CLASP
policy solutions that work for low-income people

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How Welfare and Tax Benefits Can Discourage Work

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Thank you for the opportunity to submit testimony for the record on this important topic. CLASP develops and advocates for policies at the federal, state and local levels that improve the lives of low-income people. Much of CLASP's efforts focus on improving low-income people's connections to the workforce and access to quality jobs. Stable employment in a well-paying job is the best pathway out of poverty and into the middle class. Moreover, employment is one of the key ways that people contribute to society. However, we also believe that public benefits are essential to fill the gaps when work does not generate enough income or provide needed benefits, jobs are scarce, or employment is not an option. We believe that it is possible to have a system of income and work supports that prevents material hardship, strengthens families, and rewards work. When our current system of benefits ― whether implemented as programs or through the tax code ― falls short of this goal, it should be improved.

Making Work Pay

To begin, it is important to recognize the significant progress that we have made toward this goal during the last two decades. Prior to the improvements of the 1990s, low-income single mothers were often made worse off by going to work — even though welfare benefits were (and remain) meager, mothers who began to work would often lose Medicaid coverage for themselves and their children, while incurring child care and other work expenses. This is no longer the case, as the result of a set of critical program improvements that were designed to "make work pay":

- *EITC and CTC*: During the 1990s, the Earned Income Tax Credit (EITC) was transformed from a modest refundable tax credit into the largest federal source of income support and asset-building assistance for low-income working families. The EITC provides low-income working families with a tax credit representing a portion of their earnings. If the amount of the credit exceeds the family's tax liability, the excess amount is paid to the family, typically in an annual lump sum. In 1990, the maximum value of the EITC was just $953, with the credit fully phased out once earnings exceeded $20,264. The expansions of the early 1990s effectively ensured that parents who worked steadily, even in very low-wage jobs, would have higher incomes than they had on welfare. In the 2000s, improvements to the refundable Child Tax Credit (CTC) made it another important work support for low-income families.

- *Child care.* Parents need child care to work. Quality child care is expensive and often far out of reach for low- and middle-income families. Research is clear that parents are more likely to work when they have reliable child care, and they find it challenging to work when they do not. Simply put, helping families pay for child care makes it more likely they can get and keep a job. The 1996 welfare reform law increased federal funding for child care both directly, and through states' ability to use Temporary Assistance for Needy Families (TANF) block grant funds for child care. While families on and leaving welfare generally continued to receive priority for services, the new resources expanded the availability of child care to other low-income working families. Between 1996 and

2000, combined federal and state spending for child care tripled, the number of children receiving child care subsidies nearly doubled, and states were able to initiate a set of new initiatives to promote child care quality. Yet, since 2002, federal funding for child care has been relatively flat with only modest increases. Today the Child Care and Development Block Grant reaches only one in six federally-eligible children and the number of children served is projected to soon reach a 15-year low (Matthews, 2012).

- *Health Insurance:* Congress took action during the 1980s and 1990s to broaden health care coverage for families and children outside of welfare. Originally andwith few exceptions, Medicaid coverage for families was limited to those receiving cash welfare, so loss of welfare meant a risk of lost medical coverage for parents and children. Low-wage jobs have increasingly become unlikely to provide health insurance coverage, and it is often unaffordable even when offered. Between 1986 and 1991, Congress extended Medicaid eligibility to more low-income children, regardless of their families' welfare status. The delinking of Medicaid for adults from receipt of cash assistance, and the creation of CHIP, the Children's Health Insurance Program, helped assure that parents could go to work without losing health insurance coverage for their children and often could continue their own coverage.

- *TANF:* Under AFDC, earnings were disregarded from the benefits calculation for only a limited time after recipients started work; after that point, benefits were reduced nearly dollar for dollar. Nearly all states have changed the ways that their TANF cash assistance programs treat earned income, allowing recipients who go to work to keep a greater portion of their earnings for a longer time than under AFDC. Although time limits and other countervailing pressures prevent most recipients from taking advantage of the opportunity to combine welfare and work (Matsudaira and Blank, 2008), this policy change allowed welfare offices to unambiguously tell recipients that they would be better off if they worked.

- *Supplemental Nutrition Assistance Program (SNAP, formerly known as food stamps):* While the federal eligibility and benefit calculation rules for SNAP have been largely stable over the past two decades, during the 2000s, most states adopted policies and practices that had the effect of making it easier for eligible workers to receive and retain benefits. These include longer recertification periods and simplified change reporting. Many states have also used broad based categorical eligibility to streamline benefit access and modestly expand eligibility to low-income workers.

As a result of these changes, the employment rates of less educated single mothers shot up during the 1990s and are now comparable to those of similarly situated single women without children (Trisi and Pavetti, 2012b). That is a truly dramatic change of the sort that is rarely seen in public policy. Moreover, the EITC and CTC have also been critical portions of the safety net in the recent deep recession, lifting an estimated 9.2 million people — including 4.9 million children — above the poverty line in 2010 (Charite et al, 2012). Medicaid and CHIP have also been quite effective in maintaining insurance coverage for low-income children in the face of the recession, so much so that the share of uninsured children declined slightly from 2000 to 2010, even though coverage from employer-sponsored insurance fell by nearly 12 percent (Gould, 2012). At least for low-income families with children, we have been remarkably successful in building a system of benefits and tax supports that both promotes work and helps low-income workers meet their families' basic needs.

Plateaus and Cliffs

Recognizing this key success does not mean we should not pay attention to the question of possible work disincentives in the benefit and tax structures. It is true that the interaction of various programs' phase out ranges can create long income "plateaus," where gains in earnings are partially offset by loss of benefits, leaving workers and their families only modestly better off as earnings rise. As Steurle testified before this committee, one of the effects of the expansion of means-tested programs for low-income families has been to shift the area in which there are such plateaus, and thus possible work disincentives, to a somewhat higher income range — what he refers to as the "twice poverty trap" as opposed to the former "poverty trap."

Moreover, our benefits system is riddled with "cliffs" ─ situations where a small change in earnings results in a sudden loss of a benefit. These are far more visible to recipients than gradual phase outs, and thus much more likely to have behavioral effects. Moreover, such cliffs violate our basic notions of fairness, our sense that our benefits systems should never leave a worker *worse* off as a result of an earnings gain. Some areas where workers experience benefits cliffs in our current system include:

- Our current system of Medicaid and CHIP creates two cliffs for working parents. The first comes at the earnings level where parents lose access to Medicaid. (As of January 1, 2012, in the median state, the Medicaid eligibility threshold for working parents is only 63 percent of the federal poverty level (Heberlein et al, 2012).) The second comes at the much higher income level point where children lose access to health insurance through CHIP. These cliffs will both be eliminated when the health insurance subsidies provided under the Affordable Care Act (ACA) are implemented, as shown in the graphs in Steurle's testimony. At least, they will in those states that adopt the Medicaid expansion under ACA. Currently, only 18 states, including DC, extend Medicaid eligibility to parents at or above the federal poverty level. If the remaining states do not adopt the expansion, working parents will continue to hit a cliff where they lose Medicaid coverage, and will not gain access to the tax-based subsidies until their family income reaches the federal poverty level.

- Another major cliff occurs at the gross income limit for SNAP benefits. Households with high child care, child support, housing or medical expenses may reach the gross income limit while their net income (after applying the appropriate disregards) is still low enough to qualify them for benefits. This is one of the reasons why more than half of the states have used broad based categorical eligibility to effectively raise the gross income limit under SNAP (FNS, 2012); if Congress eliminates this option in the Farm bill, it will create a new benefit cliff for recipients in those states.

- Working parents in many states experience cliffs at the point where they lose eligibility for child care assistance. Eleven states have designed their child care programs to avoid cliffs by establishing higher exit eligibility level that allows families to stay on child care assistance even if their incomes grow to exceed the initial eligibility cut-off. However, given the very limited pool of funding for child care assistance, there is an acute tradeoff between serving more low-income families and reducing the benefit cliff. Congress should expand funding for child care assistance so that more families can get the help they need to go to work. Making the child and dependent care tax credit refundable would also help reduce the cliffs that families experience when they reach the child care subsidy limits.

It is worth noting that low-income childless adults face a very different schedule of benefits and phase-outs. They do not receive the child tax credit and are only eligible for a very modest Earned Income Tax Credit. In some cases, especially when they are non-custodial parents, they may face very high effective marginal tax rates beginning with the first dollars earned, because a portion of their earnings is withheld to meet their child support obligations CLASP therefore strongly supports proposals to expand the EITC for childless adults in order to help "make work pay" for all workers.

Young low-income adults are particularly likely to live in multi-generational households and to be the second or third potential earner in these households. Programs that treat all household members' earnings as equally available to the family may result in high effective tax rates for these young adults. Therefore, it may be appropriate to consider excluding from the benefits calculation the earnings of young adults who are not the head of households, in order to encourage work. It is also worth exploring proposals such as those of Gordon Berlin (2007) to provide earnings tax credits that are based on individual, rather than household, income.

Do These Incentives Matter?

Having established that the combination of public benefits and tax policy does create, at least for some workers, a set of income plateaus and cliffs, an important next question is whether workers actually respond to these incentives by reducing their work effort. In fact, economic theory predicts that workers could respond to lower effective wage rates either by reducing paid work (because the relative value of non-market activities including caregiving, household production, and leisure increases) or by increasing work effort in order to achieve a desired target level of after-tax and after-benefit income. In order for incentives to matter in either direction, workers must be aware of the effects of benefit and tax policy, must think of them when they make their choices, and must have the ability to control their hours of work and/or their wages.

The research literature on this question suggests that any work disincentives caused by the phase out are relatively limited in their scope, and are certainly modest compared to both the work-incentive effects of the Earned Income Tax Credit and Child Tax Credit and the overall anti-poverty effectiveness of the safety net (e.g. Ben-Shalom et al, 2011). Very few if any low-income workers are fully aware of the complex system of phase outs and threshold that affect their eligibility for benefits. They are likely to receive only indirect and delayed information on the effects of earnings changes on benefits, which reduces the degree to which these effects actually influence behaviors.

Qualitative studies of low-income parents confirm that when faced with the decision about whether to accept an offered promotion that would result in a modest increase in wages, the phase-out of public benefits is rarely a consideration. By contrast, low-income workers do talk about the effect the position would have on their work schedules and commutes, and sometimes turn down promotions that would shatter fragile child care arrangements (Seefeldt, 2008).

Studies focused on the EITC indicate that the availability of the credit has a far stronger effect encouraging low-income parents to work in the first place than its phase-out has in reducing work effort. This should not be surprising to anyone — because of the nature of our employment system, workers have far more control over the decision whether or not to work than over how many hours per week to work. Workers who do wish to reduce their work hours in order to meet personal or family responsibilities often find themselves unable to do so without paying a very high price in reduced hourly wages and benefits. To the extent that the phase-out of the EITC has any effect on work effort, it appears to be concentrated on second earners within a family (Eissa and Hoynes, 2005).

Tradeoffs

It is important to recognize that there is a very real tradeoff in program design between the cost of a program and the steepness of the phase-out, which results in plateaus and cliffs. We need to be honest in acknowledging that eliminating cliffs and slowing the phase-out of benefits both increases benefits to higher earning recipients and adds new less-needy individuals or families to the pool of eligible recipients.

Some conservative organizations have been promoting an inaccurate narrative that means tested benefits are growing out of control. They rarely acknowledge that, prior to the recent recession, the growth in non-medical spending was overwhelmingly driven by the program changes that were made to make work pay. In fact, for families with the least labor market income, the safety net has become even more fragile, as the TANF program only reaches a small share of even the poorest families (Trisi and Pavetti, 2012a).

To the contrary, these organizations give a deliberately misleading portrayal of our safety net. First, they come up with an inflated value for the amount we spend on safety net programs, by combining spending on programs that provide funding for schools and communities with spending on programs that provide direct benefits to individuals and families. Then they divide this figure by the number of poor families. Hearing how much the government supposedly spends per poor family, the listener is left to conclude that the safety net for poor families is quite generous, that the government is wasting a lot of money, or both.

Sometimes, these figures are followed by an acknowledgement that not all of the benefits of these programs go to poor families. The implication then is that if we strengthened the means testing of these programs to cut the near poor out, we could save significant money without harming the most vulnerable "very poor." This has two major problems:

- The official poverty threshold is helpful for statistical purposes, but is far below the levels needed to achieve a modestly acceptable standard of living in most areas. When work expenses, particularly child care, are taken into account, many families with incomes as high as twice the poverty level have as much difficulty meeting their basic needs as families with incomes below the poverty level.

- Making programs more means tested implies either creation of new benefit cliffs or increasing the phase-out rate for benefits, and therefore increasing the implicit marginal tax rate. In other words, it makes the problems highlighted by this hearing worse. If you are serious about being concerned about the work disincentives under benefit programs, and not just using them as a rhetorical cudgel to criticize such programs, you should strongly oppose such changes. For example, you should reject the current proposals to eliminate categorical eligibility under SNAP.

What about Work Requirements?

Some have suggested that the solution to possible work disincentives is to add work requirements to more programs. However, as discussed in the first section, low-income parents already unambiguously experience earnings gains as they move into work. The challenge that remains is that they do not always experience significant gains as they move from some work to "more work" (more hours or weeks of work per year, or higher wages). A work requirement aimed at promoting "more work" would be hard to define and would require an unacceptably high level of government intrusion into both the lives of low-income workers and the businesses that employ them. Moreover, the target population would be quite large and such a requirement would necessitate a significant new bureaucracy. Given the lack of evidence that work disincentives caused by phase-out rates are a real factor, this proposal would almost certainly create more problems than it solves.

Work requirements are often couched as "building on the successes of TANF," which does have a strong work requirement for participants. There is no doubt that welfare reform understood broadly ― including the changes made under TANF, but also the improved work incentives under the EITC, Medicaid coverage, and expanded funding for child care assistance ― did increase employment rates of single mothers. But work requirements were only one piece of this package.

It is also important to recognize that the work requirements came at a real price in terms of adequacy of support. While the share of poor single mothers who are working increased in the wake of welfare reform, so did the share of poor single mothers who are "disconnected" ― neither working, nor receiving cash assistance. In 2010, during the height of the recession, 38 percent of poor single mothers were disconnected in this way (Gabe, 2011). While many of these families receive SNAP, not all do. If disconnected families were also turned away from SNAP benefits, there is little question that more children would go hungry, with long-term developmental and economic consequences.

Finally, one of the key lessons from TANF is that we simply have not done a good job of figuring out how to enforce work requirements in a way that is helpful and respectful and distinguishes between those who are capable of work with the right incentives and those who are not. Instead, we have created a system where job search programs often have far more to do with discouraging welfare receipt than finding work, and that fails to provide meaningful help to many of those with the greatest barriers to employment. We need to get this right before we should even consider expanding work requirements to a broader set of programs.

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