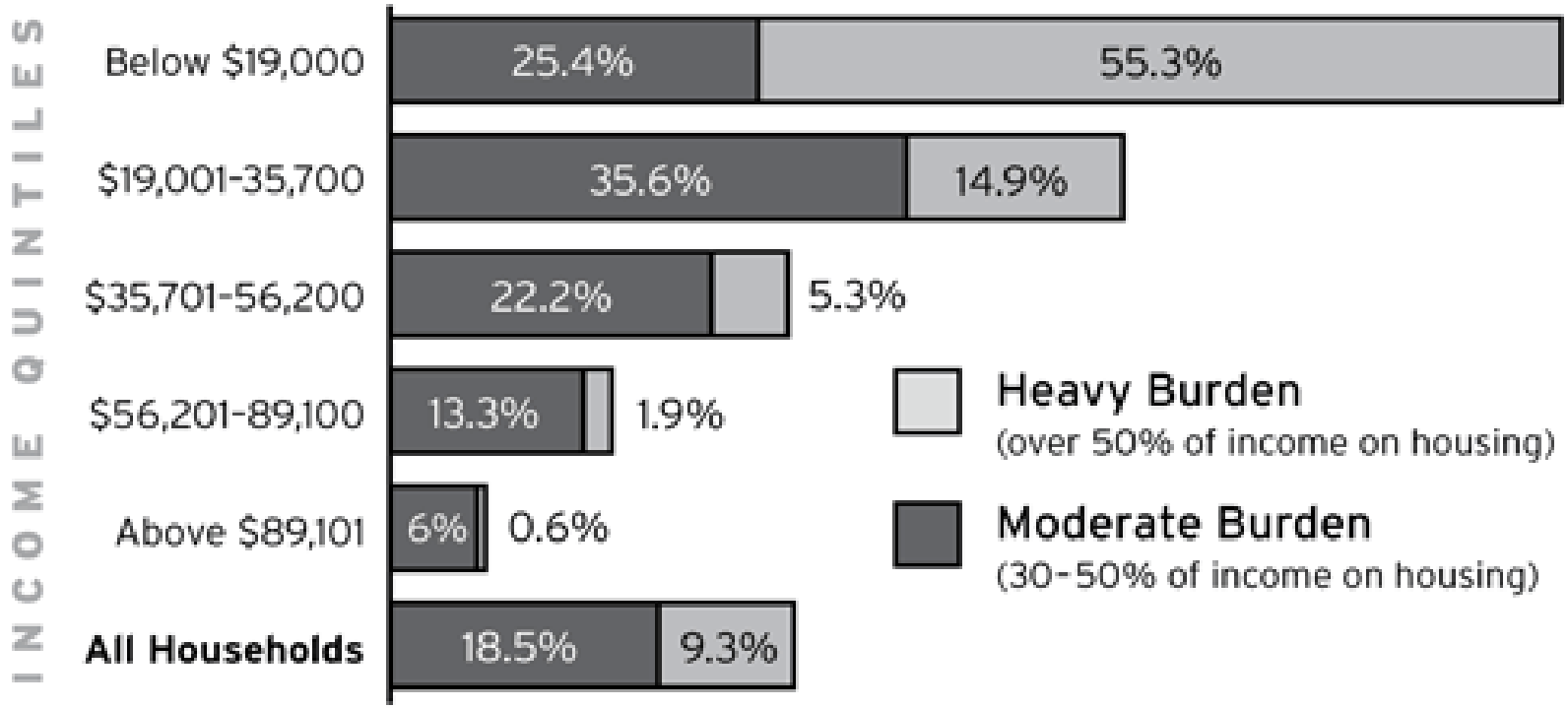
- Close to work, stores, airport shuttle and the airport
- Quiet neighbors
- A yard, possibly a pool
- A park minutes away in a car
- Playground in the apartment complex
- Privacy
- Large open space/freedom

Housing Cost Burden and Neighborhood Resources

- How much do families pay for housing and utilities?
- What type of resources do they get for their money?
- Are the houses costs and resources similar or different based on race?

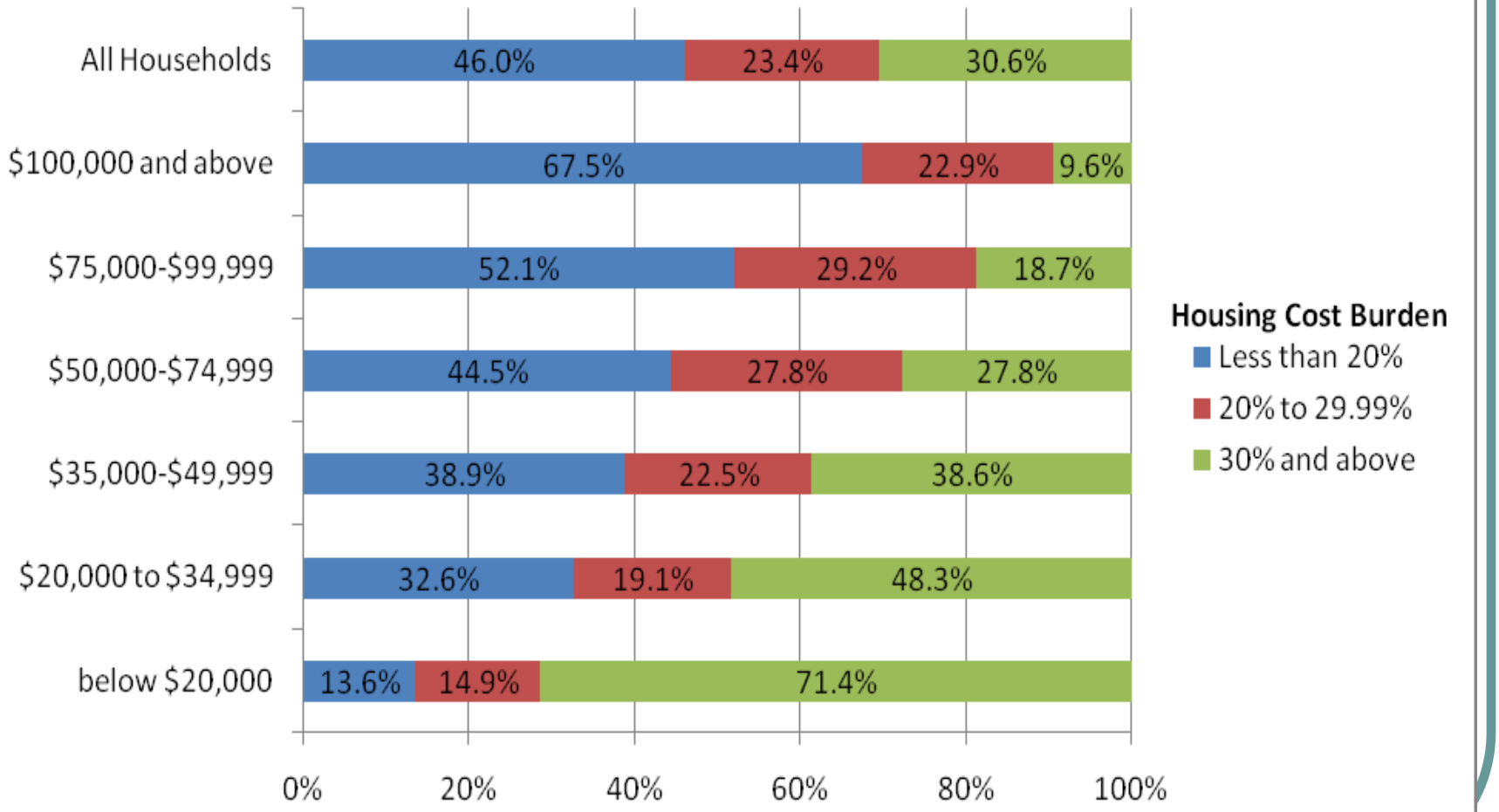
Housing Cost Burdens: 2005

(Households with earners who worked 27+ weeks)



Source: Data from the U.S. Census Bureau, American Community Survey 2005, provided by Dan McCue, Joint Center for Housing Studies of Harvard University. Calculations by the author.

Housing Cost Burden 2009



Source: Data from the U.S. Census Bureau, American Community Survey 2009. Calculation by the authors

EITC Families Housing Cost Burden

- Housing Cost Burden
  - Mean = .47 and Median = .34
  - Low (under 30%) = 40.4%
  - Moderate (30-50%) = 34.4%
  - Severe (over 50%) = 25.1%

Housing Cost Burden w/Gov Income

- Housing Cost Burden, including government income (TANF, food stamps, SSI, WIC, Unemployment, other support)
  - Mean = .30 and Median = .29
  - Low = 52.2%
  - Moderate = 34.6%
  - Severe = 13.2% (decrease of 11.9%)

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 some families it is 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

Tax Preparation

- Roughly 70 percent of sample used commercial preparers
- 30 percent used another method, including self preparation and VITA sites

Overall Financial Goals

- Save for home/trailer
- Clean up credit
- Move
- Go back to school
- Buy car or other household durables
- Send kids to college
- Taking kids on vacation (Disney)
- Saving for unspecified goal
- Open small business
- Save for retirement
- Fairy tale wedding

Jobs

- Receptionist for a body shop
- Medical assistant
- CNA
- Fast food sandwich shop
- Wal-Mart
- Hair stylist
- University maintenance: painting, grounds
- Traveling carnival – slaughter help, game jockey
- Prep cook
- Lunch asst and bus monitor
- Van driver

Economic Edge: Groceries

- Almost a quarter (22%) said they would “buy groceries” with the refund. (~27% bought food).
- An early indication that many of our families were living on the economic edge and having trouble covering basic necessities month to month.
- About 47 percent (n = 78) of the sample participated in SNAP.
- For the 21 families receiving SNAP and purchasing groceries with their refund, the median difference between SNAP benefits and monthly food budget was $145.
- For the 57 remaining families receiving SNAP and not using the refund to buy groceries, the median of the difference was $60.

Pathways to Increasing Education

- 56 Families
- Financial Aid,
  - Family
  - Federal aid (Pell Grants and Work Study, etc…)

Education Quote

- Yeah, I'm hoping that it will make an impression on my children and hopefully they can see - the sacrifices that I have to make right now with them. You know [it] is really hard because a lot of my time has to go for school and it's really difficult to be able to weigh that, you know. Is it worth it to give up some of my time with them in order to study and go to class and do all the things that I have to do? So it's really [tough] – but I'm hoping that in the long run they'll see my efforts and then they'll want to go and make their life better and get an education and do that kind of thing. I don't know, we'll see.

Concrete Plans to Buy a House

Twenty-three Families

- Rent-to-own Agreements (n= 4)
- Building up savings
- Talked to builders
- Paying down other debt
- Using prepaid credit cards to build up credit