

How Rural Working Families Use the Earned Income Tax Credit: A Mixed Methods Analysis

Sheila Mammen and Frances C. Lawrence

The Federal Earned Income Tax Credit (EITC) affords cash-strapped and credit-constrained working families the opportunity to increase their purchasing power and savings potential. Mixed methods were used on a sample of 237 rural working mothers who participated in a multi-state study. Approximately two thirds of those eligible claimed the EITC. They stated the tax credit was used to pay bills and loans, improve access to transportation, purchase various consumer durables and nondurables, establish savings and build assets, engage in leisure activities, and make human capital investments. Use of the EITC within the context of the Behavioral Life Cycle Theory, implications for financial practitioners, and suggestions for future research are discussed.

Key Words: earned income tax credit, low-income families, poverty, welfare reform

Introduction

The Federal Earned Income Tax Credit (EITC) is a refundable tax credit designed to supplement the wages of working low-income families. Enacted by Congress in 1975, it was intended to be a small, temporary program to provide an incentive to work and to offset the burden of Social Security taxes. After numerous expansions, the EITC has become the largest federal aid program targeted towards working poor families (National Low Income Housing Coalition, 2005). In 2005, over 21 million workers claimed more than \$39.5 billion in Earned Income Tax Credits, and the amount is expected to increase to \$42.2 billion in 2007 (Center on Budget and Policy Priorities, 2005). In addition to the federal EITC, 15 states and the District of Columbia offer a state EITC and a number of additional states are considering enacting an EITC in the 2006 legislative session (Community Resources Information, Inc., 2005; Levitis, 2006).

The EITC's benefits are significant: it increases families' purchasing power; it is a powerful incentive for single mothers to increase labor force hours (Meyer & Rosenbaum, 1998); it reduces income inequality by supplementing the wages of low-income families (Berube & Forman, 2001); it provides significant relief to

households burdened by housing costs (Stegman, Walter, & Quercia, 2003); and it is the single largest program that has decreased child poverty (Blank, 1999; Greenstein & Shapiro, 1998). In recent years, policymakers have encouraged asset building among low-income families (Edin, 1998; Smeeding, Phillips, & O'Connor, 2000), and the EITC, on its own or in conjunction with Individual Development Accounts, is considered a vehicle that families may use to save. The retail market potential of poor neighborhoods has increased with the concentrated EITC spending power (Berube & Forman, 2001); the net result of the ripple effect is that low-income families are further beneficiaries, directly and indirectly, through more jobs and greater accessibility to goods and services. A final benefit of the EITC, not to be overlooked, is the bipartisan political support the program has enjoyed, because it encourages employment (Cooper, 1995; Grogger, 2003).

High and persistent poverty are disproportionately found in rural areas, with remote rural areas experiencing the highest poverty (U. S. Department of Agriculture [USDA], 2005; Rural Poverty Research Center, 2004). Time limits imposed by recent welfare reform legislation require welfare-dependent individuals to seek employment. Working low-income rural families are entitled to the

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EITC and, as long as they remain in the labor force and have not reached their phase-out point, they continue to receive the tax credit.

Despite the EITC benefits and the high and persistent poverty found in rural areas, few studies exist on the behavior of rural families surrounding the tax credit. The purpose of this research is to explore rural working families' experiences with the EITC by answering three questions. First, do all eligible working rural families receive the EITC? Second, do rural low-income families understand the EITC? Third, how does the EITC affect the consumption patterns and asset behaviors of rural working families?

Background and Literature Review

The EITC provides many benefits to working families, and larger percentages of eligible families claim the tax credit than other more traditional assistance programs such as Temporary Assistance for Needy Families (TANF), Food Stamps, and Medicaid (Berube & Forman, 2001).

Participation rates differ significantly according to the number of qualifying children in the household. Those with one and two children have high participation rates, 93% and 96%, respectively. Larger families and childless households are less likely to claim the credit, 62% and 45%, respectively (Burman & Kobes, 2002). Other groups less likely to file include former welfare recipients, families with extremely low incomes, and those who have difficulties with the English language (Scholz, 1994). In general, many of those eligible for the EITC have a poor understanding of the program (The Urban Institute, 2001). This is particularly true of minority families, especially low-income Hispanic parents, who are less likely to know much about the tax credit or to report receiving it (Varcoe et al., 2003; Varcoe, Lees, & Lopez, 2004).

Families in large cities are the most likely to receive the EITC, followed closely by families in rural areas; those in smaller metro areas and large suburbs, in comparison, are less likely to receive the credit (Berube & Tiffany, 2004). Given the income differential and the prevalence of low-wage jobs in rural areas, rural families stand to gain significantly more from the credit, making it a major source of income support. In fact, after the expansion of the credit, the adjusted poverty rate among female-headed families in nonmetropolitan areas declined from 49% in 1992 to 35% in 1999 (Lichter & Jensen, 2002). Rural families in Southern states are even more likely to earn

lower incomes and receive less cash assistance than those in any other part of the nation. As a result, the share of these families receiving the tax credit is well above the national average (Economic Research Service/USDA, 1996).

To understand fully low-income families' behavior regarding the EITC, it is useful to examine their general behavior and attitude toward money. Previous studies (Edin, 1998; Oliver & Shapiro, 1995; Shapiro, 1998) have concluded that poor families' attitudes about savings are not unlike that of the rest of the population. When presented with appropriate incentives and opportunities to save, they are willing to make sacrifices by postponing present consumption to improve their long-run economic well-being. The typical low-income household requires more than 100% of its income to meet expenses and thus relies on borrowing and/or unreported earnings for the rest (Edin & Lein, 1997). Because mothers on welfare live day-to-day, struggling just to make ends meet, they are unable to save even though they are interested in building assets (Edin, 1998; The Urban Institute, 1999).

Lump Sum Payment Versus Advance Payment

Families who qualify for the EITC can choose between advance payments and a lump sum payment. To receive an advance credit, families must file the Earned Income Credit Advance Payment Certificate with their employer. The advance credit, included in each paycheck, must be reported on the families' year-end W-2 form; furthermore, these families are required to file a tax return. If families receive the credit as advance payments, it will increase household income flow and utility; however, more than 98% of the recipients receive a lump sum payment (McCubbin, 2000; Olson & Davis, 1994; Romich & Weisner, 2000; Scholz, 1994). Smeeding (2000) suggested some reasons for this behavior. Employers may be unwilling to participate in the program, employees may be reluctant to inform the employer because of stigma attached to it or fears of lower pre-tax wages, and employees may prefer the forced savings aspect of the lump sum payment. Some families may also be reluctant to select the advance payment option for fear of having to repay the IRS if their personal circumstances changed and they no longer qualify for the amount of tax credit received. Finally, the use of the credit to purchase consumer durables is yet another reason why families may prefer a lump sum payment (Barrow & McGranahan, 1999).

Behavioral Life Cycle Theory

Modigliani and Brumberg's (1954) life-cycle theory of saving and Friedman's (1957) permanent income hypothesis, although elegant in their structures, have not been completely successful in explaining household consumption patterns. Shefrin and Thaler's (1988) behavioral life-cycle (BLC) theory provides an effective framework to explain consumer behavior related to when and how the EITC will be spent. Shefrin and Thaler proposed the addition of three aspects of behavior into the life-cycle theory of saving: self-control, mental accounting, and framing. According to the BLC theory, self-control is costly and individuals will use a variety of means to postpone making a decision or having to exert self-control; hence, they would prefer receiving EITC as a lump sum rather than as an advance, particularly because the lumpy nature of the credit supports the purchase of large consumer goods. Mental accounting occurs when consumers separate funds into "income" and "wealth," considered less tempting to spend; hence, a lump sum will be seen as different from advance payment in the form of additional income received in a paycheck. Finally, consumers "frame" a lump sum bonus differently from regular income even though the bonus is anticipated; hence, the marginal propensity to save from a lump sum (wealth) is greater.

EITC Usage

The literature review on families' use of the EITC indicated many ways of categorizing the program's use. Smeeding et al. (2000) used two categories in a Chicago study: (a) expenses for making ends meet, that included payment of regular bills, clothing, household appliances, furniture, and personal or regular household expenses, and (b) chances for improved mobility, that included payment of credit card, automobile or personal debts, human capital, moving expenses, home improvements, and sharing money with family members.

Between 75% and 80% of the urban families in the Chicago study used the refund to pay a bill, the single highest priority for almost half of them, or make consumer purchases, the second highest priority (Smeeding et al., 2000). At the same time, about half of the families reported that they saved some or all of their refund for uses such as paying bills, purchasing consumer durables, and making educational investments in themselves or their children. A major finding of the Chicago study was that the EITC also played an important role in improving the

social mobility of its recipients, defined by the authors as purchasing or repairing a car, paying for education, and moving. In another study, 21% of the respondents who used the EITC for savings indicated that their first priority was to establish precautionary savings (Beverly, Tescher, & Marzahl, 2000).

Using Consumer Survey Expenditure data, Barrow and McGranahan (1999) found evidence of expenditure seasonality for families who receive the EITC. These families tended to spend more on all expenditures, including big-ticket consumer durables, in February, the modal month of the EITC payments. Expenditures during the spring and summer, when the non-EITC households generally take vacations or purchase automobiles, declined among the EITC recipients. This is likely because after the EITC recipients spend all or most of their tax credit, they rely on their regular income that is typically small; therefore, their consequent purchasing power is usually low.

The results of an ethnographic study of 42 working Wisconsin families were consistent with Shefrin and Thaler's (1988) BLC theory of a lower propensity toward current consumption with lump sum payments (Romich & Weisner, 2000). These families used the lump sum EITC payments and tax refunds to purchase large-ticket consumer goods, accumulate assets, and create savings. Expenditure on children was a priority item, followed by purchase of furniture and a variety of other consumer durables, as well as making improvements in their transportation and housing situations.

Methods

This research is part of the USDA-funded multi-state longitudinal project, NC-223/NC-1011, "Rural Low-Income Families: Tracking Their Well-Being and Functioning in the Context of Welfare Reform." See <http://www.ruralfamilies.umn.edu> for a complete project description.

Wave 2 data collected from August 2000 to May 2001 were used. The sample consisted of 299 rural low-income families from 23 counties in 13 states. The states represented all regions of the country and included California, Indiana, Kentucky, Louisiana, Massachusetts, Maryland, Michigan, Minnesota, Nebraska, New Hampshire, New York, Ohio, and Oregon. To be eligible for the study, families had to have annual incomes at or

below 200% of the federal poverty line and at least one child under the age of 13. Within each county, families were selected purposely to represent the diversity in the types of families with children who were considered low-income. Participants were recruited through programs that serve low-income families such as the Food Stamp Program, Supplemental Program for Women, Infants, and Children (WIC), food pantries, survival centers, and welfare-to-work programs. This method of selection resulted in a sample of convenience and, thus, the findings cannot be generalized to the entire rural population. Nevertheless, because the participants were recruited broadly from various agencies and represent states in all four regions, the findings provide an extremely useful account of how rural working families view and use the EITC.

Trained interviewers collected in-depth qualitative and quantitative data from the mother, during face-to-face interviews at a site of the respondent's choice. The semi-structured protocol included questions on a variety of areas, e.g. socio-demographics, employment, and objective and subjective measures of income. All family interview data were coded by one university team using agreed upon themes, rules, principles, and factors. Qualitative interview data with mothers were transcribed verbatim and coded for thematic content using the principles of grounded theory (Glaser & Strauss, 1967) and qualitative analysis techniques (Berg, 1997; Kvale, 1996).

Respondents were asked if they received the EITC and, if so, how much. In addition, respondents were asked how the tax credit was used, although not the exact amount spent on each item they purchased. It must be noted that respondents' tax returns were not checked and therefore, it was not certain that they received the EITC. However, from the size of the reported refunds, it appeared that benefits were received. It was also possible that the mothers did not distinguish between the EITC and regular tax refunds and, therefore, the figures used in this study may reflect the combined amounts for the EITC and tax refund. This was not unlike the situation faced by Romich and Weisner (2000). Recognizing the limitations, a strength of the study is that it uses a mixed-methods approach and provides unique insights into the lives of low-income rural families. Furthermore, given the dearth of studies in this area, it adds tremendously to the understanding of the behavior of rural families regarding the EITC.

Of the 13 states that participated in this study, 6 (Indiana, Maryland, Massachusetts, Minnesota, New York, and Oregon) provided a state EITC in addition to the federal tax credit. The other 7 (California, Kentucky, Louisiana, Michigan, Nebraska, New Hampshire, and Ohio) did not.

Sample Description

Of the 299 mothers who participated in the study, 237 qualified for the EITC, because either they or their spouse were in the labor force in the preceding year. Table 1 presents the socio-demographic information of the mothers who qualified for the tax credit. Over two thirds (71%) of them were between the ages of 25 and 45; the median age was 27 years. Approximately two thirds (63%) of the families were White-non-Hispanic, one quarter (25%) were Hispanic, and 6% were African-American. About two thirds (68%) of the mothers were married or living with a partner, and 14% were divorced or separated; the rest (18%) were single. Twenty-nine percent of the rural mothers had one child, another 29% had two children, and 42% had three or more children. The modal level of education was more than high school. Slightly more than two thirds (69%) of the mothers were employed; 95% of spouses or partners were employed. Median monthly income of the rural families who qualified for the EITC was \$1,476.

Results

Do All Eligible Rural Families Receive the EITC?

Although 237 families were entitled to the EITC, only 62% (147 families) claimed the tax credit. Table 1 also provides a comparison of socio-demographic characteristics between those who were eligible for the EITC and those who ultimately claimed it. Rural working mothers who claimed the tax credit were slightly older (median age, 29 years), more likely to be White non-Hispanic (71%), more likely to be high school graduates (67%), more likely to have one or two children (62%), and had a lower monthly median income (\$1,310). A closer look at the nonfiling rural respondents revealed that they shared most of the same characteristics of nonfilers reported in previous studies (Scholz, 1994; The Urban Institute, 2001; Varcoe et al., 2003), i.e. more likely to be minorities burdened by language and cultural barriers, to have more children, and to have very low income.

The qualitative data were analyzed to determine the reasons for not receiving EITC. Two themes prevailed: not being aware of the tax credit and failing to file. An Oregon

Table 1. Socio-Demographic Characteristics of Eligible Rural Mothers

Characteristic	EITC eligible (n = 237) %	EITC eligible, filing (n = 147) %
Age		
Under 25	27.4	30.1
25 - 45	70.8	68.5
Over 46	1.8	1.4
<i>Median age</i>	<i>27.0</i>	<i>29.0</i>
Ethnicity		
White, non-Hispanic	62.6	70.5
Hispanic	25.1	14.4
African-American	6.4	8.2
Other	5.9	6.9
Marital status		
Married/living with partner	68.2	58.5
Divorced/separated	13.9	19.0
Single	17.8	22.5
Education		
More than high school	44.7	30.6
High school	28.9	36.1
Less than high school	26.4	33.3
Number of children		
One	29.2	31.3
Two	28.8	30.6
Three or more	42.0	38.1
Mother's working status^a		
Working	68.6	61.9
Nonworking	31.4	38.1
Spouse/partner's working status		
Working	95.0	85.0
Nonworking	5.0	15.0
Monthly income of employed families		
< \$1,000	26.8	32.9
\$1,000 - \$1,499	19.6	25.2
\$1,500 - \$1,999	21.2	21.7
\$2,000 - \$2,500	18.5	10.5
> \$2,500	13.9	9.8
<i>Median income</i>	<i>\$1,476.00</i>	<i>\$1,310.00</i>

^aEligibility for EITC is based on the working status of either the mother or the spouse.

mother admitted not filing taxes for two years; no reasons were given. Similarly, a mother from Massachusetts confessed, "I haven't filed taxes in years. I need help with that."

Understanding of the EITC among Rural Working Mothers

There were a variety of reactions from the mothers regarding the EITC. Some recognized it immediately, some required prompting, and some could not distinguish between it and their regular tax refund. Although there were mothers who remembered the exact amount they received, others could provide only an estimate. Some were off by thousands of dollars, as in the case of one New York mother who, at the face-to-face interview, said she received \$6,000. Later, during a follow-up phone call to verify the amount, she corrected it to \$1,800 from tax refund and \$1,000 from the EITC.

Some of the mothers were not sure if they qualified for the tax credit or if they received it. Some were generally confused, such as these mothers from California, Louisiana, and New York:

Um, earned income credit, it's some, they do for... each, for the taxes. I don't know, because I didn't do my taxes, my bookkeeper took care of that.

Um, No ma'am. No I don't, I had W-2 forms but I didn't file because I was told you know, I wasn't going to have, you know a income back. And so I didn't uh, worry about it.

No, I don't think we got that [EITC] because we didn't make quite enough or somethin'. I don't know how that worked. I don't think we did though.

Regardless of the level of understanding of the EITC among these rural mothers, it was reasonable to assume that the EITC was received if three conditions were met: (a) either the mother or her spouse worked the preceding year, (b) taxes were filed, and (c) a refund was received.

Lump Sum Payment Versus Advance Payment

Although the respondents were not directly asked if the EITC was received as a lump sum and/or an advance payment, it is evident that the overwhelming number of these rural families received it as a lump sum. This is consistent with the findings of others (McCubbin, 2000; Olson & Davis, 1994; Romich & Weisner, 2000; Scholz,

1994). A New York mother, the only one who received it as advance payment, said:

R: Yeah. It's put right into my check and I think that's like \$32.00 a paycheck. Biweekly.

I: So that's biweekly. And, so what do you do with the money?

R: Oh, I usually use it for extra groceries, or [chuckles] stuff like that.

The advance payment helped this mother get by. On the negative side, one gets the impression that because it was a modest amount compared to a lump sum payment, she spent it immediately and had no large purchase or savings to show for it. This was in contrast to the 119 other rural mothers who appeared to have received their payment as a lump sum and, perhaps consequently, were able to purchase big-ticket items and, in some cases, even save a portion.^a

Rural Families' Usage of the EITC

Mothers were asked how they used the EITC payment. Table 2 presents the seven categories that were identified: (a) pay bills and loans, (b) improve access to transportation, (c) purchase consumer nondurables, (d) establish savings and build assets, (e) purchase consumer durables, (f) enjoy the benefits of windfall income, and (g) increase human capital. Respondents could have purchased items in any number of expenditure categories. They were not asked how much they spent on each item or in each category.

Pay bills and loans. Bill paying is a regular activity for most families, regardless of their financial status. For low-income families, however, this often poses a substantial burden, because they have to stretch their limited income simply to get by. As a result, sometimes their bills accumulate. An infusion of cash from the EITC is, therefore, extremely helpful in meeting their financial obligations. As was the case with urban families, the most commonly cited usage of the EITC by these rural families was to pay bills; almost 44% of the sample indicated that they used all or part of their tax credit to pay a variety of bills including utilities, cable, and credit cards. It was clear that paying bills, current and past due, was a priority for rural families such as this New Hampshire mother:

Yup, paid bills. Bought a little bit of extra food for the house. Uhm... I had thought about getting a car, but,

at the time, I found the bills and stuff were more important to pay.

The following exchange between an interviewer and a rural respondent from Indiana highlights the important contribution of the EITC in making ends meet:

R: We used it to take and catch up bills that we was behind on from just basically getting behind every month.

I: Bills such as?

R: Just hospital bills, um current bills like utility bills that we was behind on. And you know just basically catching up different you know type of bills, loans, that we was behind on.

I: Uhum. OK. What kinds of loans?

R: Like small security loans. Personal loans.

Interestingly, 3% used the refund to pay some of their bills ahead of time, like this mother from Oregon who underscores its importance to her family, in spite of having had to pay a tax preparer:

I think it ended up costing us \$130 total to get, like I said it was a total of like \$1,300 back, but we had like, \$1,180 of that back the very next day... Yeah, that was really nice. And we paid \$1,000 in rent, cause that was when we both lost our jobs, so we wanted to make sure rent was ok, so we went ahead and paid ahead; that was nice.

Table 2. EITC Usage of Rural Families, N = 147

Categories	n	%
Pay bills and loans	65	44.2
Improve access to transportation	35	23.8
Purchase consumer nondurables	30	20.4
Establish savings and build assets	27	18.4
Purchase consumer durables	16	10.9
Enjoy benefits of windfall income	16	10.9
Increase human capital	5	3.4

Note. Families could have used the tax credit to purchase items in more than one expenditure category.

Paying bills such as electric, water, telephone, or insurance ahead of time may provide families peace of mind and ease their anxieties about not having the necessary funds when their bills are due. One Minnesota mother remarked:

I try to get my monthly stuff down, 'cause it's so tight from month to month. So, anything I can pay a year's worth at a time I do in February.

The reference to February reflects the observation that it is the modal month for EITC payments (Barrow & McGranahan, 1999).

One way that low-income families meet their living expenses is by borrowing, often from other family members (Edin & Lein, 1997). The rural families in this study revealed similar behavior. Usually the only way they were able to repay these loans was when they received an influx of cash such as the tax credit. As a result, in addition to paying off bills with their EITC refund, several families used it to pay back loans extended to them. This was the case with this Indiana mother:

Um, I paid off all the stuff that I borrowed for school. I paid, I fixed my car, actually, this year, is what I did. This last year. 'Cause I borrowed some money from my dad to fix it while it wasn't working and then... I got my check and he said, "Aha!"

One Minnesota mother borrowed money to purchase a house, which may be viewed as an opportunity for improved mobility:

Um, let's see what else did I do? I know I put I paid five hundred back to my brother-in-law who gave me ten thousand you know, to buy this house.

Increasing access to transportation. Reliable transportation is essential for low-income adults to seek and maintain employment as well as for job mobility. The importance of cars to low-income families has been established by Danziger et al. (2000) and Edin (1998). Lack of reliable transportation, however, is a serious problem for many. This is particularly true for families who live in rural areas and, if they lack a reliable vehicle, cannot depend on public transportation because it is often not available. Hence, this becomes a significant threat to their well-being, especially because any trip such as one to a job, a doctor, or a grocery store is difficult. The EITC,

therefore, can be an important source of funding for families when it comes to a vehicle, whether it is used for purchase or repair, to make a down payment, to pay a loan, or for insurance.

About one fifth (21%) of the rural families spent their EITC refund on various transportation-related expenses. The largest percentage (40%) used part of their EITC funds to purchase a car, van, or truck.^b One Indiana mother reported the purchase of two trucks in addition to a car:

Let's see. My husband bought one car to play with... two trucks because one was not quite right when he got it, so he got another one and have some mechanical work done to it so we can get back and forth to work and I can start up my van.

About one third (37%) of the rural families used their tax refunds for repairs on a car, van, or truck. A mother from Kentucky elaborated on what would be done to their truck using their tax refund:

But we're goin' to paint the truck with it this year. Because the truck we bought, it's not brand new. It's a '94 model. The rocker panels on the bed have got to be fixed, they're rustin'. But we're gonna paint it and put that fiberglass in there.

Eleven percent used their refunds for a down payment on a car or van; 11% bought new tires or license plates. Nine percent made car insurance payments with their refunds, and 6% were able to pay off their car loans.

Purchase consumer nondurables. The infusion of cash from the EITC provides working families the opportunity to take care of immediate or urgent consumption needs. This was true for 19% of the sample that spent part of their EITC on child-specific expenditures, such as clothes, toys, and school supplies, clothes for adults, extra food, and other unspecified small items. The demand for children's clothing was extraordinarily high in this category with 81% using their refund checks for this. One Minnesota mother remarked:

Clothing. Oh my goodness did I spend money on clothing. Spent like six hundred bucks on clothing just for my daughter. Then she outgrew it all already. It's like man I can't win for nothing.

Clearly, the EITC is helpful to parents whose growing children require that they buy several clothing items at one time. Regardless of what consumer nondurables they buy, it is clear that the EITC is extremely beneficial to rural families, because it increases their purchasing power. This was evident in the case of this Indiana mother:

We buy the clothes and things they need that we cannot buy during you know... I usually go out and get them something expensive, something new.

Establish savings and build assets. Saving or putting money aside for future needs is a worthy goal for all consumers. Low-income families, in particular, need an emergency cushion because if faced with an unexpected expense or sudden loss of income, they may not be able to approach a financial institution. And, with no other alternative, the results of going into debt could be especially disastrous for them.

The EITC payments provide a significant source of savings, because it enables working rural families to save for emergency spending as well as for asset accumulation. For the purposes of the current study, building assets include buying or maintaining a home, fixing a home, paying property taxes, and owning a business. Sixteen percent of the rural sample used part or all of their EITC payment for savings or to accumulate assets. Of these, 70% of them put money aside for savings, much like this mother from Indiana:

Rather than last year using my tax return for the roof, I have not used my tax returns in the last three years.

The value of EITC to rural families also lies in its ability to allow them to get by or, as described by one Minnesota mother, “to keep afloat.” This was clearly evident in the comments of two other mothers, the first from Minnesota and the second from Oregon:

I lived off of it. I was out of work for a month and a half so lived off (and that’s how I paid all the bills).

... So on earned income I’ve had like \$3,700 back that year. Which was nice ‘cause then I had Micah and we lived off of that for, shoot it probably started and was gone when I had, started, had to go back to work. About 8 months. I did the right thing with it...

About one fifth (21%) of the rural sample were homeowners; 30% of those who put their money aside in savings, ultimately, used it for a variety of house-related expenses including fixing the roof, building a brick fence, carpeting and tiling, paying for house insurance and property taxes, and making a down payment on a house. A typical response was like this from a mother living in New York:

I used it for my wedding, and I paid \$1,600 on his house and property so he didn’t lose it.

Previous studies have shown that the poor, like the rest of the population, would like to save and accumulate assets if they could (Edin, 1998; Oliver & Shapiro, 1995; Shapiro, 1998; Smeeding, 2000). For many of them, however, postponing current consumption for future expenditures is impossible. Because money is tight and their needs are great, in the final analysis, these rural families simply do not have the extra funds to save. Nevertheless, they are aware of the benefits of saving. Here is an apologetic mother from Massachusetts who received \$2,000 from the EITC:

What did I do with that? I paid off my credit card. I paid \$1,400 to my credit card. I think I took care of a lot of odds and ends things. I needed a new rug, so I bought the new rug. I bought a VCR that I needed in here. Then I think I spent the rest of it. I might have done something constructive, but most of the time I plan all my money right to the end.

Purchase consumer durables. Because of limited income and little or no access to credit, low-income families find it more difficult to acquire big-ticket items such as consumer durables. The lumpy nature of the EITC refund checks can help these families to afford these items. In the case of our sample of the EITC-filing rural families, the median monthly income was \$1,310 and the average refund was \$2,294. Thus, the refund represented a substantial amount of additional income for these families; as a result, 10% of them chose to purchase a variety of durable goods with their tax refund. The durable goods that were purchased included furniture, such as entertainment centers, bedroom sets, living room furniture, and kitchen tables; household appliances including refrigerators, washing machines, and dryers; and entertainment equipment, such as DVD players and televisions. Of these, the most common purchase was furniture, especially beds for the children.

A smaller percentage of these rural families used their tax credits for consumer durables compared to previous studies of urban families, 10% and 60% respectively (Romich & Weisner, 2000). Nevertheless, the enormous benefit of the tax refund on rural families who wish to buy big-ticket items should not be ignored. This was demonstrated by a respondent from Oregon who reported that she purchased a “washing machine, espresso maker, kitchen table, couch, bedroom set, DVD player.” Often, the durables were purchased along with various other items, as was the case with this Indiana mother:

Um well we... I got new tires on the car. We got the boys bunk beds. I got new carpet. We went to the grocery store. We all went and got some new clothes.

Benefits of windfall income. Even though the EITC was anticipated by many of these rural families, when it arrived (for most of them, after a year of waiting), it likely felt as if they had received a windfall. With very little discretionary income to spend otherwise, the EITC allowed them the opportunity to enjoy some pleasures of life. In this way, low-income families had the same aspirations as middle and high-income American families who like to take a vacation, treat their children to something special, or do something fun. It could be argued that their ability to engage in these activities actually promotes good mental health and provides low-income families an incentive to remain in the labor force.

Among our rural sample, 10% spent part of their EITC refund as windfall income, the overwhelming majority (87%) of whom spent it on a vacation. The families visited family and friends across the country; they vacationed in North Carolina, New York City, Washington D.C., Los Angeles, the Bahamas, and Jamaica. In addition, they went to the beach and went skiing in Idaho. For the most part, the families were frugal in their vacation spending, often having to split costs with various family members. In the case of one rural Minnesota mother, she could only afford to take her children, for one night, to a Holiday Inn 15 miles away:

Whirlpool. We usually order in a pizza. You know, but it is something to look forward to once a year.

These working rural families did not want their children to feel disadvantaged. That was clear from the comments of this mother from Maryland:

Gave the kids nice birthday party, 'cause they never had a birthday party. They could invite all their friends in their class, so we took them to a local Burger King and had a big old party.

The families used part of their EITC refund for “fun,” spending only after meeting their financial obligations, such as paying bills. One Minnesota mother who shared the following details of her vacation illustrates this:

Um, I used a lot of the money. I'm sorry, I used up \$4,000 of it to pay bills, try and get a little bit ahead, and then we all splurged on Valentine's Day weekend, or something like that, and went to the hotel over by the mall, went shopping, went out to fancy, fancy restaurants where it cost \$80 for the two of us to eat. Um, went swimming... totally splurged. And I think we spent about a thousand dollars.... and then the kids-well, me and Monty went the first night by ourselves, and then the kids came the second night so they could go swimming.

Increase human capital. Investing in human capital is a wise use of resources for poor families. For adults, it could help pay for tuition at a college or technical school, because this may lead to better and higher-paying jobs. For children, the benefits of a human capital investment may include better performance in school. Of the seven expenditure categories, however, the EITC was the least often used for human capital investment; only 3% or five rural families made such an investment.

Of those who invested in human capital, 40% or two families used the tax credit to pay off their student loans; 60% or three families bought a computer. Using their EITC payments from two years, one Massachusetts family managed to purchase three computers:

R: ... Margo got her computer because the year before, my husband and Chase both got...

I: So you've got three brand new computers in the house?

R: Theirs is a year old. Hers is brand new.

This finding is at slight odds with the urban families in the Chicago study (Smeeding, 2000), where 16% of them indicated that they would use the EITC to pay tuition. A possible explanation is that in rural areas, there are fewer colleges and schools. Furthermore, there are fewer jobs,

and they pay less; therefore, these rural residents may have chosen to use their tax refund in more profitable ways.

Rural Families' Use of EITC and the Behavioral Life Cycle Theory

Rural families used the EITC to accumulate assets and savings, even if only for the short term, and to make large purchases including vehicles, furniture, and computers. According to Shefrin and Thaler's (1988) BLC theory, households tend to separate money into mental accounts, thus providing them greater self-control over what they consider wealth. Rural families' use of the EITC was consistent with the BLC theory; it suggested individuals are more likely to use current income (paycheck income) for current consumption, whereas wealth (lump sum EITC) will be put into savings or used for larger consumer goods. This was clearly illustrated by a rural mother from Minnesota:

... I would rather – with earned income credit, that's a 50% increase, almost, over my wages, if I got \$12,000 a year. So, I'm thinking I really need to control how I spend my money, so that I can keep living at \$12,000 a year, and afford that... And keep getting that extra bonus of the earned income credit...

It was obvious that this mother kept her income and the tax credit in separate mental accounts, framing her lump sum bonus differently from regular income. She used her paycheck income for daily living while saving her EITC refund until:

I decided to pay [property] taxes and insurance out of the earned income tax credit to keep my monthly (payments) as low as possible.

Besides the purchase of large items, the rural families used their EITC in other ways as well. They paid bills, both current and past due, and, in the case of a few families, even paid their rent several months ahead. In addition, they used the refund to purchase consumer nondurables, particularly children's clothing. Finally, they treated their refund as windfall income, using it for a vacation. Expenditures of this nature are not entirely incongruent with the BLC theory. Most low-income families cannot get ahead or simply make ends meet with their regular paycheck income. As a result, some of them will allow bills to accumulate even under threat of financial ruin, put off buying clothing, and never contemplate a vacation.

Therefore, it is conceivable that rural families would consider the infusion of cash from the lump sum EITC "wealth" to the extent it enables them to meet their overdue financial obligations and affords them more essentials and even some luxuries. Such was the case with this Indiana mother, who waited all year for her refund:

With our tax refund, we pay off any bills that we have fallen behind on... Um uh we buy new clothes such as, buy you know, try to buy things that we have not been able to afford for a while.

Conclusions and Implications

During the normal course of the year, the regular paycheck income of low-income rural families does not stretch to cover their day-to-day expenses or to enable them to save and make large consumer purchases. The EITC affords these otherwise cash-strapped and credit-constrained rural families an opportunity to increase their purchasing power and their savings potential. This was the case for about two thirds (62%) of working rural families who claimed the EITC. Similar to Smeeding et al.'s (2000) urban study, the current rural sample used their tax credit predominately to pay bills and loans. In addition, as in Romich and Weiser's (2000) study, it was used to improve access to transportation, purchase a variety of consumer durables and nondurables, establish savings and build assets, engage in leisure activities and, to a very limited degree, make human capital investments.

Many financial practitioners are and should continue to be involved in implementing the solutions to a variety of concerns associated with the EITC. First, not all eligible working rural families claimed the tax credit. In the current sample, approximately one third (38%) of the rural working families did not file for the EITC. In addition, similar to previous studies (The Urban Institute, 2001; Varcoe et al., 2004; 2003), there was confusion and a lack of understanding even among those who received it. Financial practitioners are in an excellent position to engage in the outreach campaign encouraged by the Center on Budget and Policy Priorities (2005). Financial practitioners likely have the knowledge and ability to explain the basics about who is eligible for the EITC and can help working individuals and families claim these credits.

Second, only one rural family in the current sample reported receiving the advance credit. Previous studies

(McCubbin, 2000; Olson & Davis, 1994; Romich & Weisner, 2000; Scholz, 1994) also reported few recipients received a lump sum payment. The findings may point to one of two possibilities: either the rest of the rural families prefer a lump sum or many of them are not aware that they have a choice. The advance credit option increases monthly cash flow and, as a result, could assist many families struggling with limited income. This option, however, may be a distinct drawback for those families who, unable to exert self-control, may not be able to save and/or make large purchases. Regardless of the option families eventually select, financial practitioners can present both options and their implications in order that their clients have information to make an informed choice.

Third, a few families reported that they used the services of a commercial tax preparer. The fee for the service is a burdensome expense for low-income families. A few of the rural families chose the Rapid Refund method even though it reduced the size of their refund. Although not all commercial tax services are predatory, it may not be in their best interest to advise the families to wait for their refunds. From a policy point of view, the government should expand the availability of free or very low-cost tax assistance through the IRS Volunteer Income Tax Assistance (VITA) program or through other local programs (Berube, Kim, Forman, & Burns, 2002). Again, financial practitioners can direct rural families to these places where they can have their tax returns completed and filed for free.

It is clear from the results of the current study that the EITC benefits these rural families in a variety of important ways, especially in helping to pay bills. Future research should address the impact of the EITC on the economic well-being and, ultimately, the quality of life of rural families. In addition, it would be useful to further analyze the differences between those rural families who file and those who, though eligible, do not file. The ripple effect of the tax refund on rural communities should also be measured to gain a clear picture of the larger impact of the Earned Income Tax Credit.

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Endnotes

- ^a A total of 147 families filed. Of these, it was clear that 1 received it as an advance payment and 119 received the refund as a lump sum. Although we feel certain that the remaining 26 also received it in a lump sum, they did not provide this information directly.
- ^b It was not clear if these respondents made an outright purchase of the vehicle or if only a down payment was made.

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