

Earnings, Refund, Windfall or Equity: How Families View and Use the EIC

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This paper analyzes low-income working families' views and uses of the Earned Income Tax Credit (EIC), including the decision to use the lump sum or advance payment form. An ecocultural model predicts that the EIC's effect should be visible through its impacts on families' everyday routines and activities, as observed ethnographically. A resources model predicts that additional income and stable work experiences will lead to improvements in family life and investments in children. Available quantitative data sources for examining use of EIC capture demographics of recipients and the point-in-time use of the refund check. We use qualitative interviews and ethnographic data on 42 economically poor families in Milwaukee to understand how the EIC figures into total family income and expenditure flow. From a family's point of view, taking the EIC in lump sum form, rather than as an advance, reflects a rational analysis of the available credit and labor constraints. Severely cash-strapped families choose the lump sum and increase their market and non-market labor supply to make up periodic financial shortfalls. The complex financial situations of low-income working families make expenditure categorization difficult. Recipients use the lump credit toward realizing their values and goals.

Introduction

Earnings supplements delivered through the income tax system, such as the federal Earned Income Tax Credit (EITC) or state Earned Income Credits (EICs), are a major policy aimed at reducing poverty and increasing well being among American families. Such credits work in two ways: they promote work by increasing its payoff and they increase income. Earned Income programs' effects on families can thus be understood through a resources model where income, education, or stable and productive work experiences will lead to improvements in family life and investments in children. An ecocultural model predicts that the EIC's effect should be visible through its impacts on families' everyday routines and activities, as observed ethnographically. We will use survey, administrative, and ethnographic data to investigate this model.

The federal EIC has a larger impact on the poverty rate among children of low-income working families than any other federal program (Porter and Primus, 1998). Additionally, 10 states, including Wisconsin, offer an EIC. Despite their impact on

poverty and hoped impact on well being, suprisingly little is known about how people use EICs. What do families buy with their credit? Do families go into debt in anticipation of the credit, use it to make durable good investments, treat it as forced savings, or divert it into their expenditure stream? In the case of families, what kind of impact does the EIC have on child well being?

These questions of consumption patterns gain additional significance when viewed in light of a policy which provides for two very different versions of the EIC. Over 90 percent of families receive the credit as a lump sum along with their income tax refund. However, since 1979, an advance payment option also allows workers to claim a portion of their credit in every paycheck. It is felt that the advance form is underutilized. In the 1993 Omnibus Budget Reconciliation Act, congressional attention focused on the low use of the advance. A report commissioned by Congress recommended increasing public awareness of the advance option. This call has been echoed by not-for-profit organizations (GAO, 1992. Center on Budget and Policy Priorities, 1998).

Our data can speak to the debate over lump sum versus advance payment options. What do families know and think about the advance option? Would payments spread over a year increase well being relative to an equivalent lump sum? During the week or weeks just after a lump EIC is received, are there transient changes and improvements in family child daily life which then fade, or do parents use the funds for expenditures which produce a more enduring influence lasting many months or longer?

We used ethnographic methods such as home visits and informal or semi-structured interviews, designed to place economic choices within the context of family

welfare-sustaining decisions. This inquiry was designed to capture the meaning and choices for using the EIC from the parents' point of view. We find that families do use the EIC credit to increase household well being. For example, they often purchase furniture or make down payments on cars. Evidence suggests that the once-yearly payment form actually increases non-market labor supply relative to more periodic payments. Families' views and use of the credit suggest that they often use the EIC for durable goods, work-supporting assets, or home buying uses, and so it should be thought of as serving a third policy goal, asset building, in addition to its other uses.

Background

Structure of the Credit and Advance Payment Option

This section outlines the federal and Wisconsin state EICs. The advance options are described.

Federal

The federal EIC is a refundable credit that targets low-income households with earned income. Administered through the Internal Revenue Service's federal income tax system, the credit supplements earnings of single taxpayers and single- or dual-headed households with children. Unlike non-refundable credits, the EIC can exceed the recipient's tax burden. A household that owes little or nothing in taxes will still receive a check from the credit.

The rate of subsidy varies by income level and number of children as the credit phases in, plateaus, and phases out. Household structure determines the lower and upper income levels for the maximum benefit as well as the point where the credit phases out

totally. Single tax payers without children filing for 1998 will receive a maximum benefit of \$341 if their earnings are in the \$4,450 to \$5,600 range; benefits end as income reaches \$10,000. Households with one child and earnings in the \$6,600 to \$12,300 range a maximum benefit of \$2,271 with benefits phasing out totally at \$26,450. The most generous benefit goes to families with two or more children. In the earnings range \$9,350 to \$12,300 the subsidy is \$3,756; complete phase out occurs at \$30,095. (US Government Printing Office, 1998)

Since inception in 1975 federal EIC has grown in both size and scope. Over the decade 1986 – 1996, unadjusted outlays on the EIC have expanded more than ten-fold, from \$1.4 to \$19.2 billion. As a percentage of total expenditure on means-tested programs, EIC has grown from 2 percent to 10 percent. (calculations from p. 1365) The IRS projects that in 1999, 18,954,000 families will claim credits totaling just over \$28 billion, or \$1516 per family. (Green Book, p 872) The Congressional Budget Office expects outlays on the EIC will exceed the amount spent on family support transfers (Temporary Assistance to Needy Families - TANF and related programs.)

Wisconsin

Wisconsin is one of ten states which offers an EIC. Like most state EICs, Wisconsin's is based on the federal qualifying restrictions. The Wisconsin EIC is only available to families with children and is prorated by number of children. Families with one qualifying child receive a credit equivalent to 4 percent of their federal amount; two qualifying children increase the credit to 14 percent. The federal credit is capped at two children, but the Wisconsin benefit is most generous for families with three or more qualifying children. Such families receive a refundable credit of 43 percent of their

federal amount. A family with three children and earnings in the maximum credit range, this can mean a \$1600 Wisconsin credit and a total of over \$5000 from state and federal returns combined.

Advance Payment Option

In 1979 the federal government initiated an advance payment option through which workers can receive a portion of their projected EIC credit in every paycheck. Current regulations allow 60 percent of the projected credit to be so dispensed. Receiving an advance credit involves coordination with an employer. The employee files a Form W-5, the Earned Income Credit Advance Payment Certificate with the employer. The employer then includes the credit in each paycheck. The total advance received is then reported on the employee's year-end W-2. All who use the advance payment then are required to file a tax return.

Wisconsin offers an option, the Working Family Tax Credit (WFTC), that allows working members of families to benefit from the credit in advance of year-end filing. By completing form WT-4B and registering it with the employer, workers who qualify for the WFTC can be exempted from all state income tax withholding. This option serves as an advance equivalent to the non-refundable portion of the credit. Families who qualify for credit beyond the value of the exempted income tax then file for the additional amount.

Figure 1 illustrates a sample family's monthly income fluctuations as experienced with a tax refund and the EIC in lump sum form versus the same income with accurate withholding and the advance option.

Policy Goals

The EIC is one policy tool with multiple goals. The credit was originally introduced in 1979 as a labor supply/tax policy designed to offset regressive Social Security and other taxes burdens facing low-income workers. The EIC has taken on new meaning within the policy arena of the 1990s and Clinton administration. Recent expansions of the credit have as their aim other goals, notably increasing labor supply and promoting family welfare. Looking back at the 1993 expansion, President Clinton stated, “What I wanted to do in 1993 was to create new incentives to help people climb the economic ladder and reach true independence; to enable people to succeed at work and at home, raising their children.” (Press Release, Dec 4, 1998) 1998 the Administration recognizes three goals:

The goals of the Earned Income Tax Credit (EITC) are to make work pay, to help ensure that working parents do not have to raise their children in poverty, and to offset the total tax burden of low and moderate income working families. (CEA report, December 1998)

Our discussion focuses on the labor supply and family well-being goals as well as a possible third use of the EIC tool, as an asset-building mechanism for low-income families.

Literature

As a tax-based policy concerning labor supply and income, the EIC has almost solely fallen under the academic scrutiny of economists (and hence has been studied quantitatively). Generally, the EIC receives less scholarly and public attention than other transfer programs such as Aid to Families with Dependent Children (AFDC) or its

replacement, Temporary Assistance to Needy Families (TANF). This section highlights relevant literature concerning the policy goals addressed above: labor supply, well being, and asset building. Other work on the EIC has focused on participation and compliance (Scholz, 1990, 1994; GAO 1992) .

Labor supply

Labor supply responses to the EIC are an active area of economic research. Recent work has used the expansions in the credit over the past decade to identify changes in formal labor supply.

Eissa and Liebman (1996) find that labor supply of single women with children increased in response to the EIC increases relative to that of married mothers and childless women. Meyer and Rosenbaum (1998) estimate that increases in EIC are a more important determinant of the increased labor supply of single mothers than are other policy changes such as expansion of Medicaid and decreases in AFDC.

Work incentives are less clear in households with married parents. Eissa and Hoynes (1998) note that the EIC creates high marginal tax rates for second workers in low-income families. They found that men increased labor force participation and while women cut back. These trends show some variation by education level and family size. Overall, among families already in labor market family labor supply decreased slightly.

In each case, labor supply is characterized by formal participation in market jobs. Eissa and Leibman (1996) look at labor force participation, defined as working a positive number of hours during a year. Meyer and Rosenbaum (1997) use ever worked in the

past week and past year as their dependent variable. Eissa and Hoynes (1998) look at annual hours worked and labor force participation.

Family well-being

Literature linking the EIC with the welfare of the families who receive it generally focuses on income and transfer efficiency. One topic is the credit's effectiveness in raising families out of poverty. Because it targets the largest benefits to families close to the poverty line, the EIC lifts families above poverty line almost mechanically. Blank (1999) holds that the EIC is our country's most efficient program targeted at low income families. Greenstein and Shapiro (1998) find that the combination of federal and state EICs are the largest single mechanism for lifting children out of poverty.

The credit has also helped stem the tide of rising wage inequality over the past two decades. Leibman (1998) estimates the credit offsets 30 percent of the decline of the share of income held by the bottom quintile of American households with children. Supplementing wages may come at a welfare cost, however. Browning (1995) cautions that an examination of the financial benefit of the EIC must take both substitution and income effects into consideration. The credit may not increase disposable income, if families likely reduce work hours.

Asset-building

A third possible use of EIC lump sum payments is pointed out by qualitative analysis. Edin (1998) documents the role assets can have in the lives of low-income families. She found financially strained women lack both the income surplus and

stability to purchase work-supporting and welfare-increasing assets such as cars, durable household goods, or business start-up equipment. Assets can buffer against income fluctuations. Equipment purchases can be used for self-employment, particularly for men. Home ownership can provide business opportunities (informal—speakeasies and auto maintenance, formal – daycare). Durable household goods increase household efficiency (washing machines) and support work (cars).

Given the importance of assets, do policies support the acquisition and maintenance of assets? No, Sherraden (1991) argues. Welfare policy is focused on income or flows of money rather than assets or stocks. Yet he argues both are relevant to well being and in the long run, assets may contribute more to well being than income.

There is a pervasive assumption, seldom questioned, that level of household income and consumption constitutes an adequate definition of welfare. This assumption overlooks household welfare as a long-term, dynamic process rather than simply an amount of goods and services consumed. (p. 35).

He coins the phrase “asset-based welfare policy”. Sherraden points out that tax and social policies promote asset building among the non-poor but not the poor. Home mortgage interest deduction, tax-sheltered retirement plans and post-secondary tuition deductions are three such examples that target the middle-class. Sherraden suggests that policy ought to encourage asset building among low-income persons. He suggests a model of Individual Development Accounts (IDAs) or protected savings accounts, which can be drawn on for certain human and physical capital investments such as education, business start-up, or home down payments. IDAs have attracted attention by not-for-profits and a variety of domestic and international programs have been modeled on Sherraden’s idea (Canedy, 1998)

Haveman and Scholz's (1994) review of all tax and other transfer programs aimed at low-income individuals calls for a strengthening of low-wage labor market to complement EIC expansion. They also advise creation of capital accounts for young people and poor families, similar to Sherraden's IDAs. Families could use accounts for "approved purposes that might involve the purchase of a home, the starting up of a small enterprise, or the support of education for a child. ... the objective is to create a stake in the future for those who now have little stake, and to enable them to use their resources for purposes that will enable independence and self-sufficiency." (p. 430)

We argue that many low-income families already view the EIC as an asset-building mechanism, and our ethnographic data provide a substantial number of examples of such use. On this point, our findings disagree with Edin (1998) who discounts the possibility that EIC credit would be used for such investments. She found in her sample that tax refunds were most frequently used for consumption goods and back bills (Christmas bills). We find greater evidence of asset purchasing. This could perhaps be due to expansions in the EIC that have taken place since she collected the bulk of her data. However, we agree with her general conclusion which calls for an expansion of the EIC and provisions allowing it to be saved without jeopardizing eligibility for means-tested programs.

Method and Data

We use data collected from participants in the New Hope Project, a community-initiated anti-poverty program in Milwaukee, Wisconsin. Sample members were recruited from two Milwaukee zip codes and had baseline annual household earnings of

less than 150 percent of the poverty line. New Hope used an experimental design. Recruits were assigned randomly to either receive benefits or be in a control group. In theory, the program and control groups should have the same distribution of family traits. Statistics comparing the two groups confirm this. (Brock, et al, 1997)

Specifically this paper draws on a subset of the New Hope participant population, households who had children aged 1-10 years at sign-up. This group is covered by a Child and Family Study, which combines survey and qualitative data. We use both types of data in this research. The theory and practice guiding collection of the ethnographic data is covered in the next section.

Survey data covering employment, earnings, income, EIC awareness as well as other areas, were collected at program entry and a two-year follow-up. We have administrative earnings data from Unemployment Insurance covering two quarters prior to program sign-up through the 4th quarter of 1997. The research group also requested and received tax filing information from the IRS and Wisconsin Department of Revenue. To preserve anonymity, individual tax records were not provided. However, we have group-level data for subgroups of approximately 15 families stratified by experimental status, income level, and family structure. This data allows us to consistently describe the mean filing rate and level of EIC credit received by sample members.

Ethnography

The ethnographic data used in this paper complement data from the New Hope survey and economic records. The ethnographic study gathers information on parents' own perceptions of family life and , using ecocultural theory (Weisner, 1996; 1997). Ecocultural theory argues from a model of socially experienced, subjective utility: given

the sociocultural and historical circumstances in which an intervention such as the New Hope offer occurs, and in which the EIC is then received, what did parents do with the funds, and what did they think about the EIC? The survey and administrative data provide scale scores and income data; the ethnography asks what those EIC earnings mean in the context of family efforts to adapt and to sustain their lives, and why parents did with the funds what they chose to do.

The ethnographic method complements the resources model (i.e., that income, education, or stable and productive work experiences will lead to improvements in family life and investments in children) with a cultural activities model. The cultural activity model (or, ecocultural model) uses the person, case, and everyday activities parents and children participate in as its units of analysis, and ethnography as a central method.

Ecocultural theory suggests that to discover the effects of the EIC on parents and children, we need to locate these effects as they are visible as a change in the activities, daily routines, and cultural models of the family. In the case of the EIC, we talked with parents about what they knew about the EIC, what they did with the EIC payment, and why. We asked about how the EIC did or did not alter their cultural routines and activities, or make them more stable and secure, or closer to their own goals and values for themselves and their families.

Advantages of ethnographic methodology

This theoretically based ethnographic framework addresses questions not answerable by survey or administrative records. One such question concerns the true effect of the credit on total income and expenditure flow. Because of the program's

universal nature, spending records alone cannot discern whether a purchase was made *because* of the EIC or simply *after* receiving the tax check. Most recipients expect a tax refund (whether or not they explicitly link it to EIC). Hence consumption may be adjusted to prepare for this lump sum. Tracking post-refund spending may highlight those expenditures parents made which had a degree of time flexibility rather than expenditures enabled by the credit.

Ethnographic work can track more forms of labor than other methods can. Economic theory recognizes the value of non-market or household labor in transforming market goods, such as groceries, into commodities consumable by the family, such as meals. (Becker, 1981) This theoretical recognition is rarely translated into empirical work, however, as non-market labor supply is rarely systematically recorded. This frequent omission may cause more bias when studying lower income families. Edin and Lein (1997) documented many non-market activities in which mothers engage in order to provide for their families. Ethnographic data tracks market and non-market labor.

Ethnographic data can examine which members of the family benefit. As welfare reforms increasingly link support for children with market labor, earned income tax credits are much more politically palatable than the former AFDC grants. Credits primarily target families with children and credits are higher for families with two or more children relative to single-child families. What happens to the credit once a wage-earning parent receives it? To what extent do credits offset the cost of children or allow families to purchase goods or make investments that target their children directly? Taken out of context, it is not clear what meaning certain purchases have for children. A car, for instance, can enable a parent to switch to a job further out in the suburbs or to pick a child

up from an after-school program. The latter directly benefits the child's well being; the former may or may not. The benefit to children from family purchases can best be seen within the context of an individual family. These kinds of trade-offs due to changes in the family daily routine and the intended and unintended consequences of such changes in the routine, are explored using ecocultural theory and ethnographic methods. In a strictly resource theory/cash flows approach they are not measured or not explicitly a part of the theory.

Sample

Statistics describing the demographics of both the survey and ethnographic sample are presented in Table 1. When applicable we compare our sample to the comprehensive national distribution of all EIC recipients as described by the General Accounting Office (1996). Overall our sample seems to be more persistently economically disadvantaged than an average federal EIC recipient, likely reflecting the persistent poverty which characterizes the particular Milwaukee neighborhoods targeted by the project.

There are 812 families originally in the New Hope Child and Family Study. Our ethnographic sample was drawn randomly from a stratification of that larger group. Over 80% of available families agreed to participate. Forty six families (23 each from New Hope and control groups) are in the full ethnographic sample. Analysis for this paper is limited to the 42 families with whom we have made at least two visits. Nineteen of these families received New Hope benefits; 23 were in the control group. Of the original 812 families, 637 or 78 percent were contacted at the two-year follow-up survey. Retention

happened to be somewhat higher among the members of the ethnographic sample; we have survey data on 40 of 42¹.

In most cases the primary respondent (and New Hope participant) is a woman. Four-fifths are between 25 and 45 years old, with the average age at the two-year follow-up being slightly over 32. About half are African-American. The full sample is about one quarter Hispanic with the remaining participants split between White, non-Hispanic and those who identified themselves as “other.” Practically, many of the latter group were Asian, mostly recent Hmong refugees resettled to Milwaukee’s South Side. Because of the importance and complexity of Hmong culture and language, and the need for a specialized study of this group, Hmong were excluded from the ethnographic sub-sample. One third of the ethnographic sample is Hispanic, a category which contains a diverse mixture of Puerto Ricans, Mexican-Americans, and immigrants from other Latin American countries.

Family structure, particularly number of children, is an important indicator of amount of EIC credit. Most families in our survey had more than one child. One fifth of the full survey and one tenth of the ethnographic sub-sample have only one child. Most have two or more and about half have three or more children, hence qualifying for the maximum level Wisconsin EIC credit. About one fifth of the full sample and one eighth of the sub-sample are married and living with a spouse; slightly fewer report living with a partner. A significant number also live in households with other adult relatives. Our sample seems to be less likely to be married than the nationally average EIC recipients; in 1994 one third of recipients filed as “married.”

¹ Recruitment for the ethnographic study started after the two-year follow up survey. However, families not located by the survey were also less likely to be located by the field workers a year later.

Labor market statistics are reported in Table 2. Between signing up for New Hope and their two-year follow up, 93.6 percent of all participants and 92.9 percent of the ethnographic sub-sample worked in a job which reports earnings to the Unemployment Insurance administration. Among those who worked, their individual average earnings were between \$8000 and \$9000 per year. They also reported working over 1400 hours per year on average. By comparison, working 40 hours for 50 weeks is 2000 hours. The respondent's earnings were not the only source of income for these families, however. Many households had other wage earners or received transfer payments such as W-2 (the Wisconsin TANF program) or SSI. The last line of Table 2 reports household earnings to cash income ratio. Earnings include primary and secondary wage earners. Cash income includes cash transfers but not food stamps. In the full sample, earned income represents 85.8 percent of household income; this is lower for the ethnographic sample, 62.8 percent. By contrast the GAO description of the average EIC credit recipient figures that an earnings-to-income ratio of 90 percent is common.

Findings

In this section we overview some general themes that arose when discussing the EIC and, more generally, household budgets and tax time. Then we turn to the specific policy areas and highlight findings concerning labor supply, family well being, and asset building.

Knowledge and views of the credit

The delivery mechanism that links the EIC with the income tax system is reflected in people's views of the credit. The families we speak with differ in the degree

to which they differentiate the EIC from their income tax refunds and other credits.² Not all families in our sample were eligible for the EIC. Two held two jobs and clearly earned too much; several others were borderline. Two are wholly self-employed in cash businesses and do not file taxes. Another three have no earned income; two rely on welfare and one receives SSI disability payments. This leaves 36 of the 42 (86 percent) potentially eligible for the credit. This is higher than the administrative estimates reported in Table 3 suggest. Regardless of specific knowledge or use of the EIC, tax time is an exciting time of year for most of the low-income working families in our sample. As one sample member exclaimed, “I tell people, ‘I can’t wait for January’ and when they ask why, I tell them its so I can file my taxes.”

EIC awareness ranges from no knowledge of the credit to strategic use of the credit structure. Fewer than 10 percent of the sample families had never heard of the EIC, even when prompted. The response of this working woman with three children is typical of this group (who did not know about the EIC at all). She worked part-time in 1997 and did file taxes,

She said that she hadn’t heard of the EITC. She said that she really doesn’t know much about her taxes at all except a lot of it is taken from each check. [She] said that last year she got a tax refund of about \$1600. She doesn’t know if that was EITC or what. It was just a refund.

Without tax records, we have no way of knowing whether or not these families claim the EIC, although often the dollar amounts of their refund often suggest that they did receive the credit.

² Wisconsin also has a Homestead Credit, which provides low-income households with earnings a credit equal to their real estate taxes if they own or the portion of their rent attributable to real estate taxes if they rent. Well-informed families also mention the Homestead Credit by name when discussing their taxes.

An additional one fifth of the sample member recognize the EIC with slight prompting, often noting that they heard about it through New Hope (if they were in the New Hope sample group), another community agency, family members or friends. Finally, about ten percent recognize that part of their tax check comes from the EIC program and can give a dollar breakdown of the amounts. The explanation of this working mother with four children, is typical of this group—she educates a fieldworker,

[She] knows pretty well what [the] EITC is, she showed me her tax forms and explained to me what [the] EITC was. According to the tax form that she showed me, last year she got \$1350 thanks to the EITC. In the end she got almost \$3,000 refunded from her income taxes.

Only a small number understand the credit thoroughly enough to engage in strategic behavior. Three of the families actually plan their tax filing status to maximize total refunds. In extended families where multiple adults share child-raising responsibilities, different people may file returns identifying different children as dependents. For example, one woman relies on her mother to baby-sit her younger daughter every weekend. The grandmother also buys school clothes for the child. In return for this care, the grandmother “gets hers back at the end of the year” by filing the child as a dependent and receiving an EIC.

Not all of these working families get their income taxes refunded. A significant proportion of the households we interview, six, or 15 percent, have their taxes garnished automatically due to outstanding debts incurred in government-administered programs. Three participants report owing back student loans, the most common reason for garnishment. The others have their refunds garnished for back taxes, overpayment of Unemployment Insurance, or convictions for welfare fraud.

While only 15 percent of families have outstanding debts to the government; almost all have consumer debt. Among families with whom we have discussed outstanding debt, one third owe over \$400. Estimated total debt ranges from \$200 in back utility bills to \$10,000 in unpaid medical bills and student loans, with an average of over \$1000. We will return to the issue of back bills when looking at the EIC's effect on family well being.

Consistent with general perceptions and the GAO report (1992), most of the families in our sample receive their credit in a lump sum. Only three (8.6 percent) of the taxpayers receive the advance payment option. Few others seem to be aware of the option, although a few have told field workers that they explicitly prefer the lump sum.

Labor Supply

The EIC credit structure decreases the rate of supplement as families move beyond the upper end of the plateau into the phase-out structure. Economists' concerns about the work disincentives on the phase-out portion of the credit is generally not reflected in the descriptions our families give of the relationship between how much they work and how much credit they get. Only one person in our even knew that his family needed to earn a certain amount in order to maximize their amount. This family, with two parents and three children, generally subsisted on informal labor ("junking") but also aimed to have about \$12,000 in reported earnings

People's understanding of exact labor supply incentives were generally unclear and often included misinformation. Overall, people commonly describe a linear relationship between the amount they work and the total amount of their check. Among

participants who discussed the relationship between the amount they work and the amount of the check, one third of the cases could be described as holding such a “more work, more money” view. One woman describes her thoughts on the issue to a fieldworker,

[She] said that sometimes when she thinks about whether she is going to work over-time, she does think that if she works more her tax check will be bigger, but that thought really doesn't sway her to work too much more.

The perception of marginal incentives may be related to work experience. Recent welfare reforms and a very strong labor market in Milwaukee have drawn many of our sample members into full time work over the past few years. Some of cases who think their combined refund and EIC will increase with increases in work have entered the workforce over the last two years. Consider one mother of four children, who moved off welfare into a relatively well paying office job in the fall of 1997,

Once she had done her taxes [for 1997] and figured out how large her return would be, she realized that it was only for four months' worth of work, 'Four months! I was wondering why I didn't have a job the entire time!' She got a very big tax return - \$4000, \$2000 EIC of which she thinks was the EITC. . . . [She] estimates she will get about \$6000 this year.

Likely she is over-estimating, but not drastically. The perception that the more work will continue to increase the check at tax time does not reflect the phase-out structure of the EIC but is consistent with over-withholding. For such families, who are new to the workforce, it will be interesting to observe the yearly learning process and its implications for labor supply as we follow this group over three years.

In addition to a general misperception of the implicit marginal tax rates, about one eighth of the sample had misunderstandings of the eligibility rules surrounding the credit. One person, the only working adult in her household, makes \$6.25 an hour yet thinks she

earns too much for the credit. Another believed she had to be unemployed part of the year to qualify. Another mother thought that she was ineligible because she did not work an average of 25 hours per week.³ Overall, few families in our sample have a complete understanding of the labor supply incentive structure of the EIC; most, however, have a generally correct notion although not one that clearly leads to the economically predicted labor supply response.

The choice between lump sum and advance payment delivery methods contains a second labor supply issue. As established, most of the families in our study use the lump sum payment structure. Following a family over time also helps us figure out how they do make ends meet in the eleven months a year when they do not get a large refund. We find both formal and informal labor supply increases to cover budget shortfalls or to cover special expenditures.

People can and do choose to work more hours when they need extra money. One woman paid for holiday gifts this way,

[In] October and November [she] had extra time to spend at work. On certain days she worked 12 hours a day, but it wasn't so bad because her job keeps her active and it is not boring. The money she made was used for Christmas gifts.

A more subtle form of increased labor supply happens informally--the extra labor of tightening the belt when finances are very short. Often, pinching pennies is extra work. Fieldnotes describe how one woman dealt with an unexpected shortage,

[She] said that she had to go down to the food pantry to get food for the kids to eat for the week. ... She hadn't been to the food pantry in a long time, but she had no choice.

³ Field worker protocol was to provide accurate EIC information to cases after collecting data concerning their awareness of the credit. When needed, we distributed information provided by the New Hope Project office and the Center for Budget and Policy Priorities EIC outreach campaign.

Other non-market strategies include cooking inexpensive meals at home (49.6 percent of the full sample reported having “enough food, but not always the kinds of food we want to eat”), being more vigilant about collecting child support from non-custodial parents, borrowing from relatives, and being very frugal with utility usage. These non-market methods of providing parallel many of those documented by Edin and Lein (1997). All of these techniques require extra labor—which is obvious when talking with women. Given the very low incomes, lack of benefits associated with most jobs, and high job turnover, struggling to make ends meet drives such informal work much of the year. In effect, the lump sum format of the EIC creates an informal labor incentive for nearly all the year other than right when received.

Well Being

Recent expansions in the EIC have emphasized the credit as a mechanism for supporting the well being of American families. Our data shows two ways in which the credit increases family welfare. First, children almost universally benefit from the family’s extra income through receiving goods. Second, and not surprisingly, perceived well being increases when the combined refund and EIC check arrives. On both these issues, it is difficult to disentangle the income effect of the additional money with the delivery effect of receiving the money in a lump sum. Experimental evidence from the larger New Hope survey sheds some light on the quandary.

Two-thirds of the parents in our ethnographic sample who receive the EIC or a substantial tax refund cite expenditures on children as a priority use of check. Among the eight families who did not specifically mention buying items for children, four were using the check as a lump sum down payment on a house or car (two cases each). Clothes

are the most commonly cited child-specific purchase. The mother of a preschool-age child and a kindergarten-age child explains,

“ when my taxes come... then I'll take the kids shopping because my kids really need to go shopping, especially [my older son]. He has no clothes. He needs clothes... I can't send my son to school like this. I need to shopping for him really bad. Once I get the money, you know send in all the papers - my W2 thing, I [am] most definitely going shopping for my son. Go to Wal-Mart and Kmart and just stock up.”

Other child-specific uses of the credit are to pay private school tuition (three cases) and establishing savings accounts (two cases). People also take joy in being able to give their kids money to spend or take the family out for a special treat—some of the credit is used for “fun money” or to “fool with.” Entertainment equipment such as TVs, VCRs and videos are another popular purchase, 29 percent report such purchases.

Generally, people look forward to tax time as a time when they can get caught up on their bills and feel a little ahead for a while. Field notes describe the thoughts of one woman who is counting on a \$4000 combined refund and credit,

She can pay off all her [back] bills, be caught up with all her bills and not feel stressed... all she has to do us keep working until December. Then in January she can turn in her tax form so she can get that money.

In this woman's case, a strict rational optimizing view might still wonder if the lump sum payment is really the best option. The prevalence of the debt and lump sum combination is relevant to the policy question surrounding the lump sum versus advance EIC. Perhaps those bills might not have accumulated if she was getting the extra money from an advance every pay period. For families with debts, does it make sense to wait for the EIC lump sum? Economic theory says no. Periodic and earlier payment of the same amount should increase ability to pay bills on time, hence decreasing stress and increasing well being. Finance charges and other late charges might be avoided.

The experimental design of the New Hope intervention allows us to cleanly investigate this question with the survey data. Families eligible for the New Hope benefits who worked thirty or more hours per week could receive an earnings supplement. This supplement was designed in conjunction with Federal and Wisconsin EICs and bears some similarity to an advance EIC. The supplement was tied to earnings and increased in generosity for families with more children. The supplement was paid on a monthly basis. On average, eligible families received supplements totally about \$450 per year over their first two years in the program, about the same as the estimated amount of their Wisconsin state EIC. Survey questions tracking difficulties in paying utility and rent allow us to compare New Hope families with a matched set of control families who did not receive the periodic supplements. Table 4 reports this comparison on a number of questions measuring financial hardship. The New Hope wage supplements did not make a significant difference in the percent of families who went without phone service, failed to pay housing costs, lost utility service, or had to borrow money or forgo needed purchases. This comparison is not a perfect proxy for comparing what families would experience if randomly assigned to receive the full available amount of their EIC credit via advance payment or advance, but it does suggest that periodic small infusions of cash do not increase welfare in this respect at least.

Our conversations with parents often focused on the sheer pleasure of receiving relatively large infusions of cash which they had “saved” through the EIC and tax system. These checks provided an ability to catch up with family matters, take their children out, and have the shared experiences that so many working poor families have learned to

desire but so seldom can experience. These are described by parents as valuable kinds of well being for many of these parents and their children.

Asset-building

In addition to the welfare benefits of consumption cited above, the EIC credit, particularly as delivered in the lump sum dosage, has longer-term effects on family welfare. Specifically, the credit allows families to build assets, defined as wealth or stocks of cash, near-cash or goods that provide a stream of welfare or future insurance. Typically studied assets are financial—bank accounts, savings bonds—or large purchases such as homes or rental real estate. These are generally not the assets held by low-income families. However, the families in our study do have and seek to build asset stocks that provide long-term benefits.

We began our interviews in late spring of 1998. Most cases were recruited into the sample in the summer months, four to six months after the 1997 tax season. Often tax matters are not discussed until the second or third visit. However, when we got around to discussing tax refunds and EIC, many families could point to some item in their lives purchased after last tax time—furniture, a car, appliances or a house.

Furniture is the most common post-tax check purchase. Approximately half of our families have bought couches, tables, beds or mattresses with their EIC and refunds. Appliances are also another necessary asset. Inexpensive Milwaukee apartments generally rent without stoves, refrigerators, washers or dryers. The first two are crucial; the latter two are important time-savers for working families. Households have also used or plan to use part of a tax check for appliance purchase.

Transportation and shelter are the next two most common uses of the refund and credit check. Just less than one quarter of our sample have used or plan to use their credit on a car. This includes buying cars outright, making a substantial down payment or repairing current cars. One person's only planned use of her refund is personal transportation, "I said I don't care what I get back as long as it's enough to get me a car... get me a car that can take me around for a long, long time, at least a year or two." Eight members of our sample (19 percent) own a home, with three having explicitly said they used their tax refund/EIC for a down payment. Two more are currently house shopping, both planning to use their tax check as part of a down payment.

Most often, people combine several uses of the EIC. Field notes describe what a working mother of two used her large check on,

With last year's EITC, she bought a "reliable" car. She said that she could have gotten a car for less, but she wanted one she could depend on. She said that she has had it for six months and has only had to replace the water pump. She also put \$500 in both Eric and Lee's savings accounts. With the rest of her tax money, she bought herself and her children clothes, and used some just as fun money.

Buying these major ticket items is much more difficult in the absence of the lump sum. Savings accounts get whittled down easily, From field notes,

[She] had to take money out of the bank that she had been trying to save, "not to get things that I want, but to get things that I need. It's like uh! Sometimes you can't win for losing." She explained that she purposely opened a bank account far away so she wouldn't take her money out so often.

It will be interesting to see whether or not people execute their planned usage of the credit. Several members of the survey report having asset-building uses in mind for this year's credit but have either not received the credit in the past or used it for consumption, mostly paying bills.

Summary and Conclusion

We have traced the policy themes of supporting labor supply, increasing child and family well being, and building assets through how the low income working families in our sample view and use the EIC. Table 5 summarizes our findings. Delivered through the tax system, the EIC is closely linked with the tax refund check. Respondents range in their understanding of the credit, from those who likely get it but do not recognize the name to those who strategically plan to maximize their credit.

Families' understanding of the incentive rate structure of the credit generally does not mirror an economic analysis of the actual marginal tax rate. Many respondents see a "more work, more money" relationship between their work effort and their total combined EIC and refund check. It is unclear if or how these understandings affect labor supply throughout the year. With regards to the debate over advance versus lump sum payment, there are both formal market and informal household responses to budget shortfalls. People work more hours and economize more at home, the latter being a usually unmeasured labor response.

Children and families definitely benefit from the tax checks. Many respondents spend part of the check on their children and other parts on goods or services that benefit the whole family. Families report an increased sense of control and well being during the time when they receive the refund check. There are also no significant differences in financial strain measures throughout the entire year between the experimental group who received periodic work-based supplements and the control group that did not. There are also lasting signs of the lump sum checks. People use the check to build assets—buying furniture, other durable goods, cars, and even homes. These purchases seem to be linked

to the lump sum nature of the credit and create, from the point of view of the family, personal equity. This asset building is suggestive of Sherraden's Individual Development Account proposal. Although the conceptions and understanding of the EIC by families rarely matches the actual marginal incentive structure, parents we talked with grasp a larger meaning: the credit provides some fairness and breathing room in the typically harsh and difficult world of making financial ends meet for the working poor.

We are still collecting data and hope to expand our analysis to fully exploit the richness of the ethnographic methodology. Again, our sample is in transition with regards to the EIC. For one thing, the credit has expanded rapidly over the past decade—people who have maintained the same work patterns over several years are getting more and more in EIC each year. Also, with welfare reforms, more and more single women with children are working or working steadily for the first time—hence their experience with tax refunds and the credit is new. We may very well see changing attitudes toward the lump sum versus advance credit trade-off. It is also possible that after more experience of former welfare recipients being in the work force and receiving refunds including EIC, that understanding of the EIC will change. These are some issues that we will see play out as we follow our families over the next two years.

Table 5

Summary of policy findings: Lump sum versus advance delivery forms

Policy Goal	Relevant findings
Labor supply	<ul style="list-style-type: none"> • some formal labor supply response to cash short falls • informal/non-market (and traditionally un-measurable) labor response to cash short falls
Family well being	<ul style="list-style-type: none"> • monthly short falls during non-refund months • increased sense of control and well being associated with refund time • difficulty with traditional savings routes
Asset building	<ul style="list-style-type: none"> • treated as forced savings • lump sum enables purchase of durable items • creation of personal equity • some uses of EIC by parents parallel Individual Development Account (IDA) theory

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