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# The Impact of the Earned Income Tax Credit on Economic Well-being: A Comparison across Household Types

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**The Impact of the Earned Income Tax Credit on Economic Well-being:  
A Comparison across Household Types<sup>†</sup>**

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**Abstract**

Using survey data from Earned Income Tax Credit (EITC) recipients in Madison County, New York, we evaluate the effectiveness of the EITC in improving the economic well-being of low-income households. In particular, we examine the impact of the EITC across household types. For tax years 2002 through 2004, we find that the EITC is responsible for significantly lowering the poverty rate of the sample, from 57 to 49 percent. The EITC has the largest impact on single parent households, lowering their poverty rate by 11.2 percentage points. However, the EITC has negligible effects on the poorest households in the sample – childless singles. A majority (64 percent) of EITC recipients intends to use at least some of the refund on basic needs and almost half plan on using part of their refund for debt repayment. This suggests that the EITC helps the majority of recipients get by but not necessarily move toward economic independence. Somewhat surprisingly, single parent households in the sample are not that different from married parent households in terms of EITC amounts, poverty rates, use of credit, and participation in government programs, despite earning less.

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## 1. Introduction

This paper examines the effectiveness of the Earned Income Tax Credit (EITC) in fighting poverty and improving economic status across household types in a rural county in upstate New York. Building on the work of Smeeding, Phillips and O'Connor (2000), we also examine the intended uses of tax refunds by household type. The EITC has become the federal government's largest cash-assistance program for low-income families, making it the centerpiece of anti-poverty programs in the U.S. As a wage subsidy for low-income workers, the EITC has been successful in both helping the working poor and encouraging work. As a result, the EITC has enjoyed broad bipartisan support, leading to its expansion over time. Eighteen states and the District of Columbia have implemented state earned income credits<sup>1</sup>. Low-income households in New York, for example, are eligible for an additional 30 percent in EITC. These tax credits are nontrivial; for households with two or more children earning between \$11,000 and \$14,370 in tax year 2005, the maximum federal credit was \$4400 and the maximum New York state credit was \$1320. Approximately 15 percent of households nationwide qualify for the EITC, based on estimates from Hoffman and Seidman (2003). However, approximately one-quarter of households who are eligible for the EITC do not claim it<sup>2</sup>.

The data used in this study are collected through the Madison County Volunteer Income Tax Assistance (VITA) program for tax years 2002, 2003, and 2004. The Internal Revenue Service sponsors the VITA program nationwide by training volunteers to prepare tax returns at no charge for low-income workers<sup>3</sup>. The Madison County VITA program, launched in 2002, is a partnership between the Internal Revenue Service, Colgate University, the Madison County Department of Social Services, and the Community Action Program for Madison County. Using

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<sup>1</sup> Nagle and Johnson (2006).

<sup>2</sup> U.S. General Accounting Office (2001).

<sup>3</sup> Go to [www.irs.gov](http://www.irs.gov) to find more details on the VITA program. The IRS is not involved with the data collection.

trained student volunteers from Colgate University, taxes are electronically filed between January and April for low-income residents at three different sites. It has resulted in over \$1 million refunded to households in Madison County over the three-year period, with approximately 60 percent of that amount coming from federal and state EITC. The average income in our sample is \$13,564 and the poverty rate is an astounding 57 percent; these figures compare to an average income of \$40,089 in Madison County in 2003 and a county poverty rate of approximately 10 percent. The average EITC recipient in our sample receives \$2,108, or 15.5 percent of their income, in federal and state EITC. Thus, our sample consists of relatively poor households who heavily rely on the EITC.

Given the richness of the dataset, we are able to examine the effectiveness of the EITC, and, in particular, its impact on different household types (single parents, married parents and singles and married couples without children). First, we explore the effect of the EITC on poverty rates in Madison County. We find that the EITC reduces the poverty rate of our sample by eight percentage points, from 57 to 49 percent, with the largest effects being documented in households with children. Next, we evaluate how households plan to spend their EITC; do they use it to meet basic needs, repay debt or purchase durable goods? Almost two-thirds of Madison County EITC recipients intend to use at least part of their refunds to meet basic needs, while half plan on repaying debts. However, a significant proportion (18 percent) plan on purchasing a car with their refund, particularly interesting in a rural county where public transportation is minimal.

We also analyze the relationship between the EITC and households' use of credit (defined as having a credit card or some type of loan). While use of credit is positively correlated with income, single parent households' use of credit is similar to that of married

households with children, despite earning less income. Finally, we examine the relationship between the EITC and other government assistance programs. Our results indicate that the EITC is a complement to, not a substitute for, other government programs targeted at low-income families.

Our work complements the literature on the EITC. While much of the published work on the EITC examines its impact on labor supply decisions (see Browning (1995), Ellwood (2000), Cancian and Levinson (2005) and Eissa and Williamson-Hoynes (2004)), there are a few studies that examine the impact of the EITC on economic well-being. Hotz and Scholz (2000) find that, compared to other poverty-reduction programs, the EITC is effective in raising the standard of living for low-income households, while keeping administrative costs relatively low. Neumark and Wascher (2001) find evidence that the combined federal and state EITC helps families rise above the poverty line and Grogger (2004) shows that the EITC is partly responsible for the rapid decline in the welfare caseload in the 1990s. Finally, Smeeding, Phillips, and O'Connor (2000) analyze the uses of EITC refunds on a sample of Chicago area households with children. They found that almost 70 percent of respondents planned to use the refund for economic or social mobility. However, 83 percent had a priority use of the EITC to pay bills and 74 percent to make commodity purchases, most commonly food and clothing. In addition to confirming many of these findings, our analysis extends the literature on the impact of the EITC on economic well-being by examining its impact across household types. Does the EITC similarly impact single parent households, married parent households and childless households?

This paper is organized as follows. Section 2 provides an overview of the EITC. Section 3 provides details on the dataset used in the analysis and briefly describes Madison County. Section 4 presents the relevant summary statistics, while Section 5 compares refund size, poverty

rates, uses of refunds, and participation in government assistance across different household types. We conclude in Section 6 by discussing the various policy implications that emerge from our analysis.

## **2. Overview of the EITC**

Starting from a small credit embedded in the tax code, the EITC has grown to one of America's most important benefits for low-income families. The EITC was initiated as a modest program as part of the Tax Reduction Act of 1975. The program was unique among tax credits as it was refundable so that poor families could utilize its benefits even if they owed little or no taxes. Unlike welfare programs such as Aid to Families with Dependent Children (AFDC), single parents as well as married couples were eligible for the program. The EITC went through minor changes in subsequent years, the most important being when it became a permanent provision of the Internal Revenue Code in 1978.

The Tax Reform Act of 1986 indexed the EITC to inflation and liberalized the EITC, helping to remove over six million Americans from poverty (Ventry, 2000). The largest expansion of the EITC occurred in 1990, when the credit amount was almost doubled. In 1993, the EITC was increased by an additional 25 percent. Both the size of the credit and the eligible population has grown over time, and was fueled by the passage of the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) of 1996, which replaced AFDC with Temporary Assistance for Needy Families (TANF). In 2004, the EITC was claimed by 16 million families, who received almost \$35 billion in benefits. Families with household income between \$10,000 and \$20,000 receive credits averaging 25 percent of their income, the equivalent of a two dollar an hour wage increase (McIntyre, 2004).

Today, the EITC acts as an after-tax wage subsidy for low-income workers and depends only on income, number of children and marital status<sup>4</sup>. An overview of the EITC structure for head of household single filers in 2005 is depicted in Figure 1. Table 1 presents the details of the EITC structure – maximum credits and income limitations - for tax years 2002 through 2004. The EITC is structured in three phases: in the phase-in period, the credit increases with income; in the plateau period, the credit reaches a maximum and levels off; and in the phase-out period, the credit falls as the claimant's income rises. At the breakeven point, or income limit, the household earns no EITC. The maximum EITC is separated into different levels for claimants with no children, those with one child, and those with two or more children. There are also different tax credits for different types of filers; married couples filing jointly are eligible for slightly higher credit amounts in the phase-out period than single filers.

Consider a family with two children and a combined adjusted gross income of \$10,000. Because the family's income is in the phase-in region, as their income increases by \$1.00, the amount of the credit goes up \$0.40. If the family has an income between \$11,000 and \$14,370, it is eligible for the maximum credit amount of \$4,400. Finally, if earnings increase past \$14,370, the family enters the phase-out range. At this point, the return of each additional dollar of income is only \$0.21 and continues to fall as income increases. If income goes above \$35,263 (the breakeven point for households with two children), the household earns no EITC.

The success of the federal EITC has led to the development of similar programs in 18 U.S. states and Washington D.C. As documented in Johnson (2000), the majority of the income tax credits put into place since the 1980s have been state EITCs. Table 2 summarizes the state EITC rates. To continue with the example above, suppose the family with two children in New

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<sup>4</sup> Many of the poorest families are ineligible for the EITC, as discussed in Hoffman and Seidman (2003).

York is currently in the plateau region, receiving \$4,400 in federal EITC. The family would also receive a New York State credit of \$1,320 (30 percent of the federal credit).

Hoffman and Seidman (2003) use the 1996 Panel Study of Income Dynamics (PSID) to estimate that one in seven households in the U.S. is eligible for the EITC. They find that the majority of the credits go to single parent households, with 50 percent of single fathers and 60 percent of single mothers receiving the credit. One-fifth of married couples with children claim the EITC, compared to 2.5 percent of childless couples and 5 percent of childless individuals. Nearly two-thirds of eligible families are in the phase-out range. Approximately 35 percent of households below the poverty line, 35 percent of households between 100 percent and 150 percent of the poverty line, and 25 percent of families between 150 and 200 percent of the poverty line are eligible for the EITC.

### **3. Data**

The data for this paper were collected through surveys completed by individuals who participated in the Madison County VITA program. As part of the program, each taxpayer is asked to fill out an anonymous survey<sup>5</sup>. The survey captures household characteristics, participation in other government assistance programs, household savings and debts levels, and the intended uses of the tax refund<sup>6</sup>. The dataset used for this study contains information for 432 households who filed their tax returns in the 2002, 2003, or 2004 tax year. The data are converted to 2004 dollars, using the Consumer Price Index<sup>7</sup>. The number of participants has increased each year (see Figure 2). Approximately 35 percent of the VITA participants do not qualify for the EITC and are, therefore, excluded from the sample, leaving us with 282

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<sup>5</sup> The survey can be found at: [www.colgate.edu/desktopdefault1.aspx?tabid=1990](http://www.colgate.edu/desktopdefault1.aspx?tabid=1990).

<sup>6</sup> It is important to note that changes were made to the 2004 tax year survey to include detailed questions about households' savings, debt, etc. Thus, the sample sizes of some variables are much smaller since tax years 2002 and 2003 are not included.

<sup>7</sup> The CPI-U was used since poverty lines are adjusted using the same index.

observations for the descriptive analysis presented below. It is important to note that some of the clients are likely to be repeat customers<sup>8</sup>; therefore, the data set does not represent 282 unique households. In addition, because filers are given the option to not respond to some of the questions, the sample is unbalanced.

Madison County is an upstate rural county located in the center of New York State. Since its beginning, Madison County's economy has been lead by agriculture; however, the employment in this sector has declined over the past 30 years and the service, wholesale and retail trade sectors have grown in importance. The proximity to Oneida and Utica provides employment opportunities to many Madison County residents. The New York State Department of Labor reports that private sector employment in Herkimer, Madison and Oneida counties remained relatively stable in recent years, decreasing slightly from 102,900 in 2002 to 100,000 in 2003 and then increasing to 100,100 in 2004<sup>9</sup>. At the same time, the unemployment rate in the region declined slightly over the time period from 5.4 percent in 2002 to 5.3 percent in 2004<sup>10</sup>.

Madison County contains one city (Oneida), 15 towns and 10 villages. Between 1970 and 2000, the population grew by 10.5 percent. Although population has actually declined in much of the upstate region in recent years, the population of Madison County has continued to grow, albeit very slowly, at about one percent; it increased from 69,453 in 2000 to 70,392 in 2004<sup>11</sup>.

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<sup>8</sup> Unfortunately, due to the anonymous nature of the survey, we are unable to track participants over time.

<sup>9</sup> New York State Department of Labor ([www.labor.state.ny.us/workforceindustrydata](http://www.labor.state.ny.us/workforceindustrydata)), Current Employment Statistics Survey.

<sup>10</sup> New York State Department of Labor ([www.labor.state.ny.us/workforceindustrydata](http://www.labor.state.ny.us/workforceindustrydata)), Local Area Unemployment Statistics Program.

<sup>11</sup> US Census Bureau, Population Division ([www.census.gov](http://www.census.gov)). Table 1: Annual Estimates of the Population for Counties of New York: April 1, 2000 to July 1, 2005.

The median household income for Madison County was \$40,089 in 2003, compared to the New York State average of \$44,139. The county poverty rate increased from 9.7 percent in 2002 to 10.4 percent in 2003<sup>12</sup>. The poverty rate for New York State in 2003 was 14.3 percent<sup>13</sup>.

#### **4. Descriptive Statistics**

##### **4.1. Demographics**

Table 3 shows the breakdown of demographic characteristics for Madison County EITC recipients who used the VITA program over the three-year period. Approximately 69 percent of survey respondents are female. The average participant is almost 37 years old and the sample is 98 percent Caucasian, which compares to 96.5 percent for the county.

The marital status and household structure breakdown of the participants is presented in Figure 3. Most filers (71 percent) are single, including the 42 percent who are single mothers, 4 percent who are single fathers, and 25 percent childless singles. Of the remaining 29 percent of the sample that is married, most (94 percent) have children. In fact, more than 73 percent of all participants have at least one child (see Figure 4). Whereas a quarter of the recipients have no children, another quarter has one child, and almost half of the sample households have two or more children. Less than 2 percent of our sample is childless married couples.

Approximately three-quarters of the respondents are employed at the time of survey, working, on average, 33 hours per week. For those who have spouses or domestic partners, 52 percent are employed, working, on average, 35 hours per week. The average annual household pre-tax income is \$13,564 and median income is \$11,806. This is significantly below the 2003 median household income of \$40,089 in Madison County. Not surprisingly, the poverty rate of

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<sup>12</sup> Poverty rates for 2004 are not yet available at the county level.

<sup>13</sup> US Census Bureau, Housing and Household Economic Statistics Division, ([www.census.gov](http://www.census.gov)).

this sample is dramatically higher at 57 percent than that of the county overall, which is estimated at approximately 10 percent in 2002 and 2003.

The average educational attainment of the sample is slightly more than a high school degree, at 12.8 years of completed schooling (see Table 4). More than 70 percent of the recipients are high school graduates, while only 10 percent are college graduates. These numbers are lower than those for all county residents. In Madison County, 83 percent of adults have high school degrees and approximately 22 percent of adults have college degrees.

Almost 70 percent of the sample receives some form of government assistance besides EITC (see Table 5) with Medicaid being the most common benefit; the survey lists Child Health Plus with Medicaid, which is a popular supplemental health insurance program in New York for children from low- and moderate-income families<sup>14</sup>. The Food Stamp Program (FSP) is utilized by 40 percent of the EITC recipients while TANF participation is almost non-existent, with a reported usage rate of only 2 percent. This is likely because of the earned income requirement of the EITC; many households on TANF do not earn income and are, therefore, ineligible for the EITC.

Table 6 shows the breakdown of use of transaction accounts (checking or savings account) and use of credit, which is defined as having a credit card or some other type of loan (mortgage, car loan, personal loan, etc.). Approximately 57 percent of the participants have at least one form of credit. The most common is a credit card, with 39 percent of participants having at least one credit card, followed by a car loan (31 percent) and mortgage (28 percent). Those with credit cards have an average balance of \$2,272. Almost three-quarters of the participants also have a checking account, but less than half have a savings account, with an average balance of \$623.

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<sup>14</sup> For more details on this program, go to: <http://www.health.state.ny.us/nysdoh/chplus/index.htm>.

According to a comprehensive study of EITC recipients in New York City by Rhine, Su and Osaki (2005), 40 percent of eligible EITC recipients in New York City did not have a checking or savings account (prior to the 2003 tax year). This compares with 26 percent of EITC recipients in our sample. Based on estimates in Bucks, Kennickell and Moore (2006) using the 2004 Survey of Consumer Finances, 75.5 percent of households in the lowest income quintile in the nation (i.e., those earning less than \$18,900) held transaction accounts (defined as checking, savings or money market accounts), with an average balance of \$600. These estimates are very close to our sample of EITC recipients in rural central New York, of which approximately 70% are in the lowest national income quintile. Thus, our sample seems to be typical of low-income households in the U.S., at least with respect to their use of transaction accounts.

#### **4.2. Tax Refunds and Economic Well-being**

Table 7 summarizes average tax refunds received by Madison County VITA participants. The average total refund is \$3,420, with \$2,720 coming from the federal government and \$700 from the state. However, there is significant variance in refunds across the sample; the highest total refund is almost \$7,300. Total refunds represent more than 25 percent of total household income for the sample. Participants receive \$2,108 in total EITC on average, of which \$1,649 is federal and \$460 is state. The EITC represents 61.6 percent of the participants' total refund and 15.5 percent of total household income. Additional tax refunds for our VITA clients are commonly from Child Tax Credits, Dependant Care Credits, Lifetime Learning and HOPE Credits, retirement savings contribution credits, and having too much deducted from their paychecks.

Given that the EITC is an anti-poverty program, it is important to understand its impact on household income and poverty. Approximately 20 percent of recipients respond that they

absolutely could not live without the refund, while the majority of others would have to delay or limit their planned expenditures without the EITC. Table 8 shows that before receiving their refunds, approximately 57 percent of the sample lives in poverty<sup>15,16</sup>. Clearly, in a county where the poverty rate is approximately 10 percent, the VITA program attracts the neediest families. If we include the tax credits in the definition of income, the EITC pushes some of these households above the poverty line<sup>17</sup>. EITC refunds (federal and state combined) effectively lower the poverty rate of our sample from 57 percent to 49 percent; total tax refunds reduce the sample poverty rate even further to 45 percent<sup>18</sup>. Thus, the EITC is responsible for lowering the poverty rates by eight percentage points in our sample, while other tax credits (children, education, retirement, etc.) have important effects on the poverty rate as well. The percentage change in the poverty rate as a result of the EITC is -14.2 percent in our sample, consistent with national estimates presented in Hoynes, Page and Stevens (2006), who find that the EITC lowered the national poverty rate from 13.9 percent to 12.2 percent (yielding a -12.2 percentage change).

An important series of questions on the survey address the intended use of the tax refund. Taxpayers are asked to rate their top three priorities for their refunds. Figure 5 shows the frequency in which each category was listed as one of the three top priorities by the participants. The most common use of their tax refund is to pay bills, with more than 60 percent reporting this as a first priority, followed by purchasing items and paying housing costs<sup>19</sup>. Savings is not

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<sup>15</sup> Note that 9 of the 282 respondents did not report income or EITC, so the poverty rate is based on 273 observations.

<sup>16</sup> Poverty lines (or thresholds) for the three years come from the U.S. Department of Health and Human Services website: <http://aspe.hhs.gov/poverty/figures-fed-reg.shtml>.

<sup>17</sup> It is important to note that the official definition of poverty is based on pre-tax income, and hence does not include the EITC or any other tax credit in its calculation of income. Thus, the EITC cannot directly change poverty rates. For a nice discussion of this issue, see Hoynes, Page and Stevens (2006).

<sup>18</sup> The poverty rates are significantly different at the 5% level.

<sup>19</sup> In the survey, housing costs are identified as mortgage, rent, property taxes and home repairs.

deemed a top priority for most households in the sample, but it is cited by more than 10 percent of respondents as a second or third priority.

In a different set of questions, we ask participants to identify what types of bills they plan on paying with their tax refunds (if they plan on using their refunds to pay bills). Respondents can check as many types of bills as they want; hence, the proportions do not add up to 100 percent. Table 9 shows that utility bills are most commonly reported (40 percent); followed by rent (31 percent), credit card payments (28 percent), car payments (22 percent) and grocery bills (21 percent). For households that plan on using their refunds to purchase items, we ask them to specify which items they plan to purchase. Clothing was the most commonly cited item (for 27 percent of the participants), followed by a car purchase (18 percent), household furnishings (15 percent), household appliances/electronics (9 percent) and entertainment (6 percent).

Using the information provided by respondents on the types of bills and purchases they intend to pay or purchase, we separate refund uses into four broad categories: basic needs, debt repayment, purchase of durable goods and other bills/purchases. The following types of intended uses are categorized as basic needs: rent, utilities, groceries, medical bills and clothing. Debt repayment consists of using the refund to pay off credit card bills, make car payments and pay down bank or student loans and personal loans. Durable goods include automobiles and household appliances. The remaining category includes child care bills, household furnishings, entertainment, other bills and other purchases. The results (in Table 10) indicate that almost two-thirds of the sample plan on using their refund to meet basic needs. Approximately half, however, plan on paying off some debt and one-quarter plan on purchasing a durable good.

## 5. Differences across Household Types

In this section, we compare refunds, poverty rates, uses of refunds, uses of credit and participation in other government programs across different household types. Specifically, we compare single parent households, married parent households and households with no children. Single parent households represent 46 percent of our sample, with most (92 percent) being mothers. Married households with children account for 27 percent of our sample. The remaining 27 percent of the sample consists of households without children, who are almost all single (91 percent). The means of all of the relevant variables and the results of the difference of mean tests across the three household types are presented in Tables 11, 12, and 13.

### *Refund Size*

Several studies have documented that the EITC can generate sizable marriage bonuses or penalties depending on the structure and income level of the family<sup>20</sup>. While married parents earn almost 40 percent more than single parents in our sample (\$19,317 compared to \$13,775 for single parents), they receive less EITC on average (\$2,325 compared to \$2,618 for single parents); however, the difference is not significant (as noted in Table 11). This is despite the fact that single parents have fewer children in the household (1.76 children in single parent households versus 2.25 in married parent households). Married parents are more likely to be in the phase-out range of the EITC, because of their higher income.

The EITC has the most significant impact on poverty rates for single parent households. In our sample, the poverty rate of single parent households falls by 11.2 percentage points (from 54.7% to 43.5%) as a result of the EITC compared to 6.4 percentage points for married households with children (from 46.1% to 39.7%), but again the difference is not significant due to relatively small sample size. We find that households without children (most are singles) are

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<sup>20</sup> See, for example, Ellwood (2000) and Ellwood and Sawhill (2004).

the poorest group in our sample, earning only \$7,698 annually on average. Because the EITC's income phase-out occurs at much lower levels of income for households without children, only very poor singles qualify for the EITC and are included in our sample. In fact, more than 70 percent of the households without children in our sample are living in poverty. In addition, the average EITC refund is significantly lower for this group, at \$982, and is, therefore, much less effective in lowering their poverty rate: the poverty rate drops by only 3.6 percentage points as a result of the EITC.<sup>21</sup> Thus, it seems that the EITC is successful at improving the economic well-being of low-income households with children – its primary target. However, the EITC has a negligible effect on the poorest households in our sample - those without children. This is not surprising given that the EITC is primarily targeted at households with children, as evidenced by the relatively small federal EITC allowances for households without children (the maximum amount is less than \$500), as shown in Figure 1.

It is surprising how similar single parent households are to married parents in this sample of EITC recipients; we find very few significant differences across the two groups with respect to income, refund amounts, poverty rates, or use of credit, as indicated in Table 11. While nationally, single parent households have much lower household incomes and higher poverty rates than households comprised of married parents, in our sample this is not the case. For example, in 2004, the median household of single parents was 47% of that of married parent households<sup>22</sup>. In our EITC sample, single parent households earn 71% of the average married

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<sup>21</sup> Note that the average total EITC refund for childless singles (\$982) is significantly higher than the maximum state and federal EITC for this group (\$507). This is due to a significant number of single women in our sample who have children that live with them but do not financially support them. Since the child(ren) lives with the mother, she can claim them for EITC but not as a dependant (the father can claim them as a dependant but not for EITC). Hence, these mothers show up as childless singles in our sample. Based on the data, we have roughly 20 of these women in our sample (or 27% of childless singles).

<sup>22</sup> DeNavas-Walt et al., US Census Bureau, 2006, Table 1.

couple with children. Thus, the EITC is targeted at the very poorest of married couple households (and single households) but reaches a more typical single parent household.

### *Refund Uses*

Table 11 also shows the categories of intended uses of refunds across household types. Households with children (both single and married) are more likely to use their refunds to meet basic needs than households without children, with single parent households reporting the highest rate at almost 88 percent. This compares to the 73 percent of households without children that plan on using their refunds on basic needs. Households with children are also more likely to use their refunds to repay debt and to buy durable goods, compared to households without children. The difference is largest for durable good purchases: only 16 percent of households without children intend to buy a household appliance or car, while closer to one-third of households with children intend to do so. Once again, we find no significant differences in the intended uses of the refund for single parent households and married parent households. All household types, on average, use the majority of their refunds to make ends meet. Clearly, the EITC is not generally viewed as a way to save significant amounts of money to make investments that will improve future socioeconomic status.

In Table 12, more details are presented on the intended uses of the refunds by household type. Several interesting findings emerge. First, with respect to meeting basic needs, households with children are twice as likely to use their refunds to pay utility bills as households without children, with the differences being significant at the 5 percent level. Winters in Madison County are relatively harsh and the tax filing season falls in the middle of winter, resulting in almost half of all households with children planning to use at least part of their refunds on utilities. One-third of single parent households plan to use their refunds for clothing, a

significantly higher rate than the other household types. We find no significant differences in the fractions of the refund intended for rent, groceries and medical bills across household types.

With respect to repaying debt, single parent households are most likely to use their refunds to pay credit card bills, with more than two-thirds citing this category, which is significantly higher than the 20 percent of households without children that cite this intended use. We find no other significant differences of using tax refunds to pay off other forms of debt across the three households types.

Both single parent and married parent households report much higher rates of using their refunds on household furnishings and appliances than singles. Many of these differences arise due to the fact that households without children are less likely to be homeowners and more likely to live in residences with other adults (besides domestic partners). However, there appears to be no significant difference in the frequency of using refunds to purchase cars across household types.

Given that the majority of refunds will likely be used to meet basic needs, and more specifically to pay bills, it seems likely that these low-income families would benefit from receiving their refunds throughout the year rather than in a lump sum. This would help them both to meet their monthly consumption needs and avoid high interest charges. In addition, given that the EITC is often used to pay utility bills, especially by households with children, it appears that the families targeted by the EITC would also benefit from further utility assistance. One possibility would be to expand the Home Energy Assistance Program (HEAP) in New York State or to introduce a similar federal program. In addition, the high frequency of using tax refunds to pay credit card bills suggests that credit counseling and financial literacy programs may be beneficial for EITC recipients, especially single mothers.

It appears that more needs to be done to help these families achieve economic mobility. While a significant proportion of our sample intend to use their refunds to buy a car, which is a critical step toward sustained employment and self sufficiency in a rural area such as Madison County, both the size of the average refund and the other claims on it (basic needs, bills) make the EITC insufficient in helping families achieve economic independence. Clearly, the EITC is not sufficient on its own and in its current form to move families toward economic self sufficiency. They need programs that subsidize investments in the future, such as cars, education and child care.

#### *Use of Transaction Accounts and Credit*

Comparing the use of credit across household types shows striking differences (as displayed in Table 11). Married households with children are more likely to use credit, with more than two-thirds reporting they have a credit card or loan, while households without children have less credit, with fewer than 40 percent reporting to have some form of credit. Interestingly, single parent households use credit almost as frequently as married parent households, with 62 percent having some form of credit, despite their lower average income. However, the amount of credit is directly related to income levels; households with the highest average income (married households with children) have the most credit while the poorest households (singles) have the least.

In comparing the fraction of households with savings accounts, we find no significant differences across household types. However, single households with children have significantly higher average savings account balances than married couples with children despite the fact that their average household income is significantly lower. Thus, single parents seem to insure themselves better against risk via their savings accounts than other types of households who are

EITC recipients. However, we find little evidence that the EITC is being saved by recipient households, at least as a top priority. Less than 3 percent of the sample cites saving their refund as a first priority and only 25 percent of the sample list savings as one of the top three priorities for their refund (see Figure 5). This suggests that perhaps it is not optimal for EITC recipients to save their refund, as it would mean incurring late fees or increased interest charges on bills or other existing debt.

### *Government Assistance*

Are there significant differences in participation in government assistance programs such as TANF, food stamps, Medicaid, Social Security Income (SSI), or Social Security Disability (SSD) for EITC recipients across household types? The majorities of all three household types are enrolled in one of these government assistance programs. Thus, while the EITC is important in improving the economic well-being of households, it complements, rather than substitutes for, other government assistance programs. As shown in Table 11, EITC recipients with children are significantly more likely to receive another type of government assistance (72% of single parents and 79% of married parents) than those without children (55%). This is not surprising given that the majority of government programs are targeted at children. However, it is important to note that childless singles are the poorest households in our sample.

Table 13 shows government assistance by specific program use for all three household types. Almost half of all single parents receive Food Stamps, compared to about one-third of married parents and households without children. In addition, households with children (single or married) are twice as likely to use Medicaid as households without children. This result is not surprising given that Child Health Plus is listed under Medicaid in the survey. Single parents, however, are less likely to receive SSI, with participation rates of 10 percent, compared to 25

percent for married parents and childless singles. Given that SSI is awarded to those who face employment barriers because of a major disability, this result supports our previous findings that married parent households and especially childless singles who receive the EITC are less economically mobile than the single parent households in our sample.

## **6. Conclusion**

In this paper, we analyze the impact of the EITC on low-income families from Madison County, New York for the tax years 2002-2004. We find that the EITC has an important economic impact on its target households. Together, the federal and New York EITC lower the poverty rate of our sample from 57 to 49 percent; however, it has the largest impact on moving single parent households out of poverty, lowering their poverty rate by 11.2 percentage points, and the smallest effect on the poverty rate of households without children, who have the highest poverty rate in the sample (over 70 percent). We also find that the refund is critical in helping most of these families make ends meet but it is not typically used for economic mobility. As a result, the majority of our sample participates in other government assistance programs. More than 70 percent of families with children and more than 50 percent of those without children are receiving some form of government assistance in addition to the EITC.

Our conclusion is that the EITC is the right tool for targeting single parent households but that the program could be improved to help this group achieve upward economic mobility. The single parents in our sample appear to be more upwardly mobile than married couple and childless households; therefore, a wage subsidy is an appropriate incentive for helping them. Single parent households have similar use of transaction accounts and have higher balances in their savings accounts, compared to married parent households, despite their lower incomes. They are also less likely to receive SSI, indicating that disability is less likely to be a barrier to

employment in these households. Financial counseling and matching savings, as well as providing information on education and training programs, could support the efforts of single mothers who are working to improve their economics status and help them to use the financial tools available to insure against risk. In addition, simplifying the process so that more of these families receive their EITC benefits throughout the year, rather than in a lump sum refund, could save high interest payments and alleviate stress from overdue bills.

However, the EITC is not as effective in moving other types of households out of poverty, most notably, childless singles. This group often qualifies for the EITC because of employment limitations that keep their incomes low and, therefore, the EITC, which is essentially a wage subsidy, does not have a significant impact on their economic well-being. For singles with very low incomes who are receiving SSI because of a disability, EITC simply makes a small amount of labor supply more attractive by compensating them for their payroll tax contributions. SSI is the program targeted toward this group but many in our sample are receiving both benefits yet remain in poverty.

This paper is the start of a research agenda that will continue to explore the effectiveness and implications of the EITC in Central New York as we continue to expand our free tax preparation service in the region<sup>23</sup>. A new version of our survey allows us to continue to protect anonymity but to track individuals over time. Certainly, many of our findings apply to other regions in New York State and the U.S., and are particularly relevant for small, rural counties with similar poverty and EITC participation rates.

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<sup>23</sup> In tax year 2005, Colgate University students expanded their free tax preparation service to neighboring Chenango County in partnership with Opportunities for Chenango, Cornell Cooperative Extension and the Chenango United Way.

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## 8. Tables and Figures

Table 1: Federal EITC Schedule for Head of Household Single Filers, Tax Years 2002-2004

|                    | 2002           |                   | 2003           |                   | 2004           |                   |
|--------------------|----------------|-------------------|----------------|-------------------|----------------|-------------------|
| Type of return     | Maximum credit | Qualifying income | Maximum credit | Qualifying income | Maximum credit | Qualifying income |
| Childless          | \$376          | \$11,060          | \$382          | \$11,230          | \$390          | \$11,490          |
| 1 Child            | \$2506         | \$29,201          | \$2547         | \$29,666          | \$2604         | \$30,388          |
| 2 or More Children | \$4140         | \$33,178          | \$4204         | \$33,692          | \$4300         | \$34,458          |

Source: IRS, <http://www.irs.gov/individuals/article/0,,id=150513,00.html>

Figure 1: Federal EITC Structure for Head of Household Single Filers, Tax Year 2005

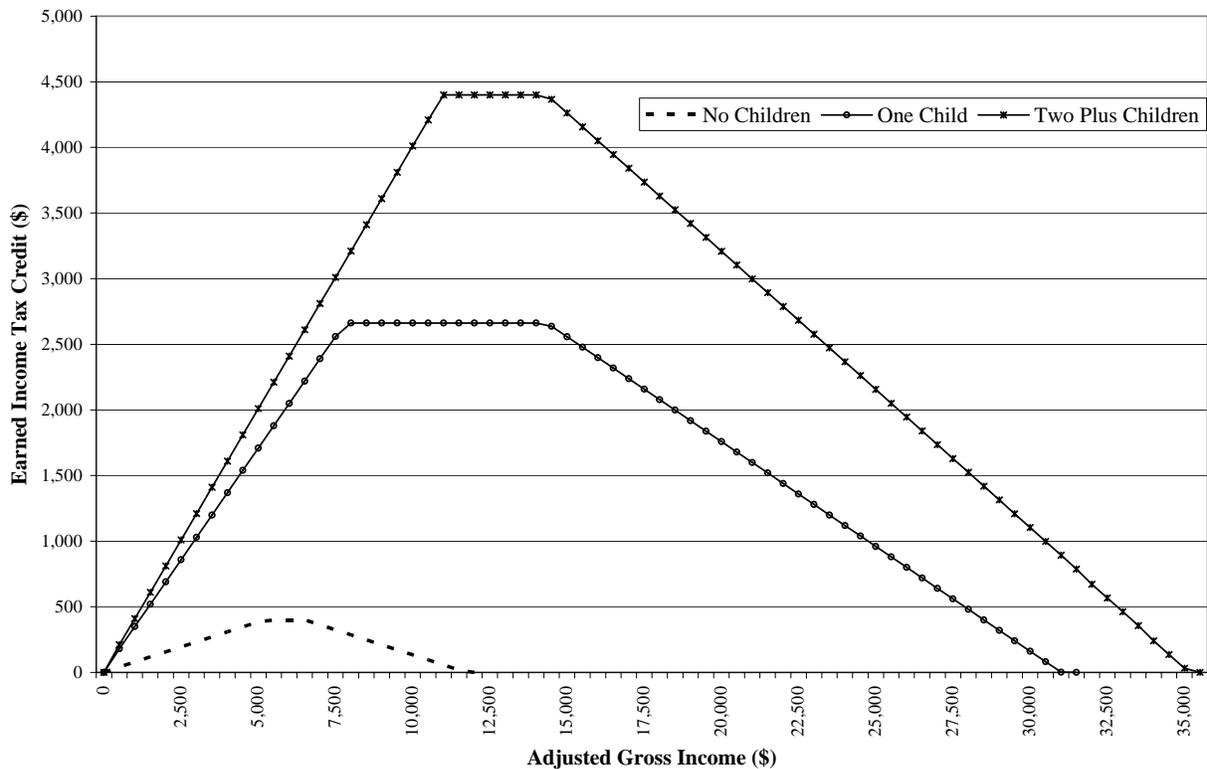


Table 2: State EITC Rates, Tax Year 2004

| Refundable Credits   |                 | Non-Refundable Credits |                 |
|----------------------|-----------------|------------------------|-----------------|
| State                | % of Fed Credit | State                  | % of Fed Credit |
| District of Columbia | 35%             | Delaware               | 20% (in 2006)   |
| Illinois             | 5%              | Iowa                   | 7%              |
| Indiana              | 6%              | Maine                  | 5%              |
| Kansas               | 15%             | Virginia               | 20% (in 2006)   |
| Maryland             | 20%             |                        |                 |
| Massachusetts        | 15%             |                        |                 |
| Minnesota            | 22-46%          |                        |                 |
| New Jersey           | 20%             |                        |                 |
| New York             | 30%             |                        |                 |
| Oklahoma             | 5%              |                        |                 |
| Oregon               | 5%              |                        |                 |
| Rhode Island         | 25%             |                        |                 |
| Vermont              | 32%             |                        |                 |
| Wisconsin            | 4-43%           |                        |                 |

Source: Nagle and Johnson (2006)

Notes: Colorado has an EITC only when the state has a budget surplus; it has been suspended since 2003.

Figure 2: Number of VITA Participants by Year

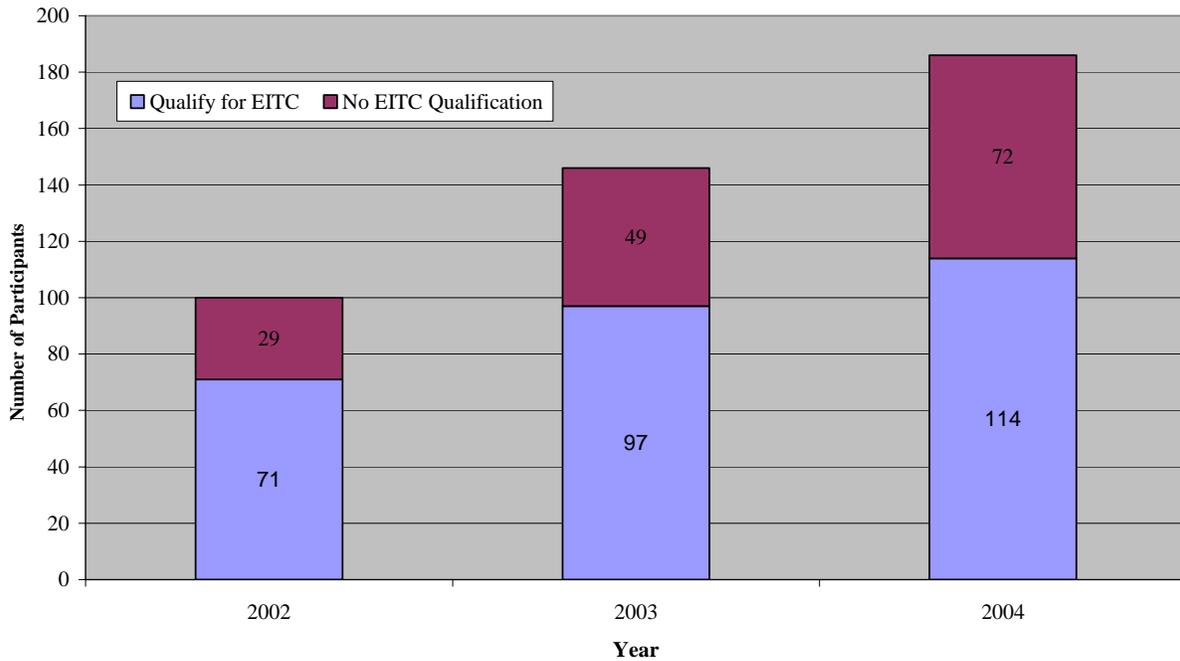


Table 3: Demographic and Employment Statistics (at time of survey)

|                         | Mean     | Std Dev  | N   |
|-------------------------|----------|----------|-----|
| Age                     | 36.6     | 10.4     | 272 |
| % Female                | 69%      | 46%      | 278 |
| % Caucasian             | 98%      | 15%      | 265 |
| % Married               | 29%      | 45%      | 282 |
| % Employed              | 76%      | 43%      | 250 |
| Hours Worked            | 33.3     | 12.7     | 81  |
| % of Partners Employed  | 52%      | 50%      | 62  |
| Hours Worked by Partner | 34.8     | 8.0      | 12  |
| Income (2004 \$)        | \$13,564 | \$10,155 | 279 |

Figure 3: Household Structure

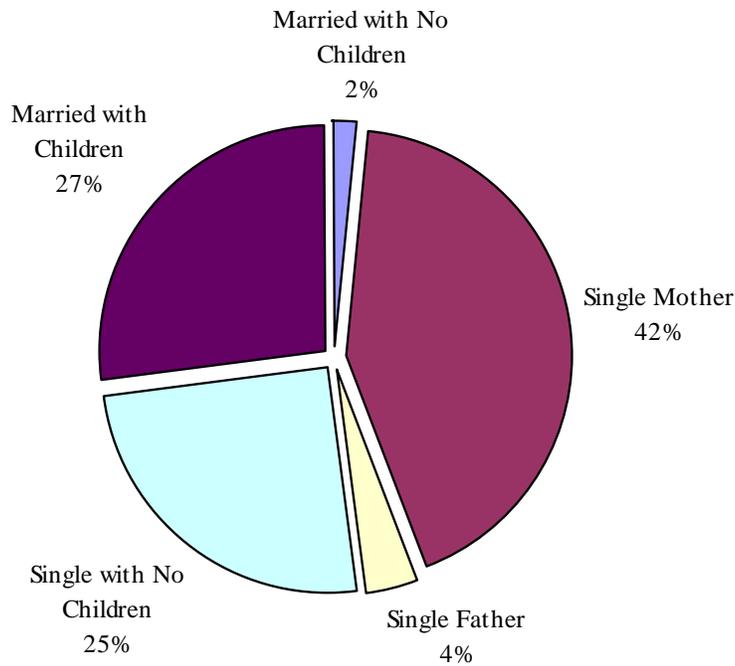


Figure 4: Children

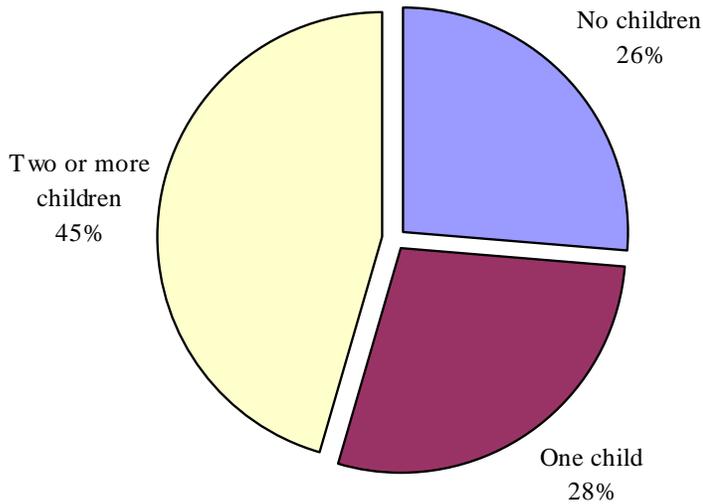


Table 4: Education

|                             | Mean | Std Dev | N   |
|-----------------------------|------|---------|-----|
| Years of Education          | 12.8 | 2.1     | 269 |
| % No High School Graduation | 12%  | 33%     | 282 |
| % High School Graduate      | 71%  | 46%     | 282 |
| % College Graduate          | 10%  | 29%     | 282 |
| % Post College Education    | 3%   | 17%     | 282 |

Table 5: Government Assistance

| Variable   | Mean | Std Dev | N   |
|--|------|---------|-----|
| % that Receive Government Assistance   | 69%  | 46%     | 282 |
| % that Receive Temporary Assistance for Needy Families (TANF)                  | 2%   | 14%     | 282 |
| % that Receive Food Stamps   | 40%  | 49%     | 282 |
| % that Receive Medicaid  | 51%  | 50%     | 282 |
| % that Receive Social Security Income/<br>Social Security Disability (SSI/SSD) | 18%  | 38%     | 282 |
| % that Receive Other Welfare   | 15%  | 36%     | 282 |

Table 6: Use of Transaction Accounts and Credit

|                              | <b>Mean</b> | <b>Std Dev</b> | <b>N</b> |
|------------------------------|-------------|----------------|----------|
| % that Have Checking Account | 74%         | 44%            | 280      |
| % that Have Savings Account  | 48%         | 50%            | 280      |
| % that Use Credit            | 57%         | 50%            | 282      |
| % that Have Credit Card      | 39%         | 49%            | 280      |
| % that Have Bank Loan        | 17%         | 37%            | 280      |
| % that Have Car Loan         | 31%         | 46%            | 280      |
| % that Have Mortgage         | 28%         | 45%            | 280      |
| Amount in Savings Account    | \$623       | \$1,927        | 63       |
| Unpaid Credit Card Debt      | \$2,272     | \$3,343        | 61       |

Table 7: Refund Statistics

|                      | <b>Mean</b> | <b>Std Dev</b> | <b>N</b> |
|----------------------|-------------|----------------|----------|
| Total Federal Refund | \$2,720     | \$1,828        | 282      |
| Total State Refund   | \$700       | \$783          | 282      |
| Total Refund         | \$3,420     | \$2,374        | 282      |
| Federal EITC Amount  | \$1,649     | \$1,293        | 281      |
| State EITC Amount    | \$460       | \$386          | 276      |
| Total EITC Amount    | \$2,108     | \$1,669        | 276      |

Table 8: Poverty Statistics

|                                 | <b>Mean</b> | <b>Std Dev</b> | <b>N</b> |
|---------------------------------|-------------|----------------|----------|
| Income                          | \$13,564    | \$10,155       | 279      |
| % In Poverty                    | 56.8%       | 49.6%          | 273      |
| Income after EITC               | \$15,714    | \$10,614       | 273      |
| Income after Total Refund       | \$16,968    | \$11,590       | 279      |
| % in Poverty after EITC         | 48.7%       | 50.0%          | 273      |
| % in Poverty after Total Refund | 44.7%       | 49.8%          | 273      |

Figure 5: Intended Uses of Refund

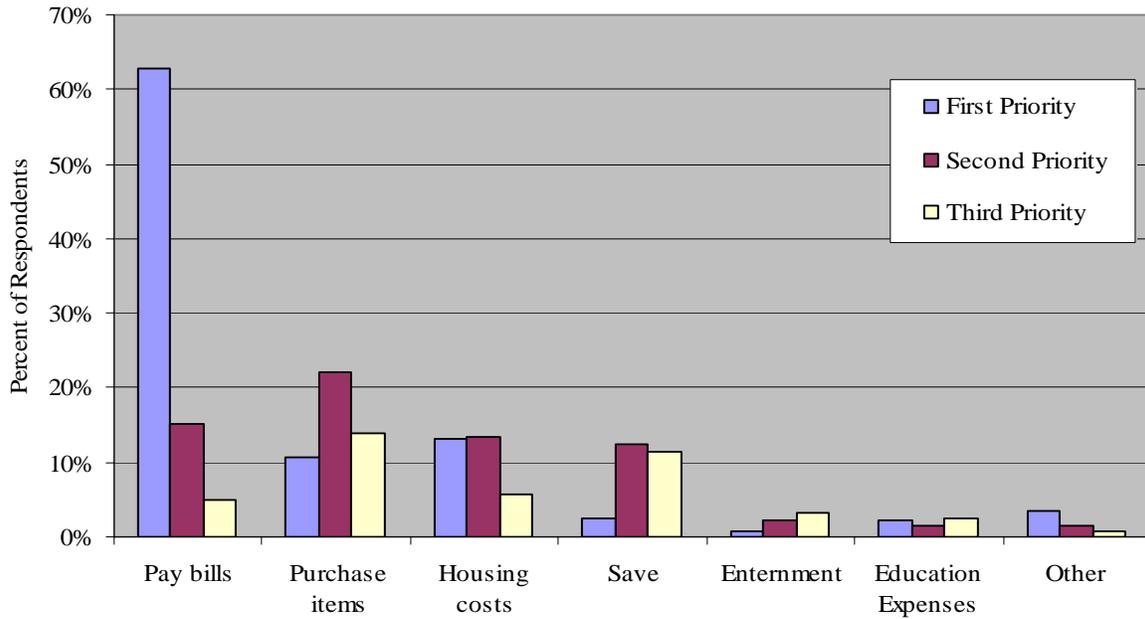


Table 9: Types of Bills and Purchases Intended to be paid with Refund

|                       | Mean  | Std Dev | N   |
|-----------------------|-------|---------|-----|
| <b>Bills:</b>         |       |         |     |
| Rent                  | 31.0% | 46.3%   | 282 |
| Child care bills      | 5.3%  | 22.5%   | 282 |
| Utility               | 40.4% | 49.2%   | 282 |
| Groceries             | 21.3% | 41.0%   | 282 |
| Car payments          | 22.0% | 41.5%   | 282 |
| Bank or student loan  | 12.8% | 33.4%   | 282 |
| Personal loan         | 10.6% | 30.9%   | 282 |
| Medical bills         | 16.3% | 37.0%   | 282 |
| Credit card bills     | 28.4% | 45.2%   | 282 |
| Other bills           | 18.1% | 38.6%   | 282 |
| <b>Purchases:</b>     |       |         |     |
| Household furnishings | 15.6% | 36.4%   | 282 |
| Household appliances  | 9.3%  | 29.0%   | 282 |
| Clothing              | 26.6% | 44.3%   | 282 |
| Entertainment         | 6.0%  | 23.8%   | 282 |
| Car purchase          | 18.4% | 38.8%   | 282 |
| Other purchase        | 7.1%  | 25.7%   | 282 |

Table 10: Intended Uses of Refund, by Category

|                          | <b>Mean</b> | <b>Std Dev</b> | <b>N</b> |
|--------------------------|-------------|----------------|----------|
| Basic Needs              | 64.2%       | 48.0%          | 282      |
| Debt Repayment           | 49.6%       | 50.1%          | 282      |
| Purchase of Durable Good | 26.6%       | 44.2%          | 282      |
| Other                    | 42.9%       | 49.6%          | 282      |

Table 11: Differences across Household Types

|                           | <b>Single Parents</b> | <b>Married Parents</b> | <b>Households without Children</b> | <b>Significantly Different?</b> |
|---------------------------|-----------------------|------------------------|------------------------------------|---------------------------------|
| Income                    | \$13,775              | \$19,317               | \$7,698                            | t1*,t2*,t3*                     |
| Total EITC                | \$2,618               | \$2,325                | \$982                              | t2*,t3*                         |
| Total Refund              | \$3,995               | \$4,273                | \$1,537                            | t2*,t3*                         |
| % in Poverty              | 54.7%                 | 46.1%                  | 70.3%                              | t2*,t3*                         |
| % in Poverty after EITC   | 43.5%                 | 39.7%                  | 66.7%                              | t2*,t3*                         |
| Basic Needs               | 87.5%                 | 82.9%                  | 73.0%                              | t3*                             |
| Debt Repayment            | 64.1%                 | 63.2%                  | 45.9%                              | t2*,t3*                         |
| Purchase of Durable Goods | 28.1%                 | 35.5%                  | 16.2%                              | t2*,t3*                         |
| Use of Credit             | 61.7%                 | 67.1%                  | 39.2%                              | t2*,t3*                         |
| % with Savings Account    | 51.6%                 | 49.3%                  | 39.7%                              |                                 |
| Savings Account Balance   | \$829                 | \$94                   | \$521                              | t1**                            |
| Government Assistance     | 71.9%                 | 78.9%                  | 55.4%                              | t2*,t3*                         |
| Number of Households      | 128                   | 76                     | 74                                 |                                 |

Note: t1 represents a test of means between single parents and married parents; t2 represents a test of means between married parents and households without children; and t3 represents a test of means between single parents and households without children. \* denotes significance at the 5% level; \*\* denotes significance at the 10%.

Table 12: Intended Uses of Refund by Household Types

|                                   | Single Parents | Married Parents | Households without Children | Significantly Different? |
|-----------------------------------|----------------|-----------------|-----------------------------|--------------------------|
| <b>Basic Needs:</b>               |                |                 |                             |                          |
| Rent                              | 34.4%          | 31.6%           | 24.7%                       |                          |
| Utility bills                     | 44.5%          | 50.0%           | 24.3%                       | t2*,t3*                  |
| Groceries                         | 22.7%          | 17.1%           | 23.0%                       |                          |
| Medical bills                     | 15.6%          | 17.1%           | 17.6%                       |                          |
| Clothing                          | 34.4%          | 23.7%           | 16.2%                       | t1**,t3*                 |
| <b>Debt Repayment:</b>            |                |                 |                             |                          |
| Bank or student loan              | 12.5%          | 17.1%           | 9.5%                        |                          |
| Personal loan                     | 13.3%          | 7.9%            | 9.5%                        |                          |
| Credit card bills                 | 34.4%          | 25.0%           | 20.3%                       | t3*                      |
| Car payments                      | 23.4%          | 26.3%           | 16.2%                       |                          |
| <b>Purchase of Durable Goods:</b> |                |                 |                             |                          |
| Household appliances              | 11.0%          | 14.5%           | 1.4%                        | t2*,t3*                  |
| Car purchase                      | 18.8%          | 22.4%           | 14.9%                       |                          |
| <b>Other:</b>                     |                |                 |                             |                          |
| Child care bills                  | 7.0%           | 2.6%            | 5.4%                        |                          |
| Household furnishings             | 16.4%          | 23.7%           | 6.8%                        | t2*,t3*                  |
| Entertainment                     | 7.0%           | 6.6%            | 4.1%                        |                          |
| Other purchase                    | 8.6%           | 3.9%            | 8.1%                        |                          |
| Other bills                       | 18.0%          | 17.1%           | 18.9%                       |                          |
| Number of Households              | 128            | 76              | 74                          |                          |

Note: refer to note on Table 11.

Table 13: Participation in Government Programs by Household Type

|                      | Single Parents | Married Parents | Households without Children | Significantly Different? |
|----------------------|----------------|-----------------|-----------------------------|--------------------------|
| TANF                 | 3.9%           | 0.0%            | 1.4%                        | t1*                      |
| Food Stamp Program   | 46.1%          | 35.5%           | 33.8%                       | t3**                     |
| Medicaid             | 56.3%          | 60.5%           | 32.4%                       | t2*,t3*                  |
| SSI/SSD              | 10.2%          | 25.0%           | 24.3%                       | t1*,t3*                  |
| Other                | 12.5%          | 18.4%           | 16.2%                       |                          |
| Number of Households | 128            | 76              | 74                          |                          |

Note: refer to note on Table 11.