Benefit Cliffs and Work Incentives

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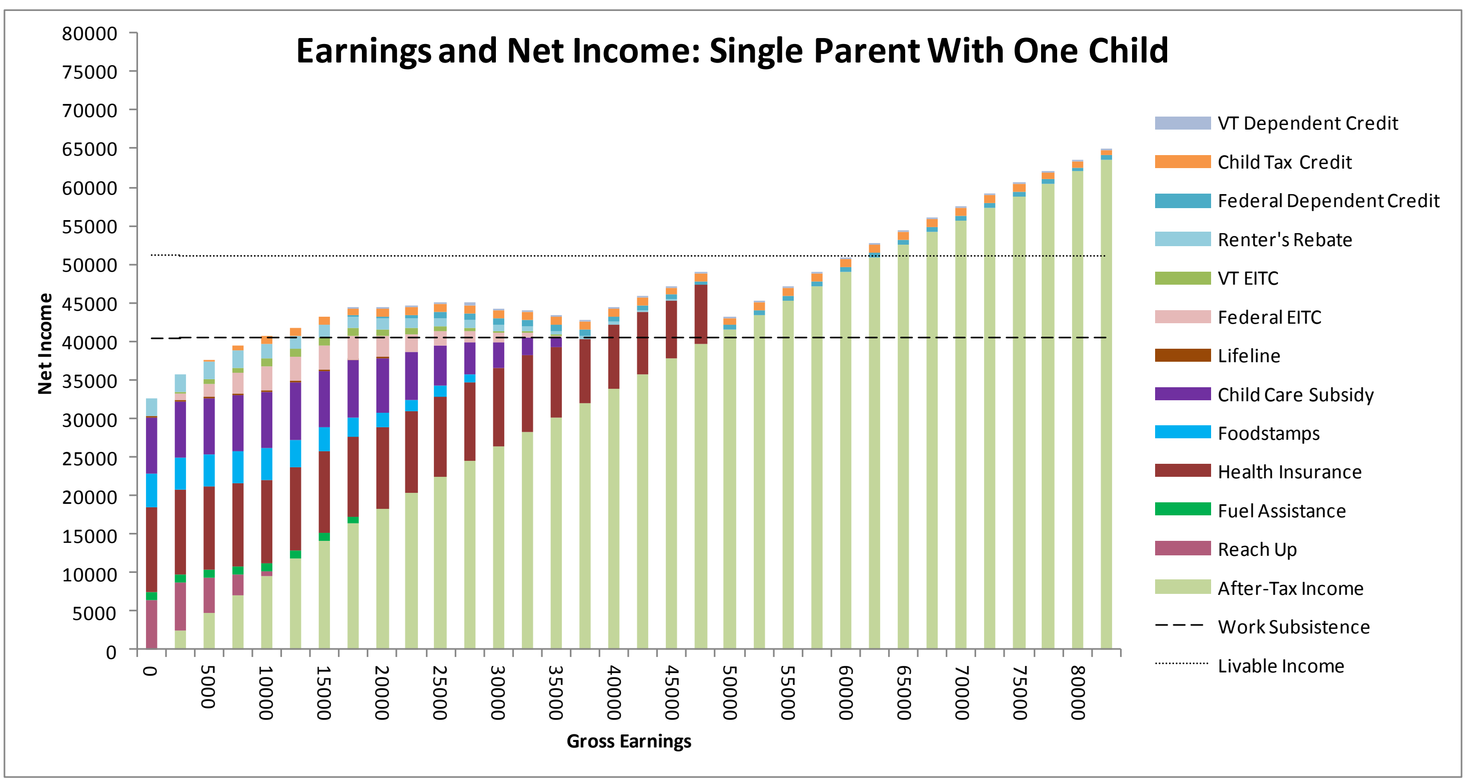
To encourage and reward work, for every additional dollar earned there should be a gain in net income. Currently, someone receiving public assistance may face a decrease in net income as a result of earning an additional dollar because of the combination of increased taxes and reduced benefits. The purpose of this analysis is to conceptualize a system of taxes and public assistance in which an additional dollar earned would result in an appreciable increase in net income.

The following chart shows the change in net income of a single parent with a preschool child as earnings increase. The various colors represent the different types of public assistance and tax credits that supplement net earnings. For reference, the dotted black line represents the livable income determined by the Legislative Fiscal Office and the dashed black line represents the net income needed to meet necessities for a working household this size: food, shelter, clothing, health care, and transportation to work. In addition to demonstrating the complexity of making ends meet, the chart illustrates two structural problems:

1. **Benefit cliffs**: there are earnings thresholds that benefit recipients do not want to cross because they will see a large decrease in benefits that will result in a decrease in net income.

2. **Work incentive**: for benefit recipients, the point at which work will actually begin to pay is so far off that it doesn't seem like a realistic possibility. It is a disincentive rather than an incentive.

Figure 1. Current Situation

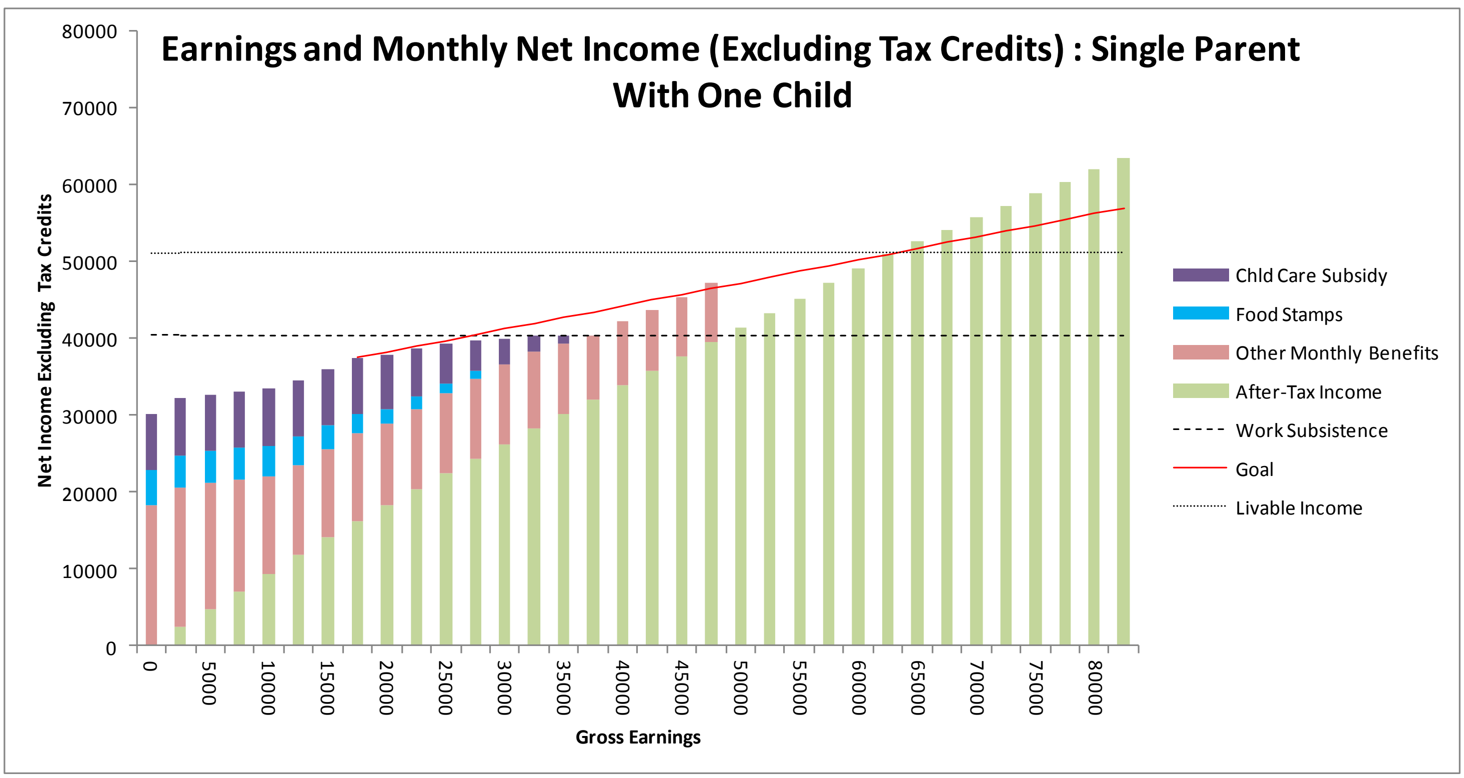


There are two general types of public financial support to help families make ends meet and to encourage work. Regular monthly benefits, including health insurance premium assistance, food stamps, Reach Up, Child Care Subsidy, and Fuel Assistance are direct and immediate help in meeting monthly costs. Tax credits, including the Federal Earned Income Tax Credit, the Vermont Earned Income Tax Credit, the Federal Child Care Tax Credit, the Federal Child and Dependent Care Credit, the Vermont Child and Dependent Care Credits, Telephone Lifeline, and the Renter Rebate are received after the annual income tax is filed after the end of the year. As such, they help the household acquire assets, put money in savings, or pay off a loan, but they are not easily applied to meeting essential monthly budget needs.

For work incentives to be effective, the working group felt the household should see a definite increase in its ability to pay for monthly expenses as it earned more income. A promised tax credit at the end of the year is less convincing than an immediate improvement in living conditions. In addition, a loss in the ability to meet monthly bills (resulting from a phase-out of public assistance) cannot be offset by a tax credit a year later for households that don't have enough income, savings or security to wait.

The chart below removes tax credit payments in order to focus on the other components of net income. The red line on the chart represents an increase of 30 cents in net monthly income (not including tax credits) for every additional dollar earned—an increase which would make the household better off immediately. The goal is to fill the gap between current net income and the red goal line.

Figure 2. Current Situation Excluding Tax Credits



If this gap were filled, the total net income (including tax credits) would also increase steadily as earnings increased—although the increase per dollar earned would be less than 25 cents.

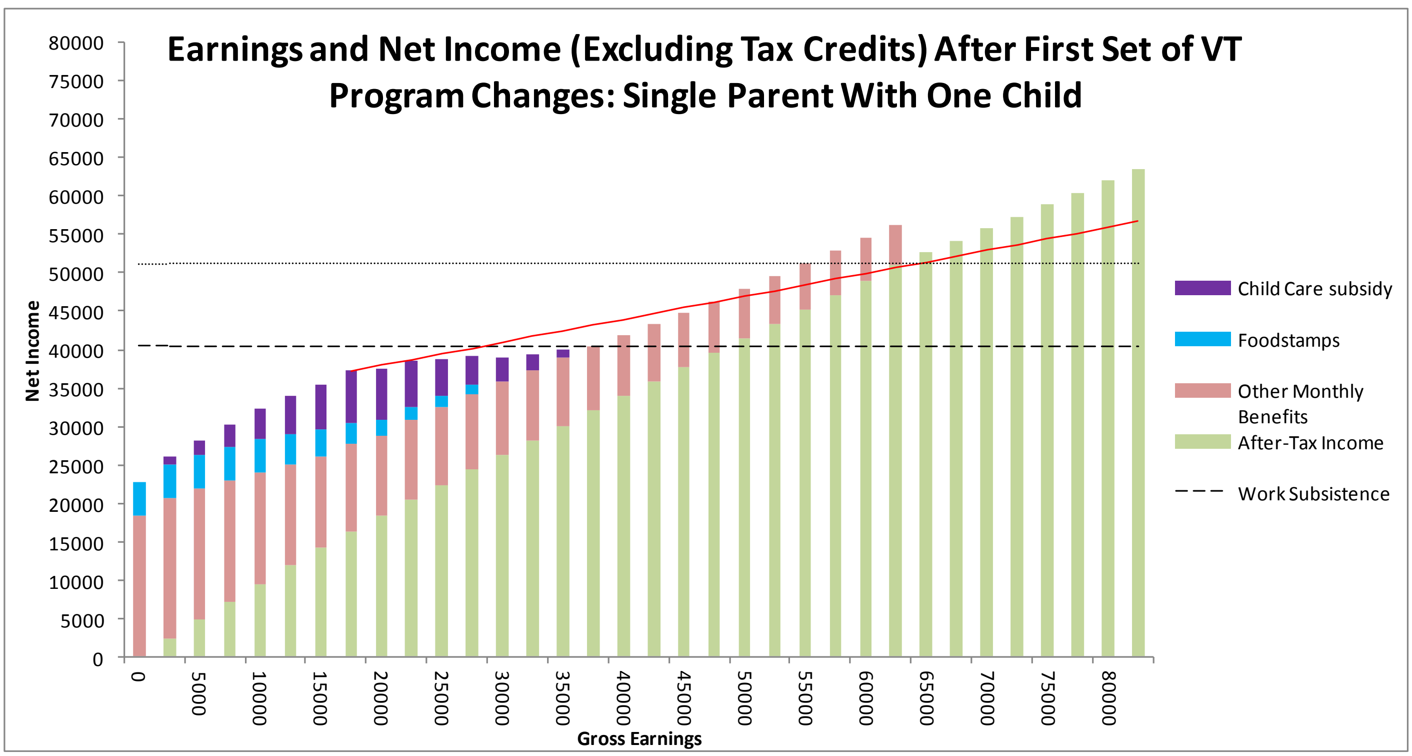
The working group recognizes success would depend on many other efforts, including benefit counseling, vocational rehabilitation services, job training, education, internships or supported work programs, and employer participation. However, the focus of this analysis is to envision the various structural changes that could be made in benefit programs, tax credits and the tax structure so that net income can increase as earnings increase.

As a first step, we looked at five suggestions that have been made by various groups who have studied the issue in Vermont, limiting the changes to those that could be made by the state. These include:

- Increase Reach Up's earned income disregard from 25% to 50%.
- Make the VT Child and Dependent Care Credit refundable and equal to 60% of what the federal credit would be, regardless of whether or not the household actually got the federal credit.
- Increase the eligibility for the renter's rebate program from $47,000 to $90,000.
- Extend the income level at which the VT EITC begins to phase out to 150% of the current level.
- Implement the ACA premium levels for health insurance as proposed by DVHA 3/21/12.

As shown in the chart below, these changes would help, but they do not fill the gap for households with children needing child care.

Figure 3. After First Set of 5 VT Program Changes



Other studies of the issue have pointed out that the problem is greatest for households with children, and that increasing the Child Care Subsidy beyond the federal parameters would be crucial. However, changes in that program alone would not effectively close the gap for two reasons:

1. Child care costs (net of any subsidy) are included in the calculation of countable income for food stamps. Therefore any increase in child care subsidy results in a decrease in food stamps, which then results in a further decrease in net income.

2. The phase out for food stamps is abrupt for certain households--especially families with children. At some income levels, earning an additional dollar results in a loss of food stamps of more than one dollar. These cliffs create erratic gaps that could not be filled with any logical schedule for paying the Child Care Subsidy, and in some cases it would mean the subsidy would need to be greater than 100% of the cost of child care.

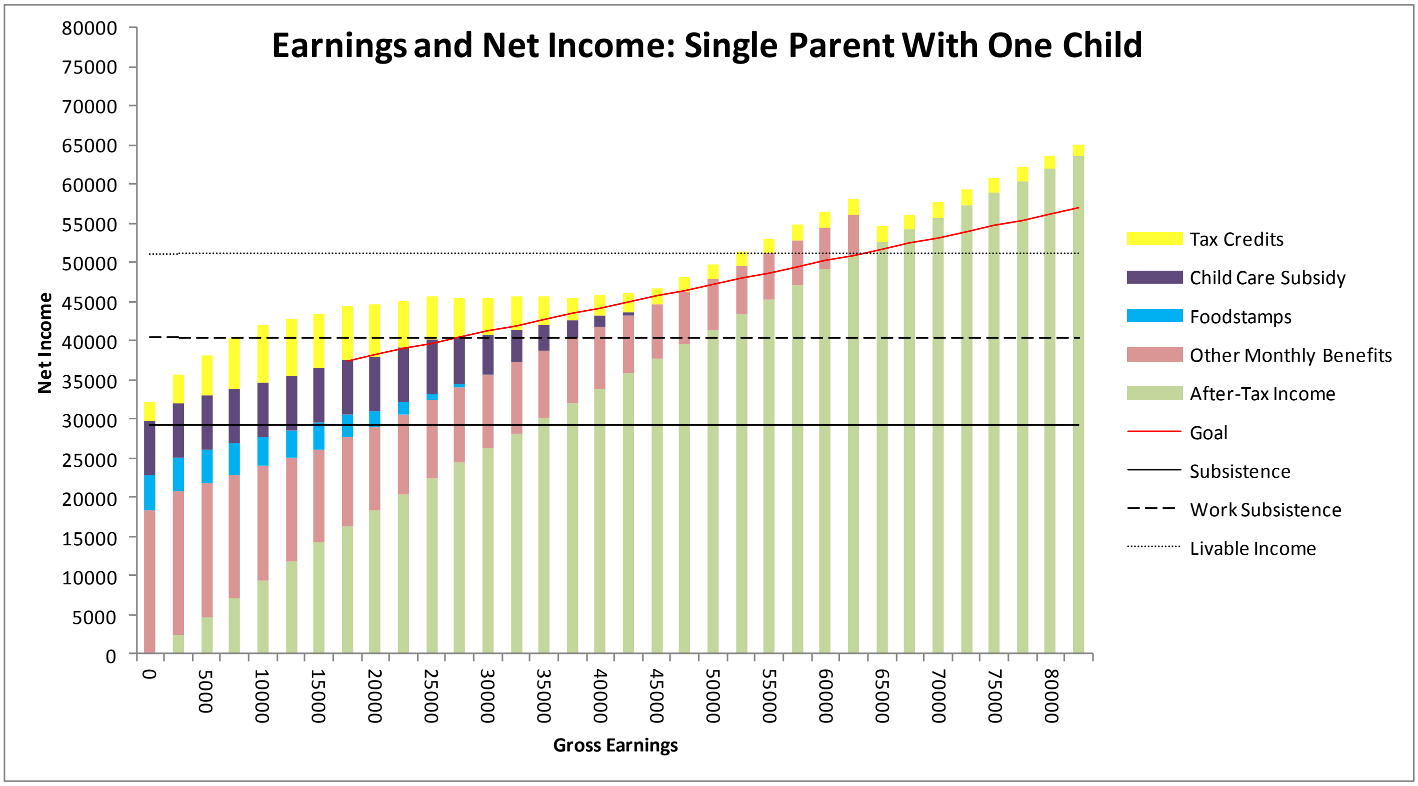
Conceptual Proposal for Next Steps

The goal is to ensure that the monthly income (net earned income plus Reach Up, LIHEAP, SNAP, Child Care Subsidy, Health Care Premium Assistance) increases by 30 cents for every additional dollar earned.

In addition to the first set of five Vermont program changes listed above and shown in Figure 3, the working group would like to look at the Food Stamp and Child Chare Subsidy programs together, and dedicate more funding, so that the two programs in combination nearly fill the remaining gap, and so they phase out rationally.

The results of initial concepts for procedural changes in the two programs are shown in the chart below. Monthly net income (all colors except yellow) approaches the red goal line. The chart also includes the tax credits, in yellow, and shows that the total net income (including tax credits) also increases as earned income does.

Figure 4. With proposed changes to Food Stamps and Child Care Subsidy



The chart is based on the following changes in the allotment procedures for the two programs:

The Food Stamps allotment would be calculated with a standard deduction for child care equal to approximately 30% of the average cost of child care. The maximum gross and net income tests would be eliminated, so that there would be an allotment if 30% of the countable income were less than the thrifty food budget for the household size. This would not change the allotment for households without children. It would extend the phase-out period for larger households, thereby increasing the cost of food stamps. At the same time it would decrease the cost of food stamps for many households who would receive more Child Care Subsidy. It would be essentially revenue neutral.

Calculation of the Child Care Subsidy would compare the household resources, including the food stamp allotment, to a subsistence budget which would include the cost of child care. If the resources were less than the subsistence budget, the Child Care Subsidy would be 100% of the subsidy as currently calculated. If the household resources exceeded the subsistence budget, the Child Care Subsidy would be reduced gradually, phasing out by 300% of federal poverty level.

Implementation of this would require:

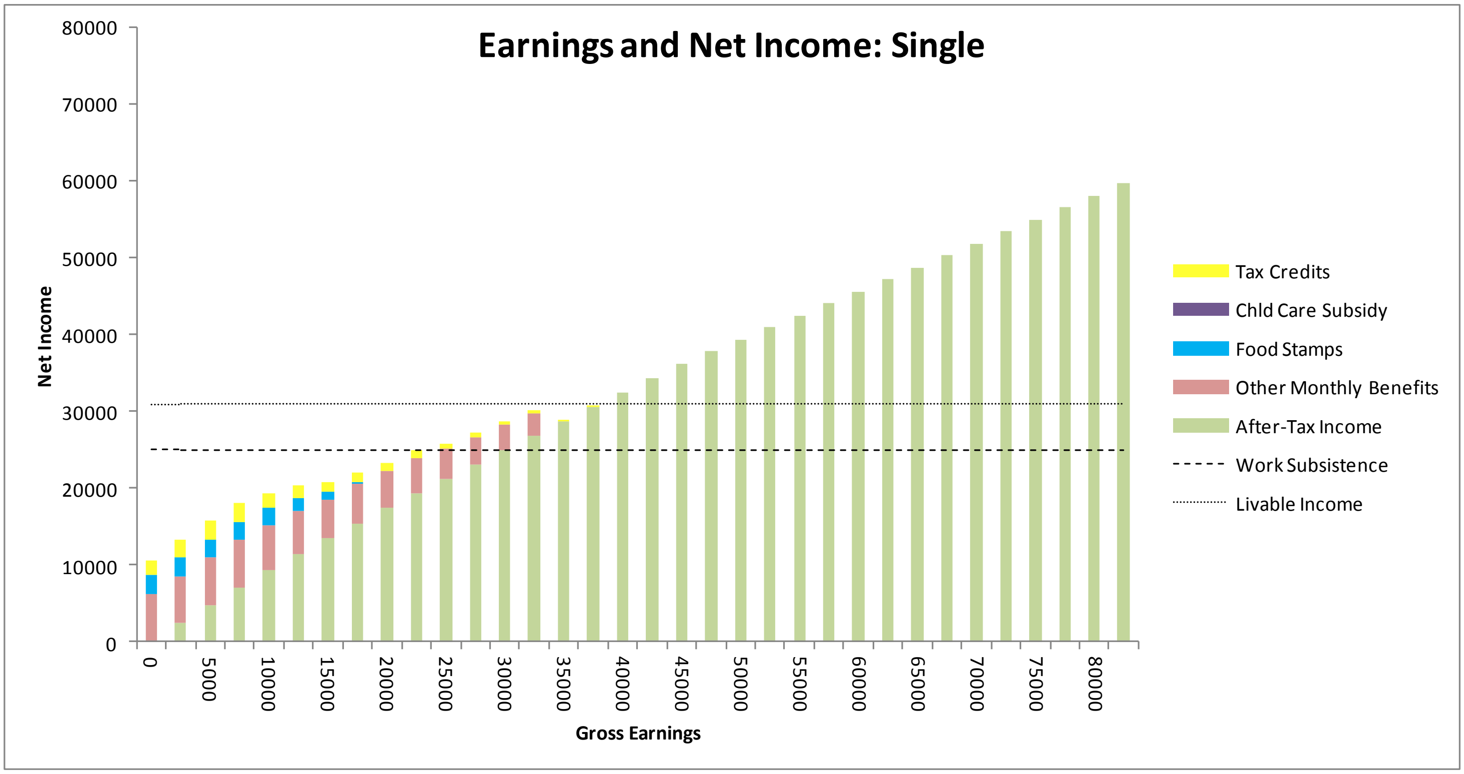
- Federal block grants for both programs — or some other means to allow us to change the interrelationships without changing the total amount of federal funds

- Waivers to allow us to change the calculation of benefits

- Additional funding from state, philanthropic, and other sources

Each page that follows shows the current situation and the result of all the changes for a particular household type.

Current



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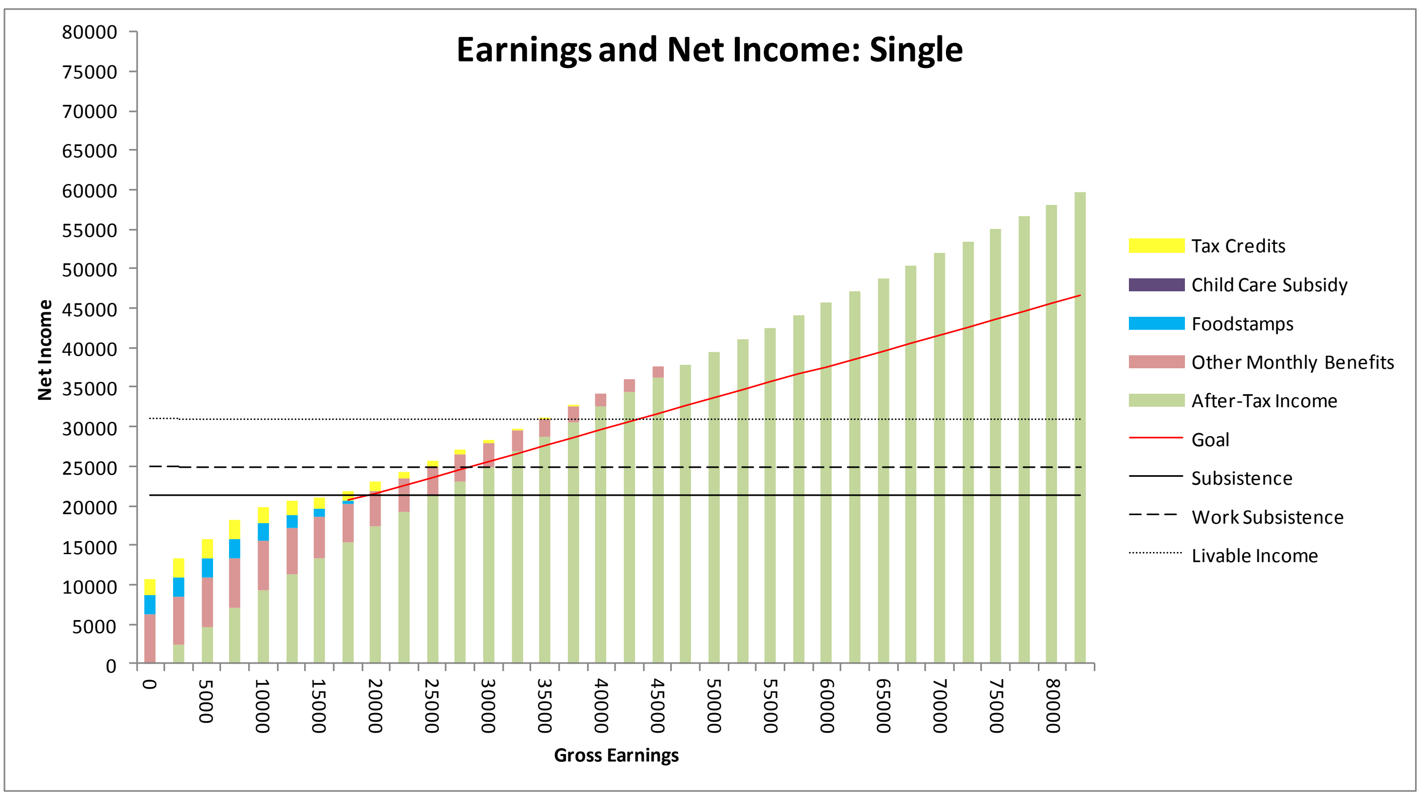

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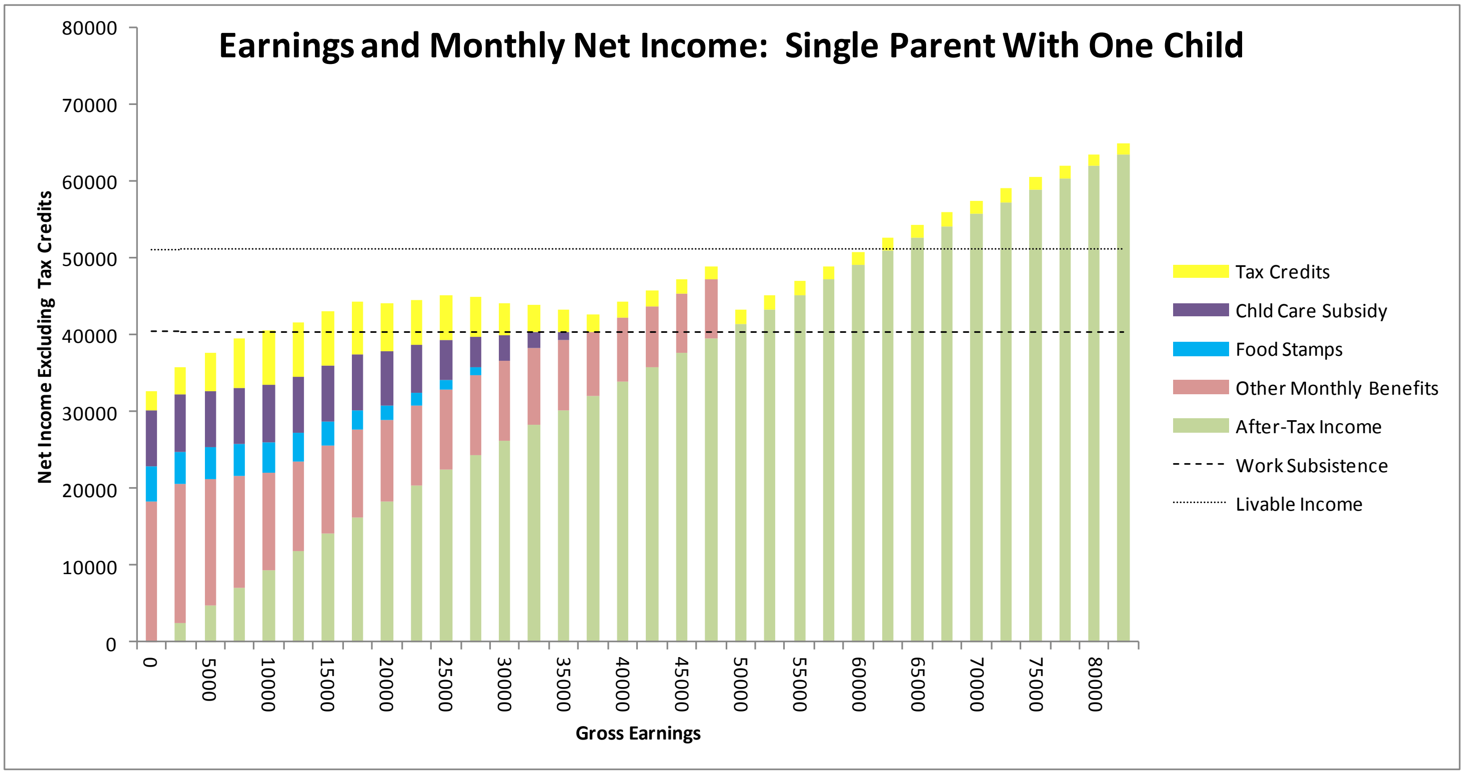

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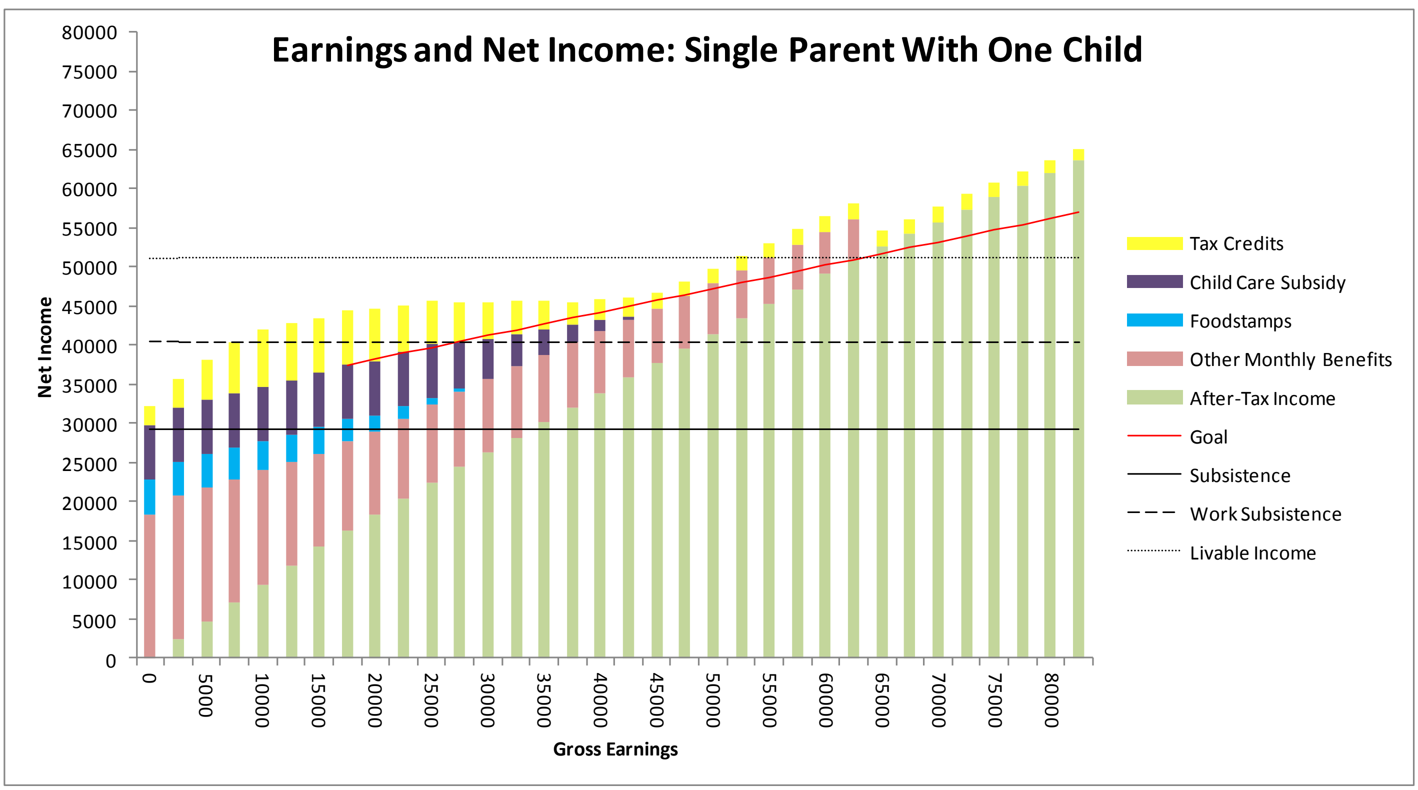

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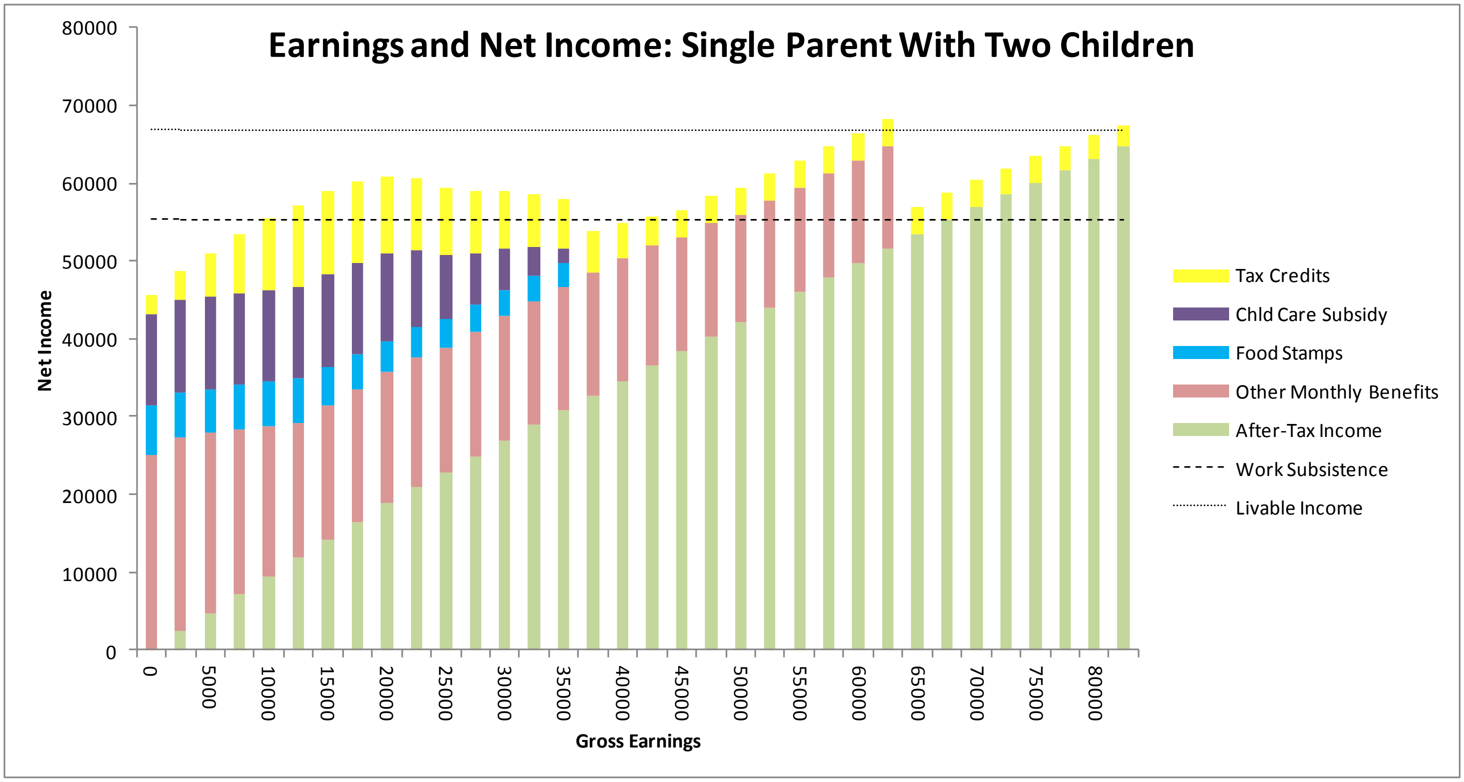

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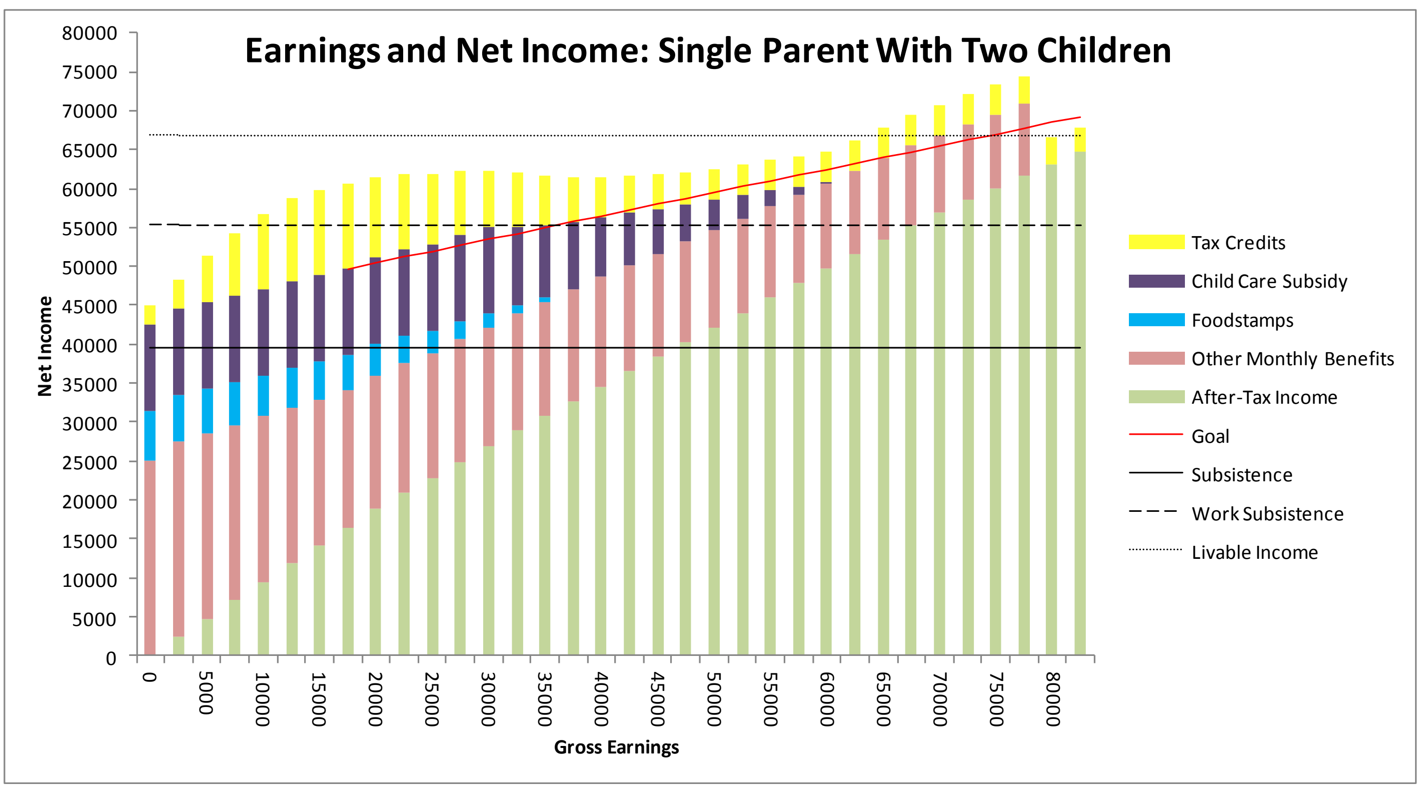

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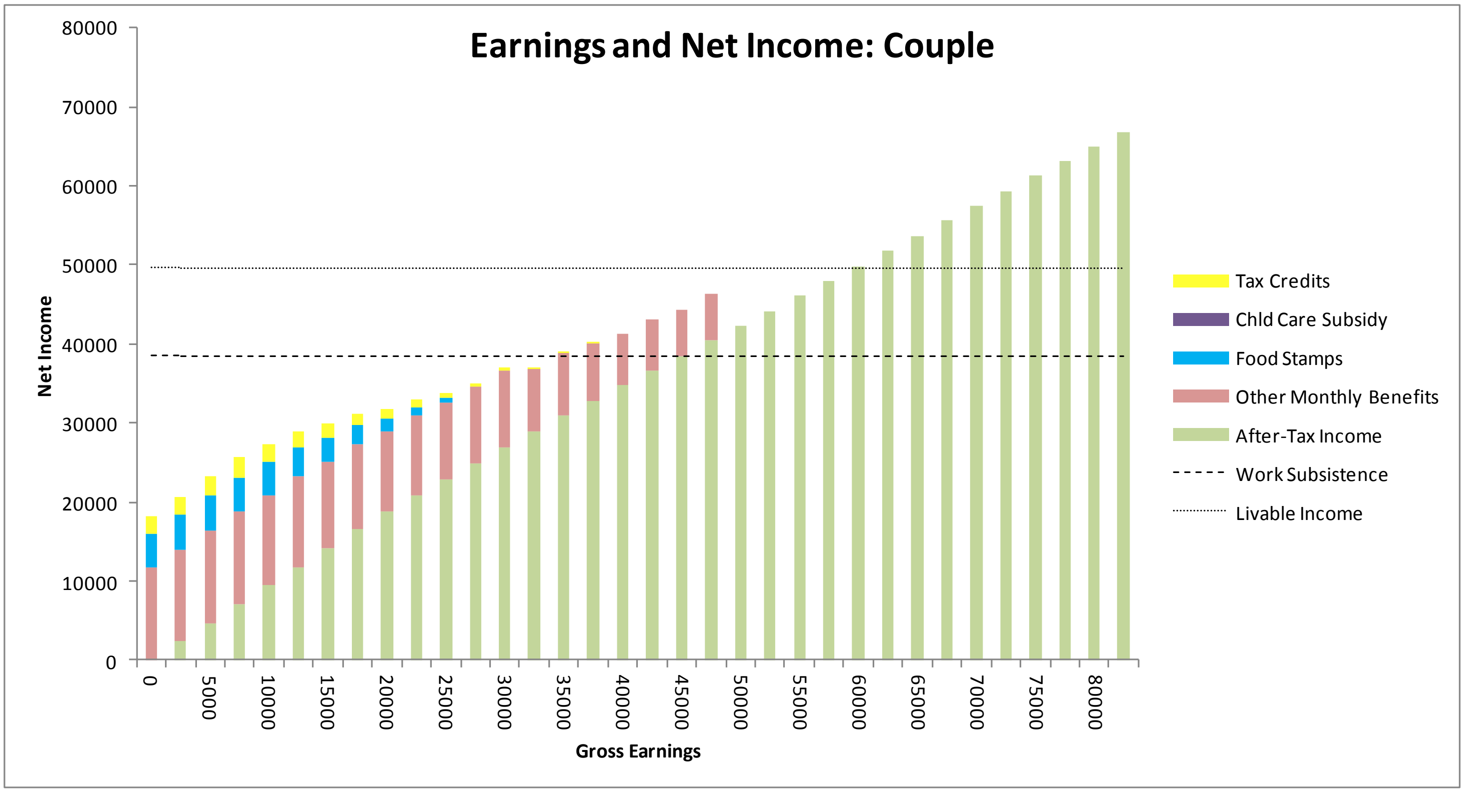

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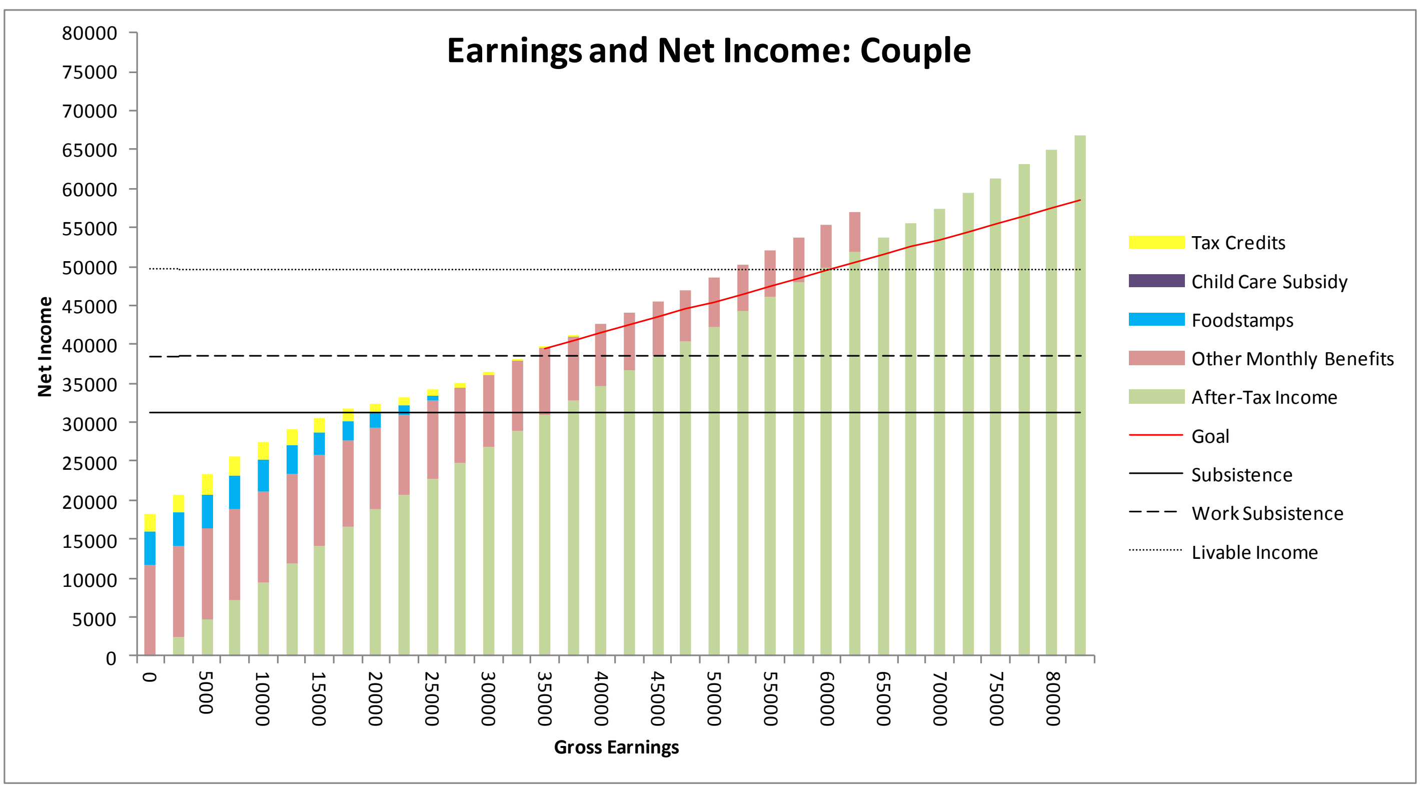

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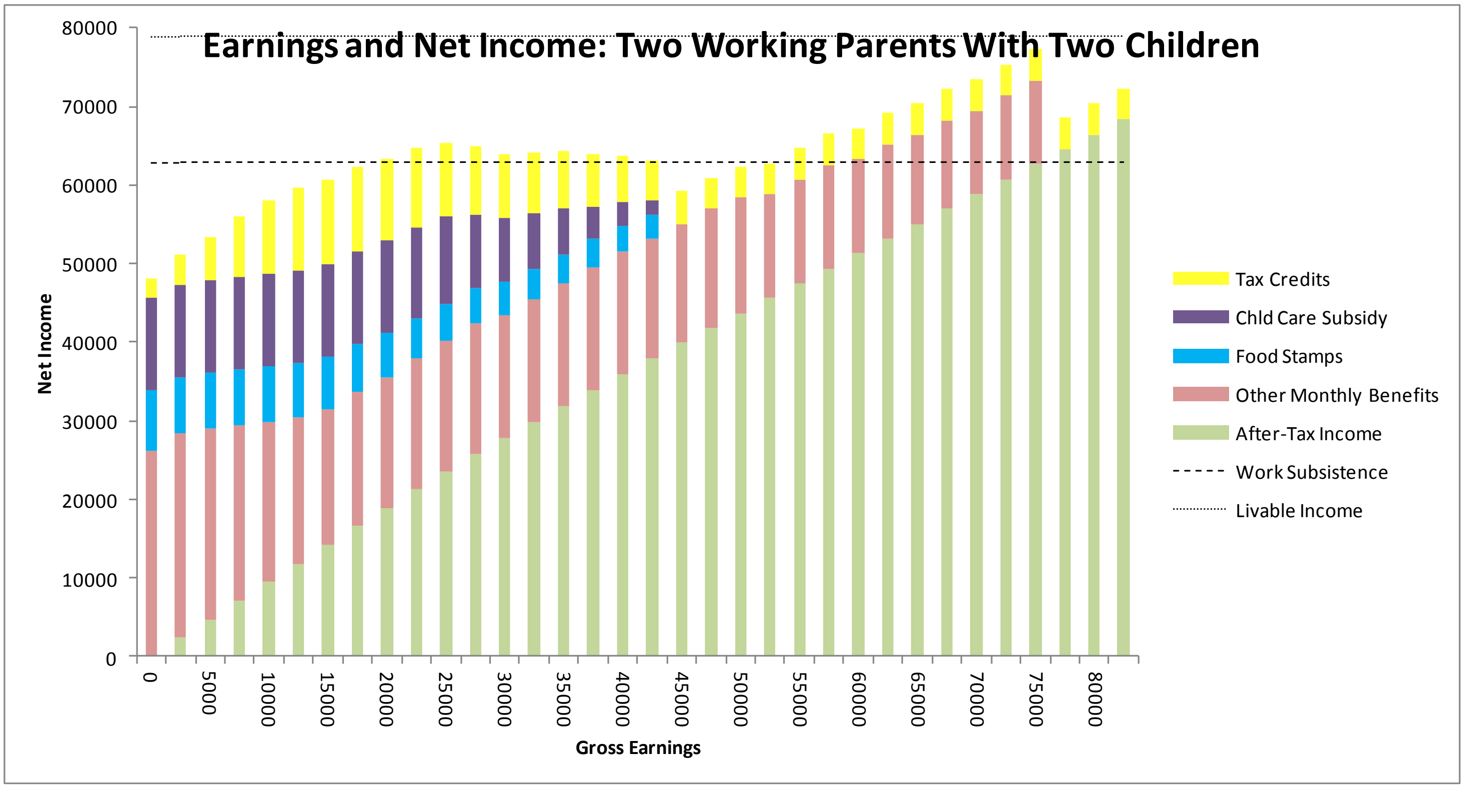

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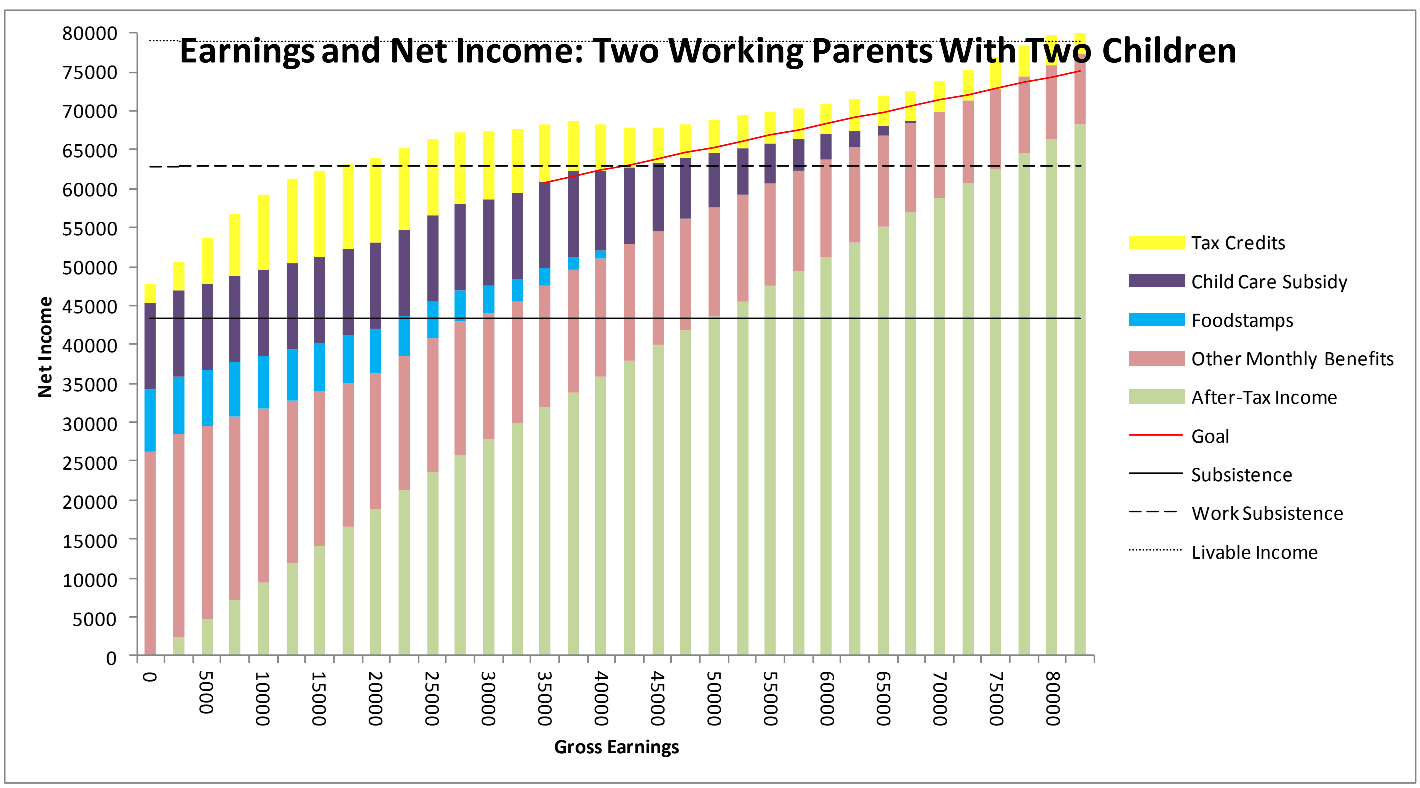

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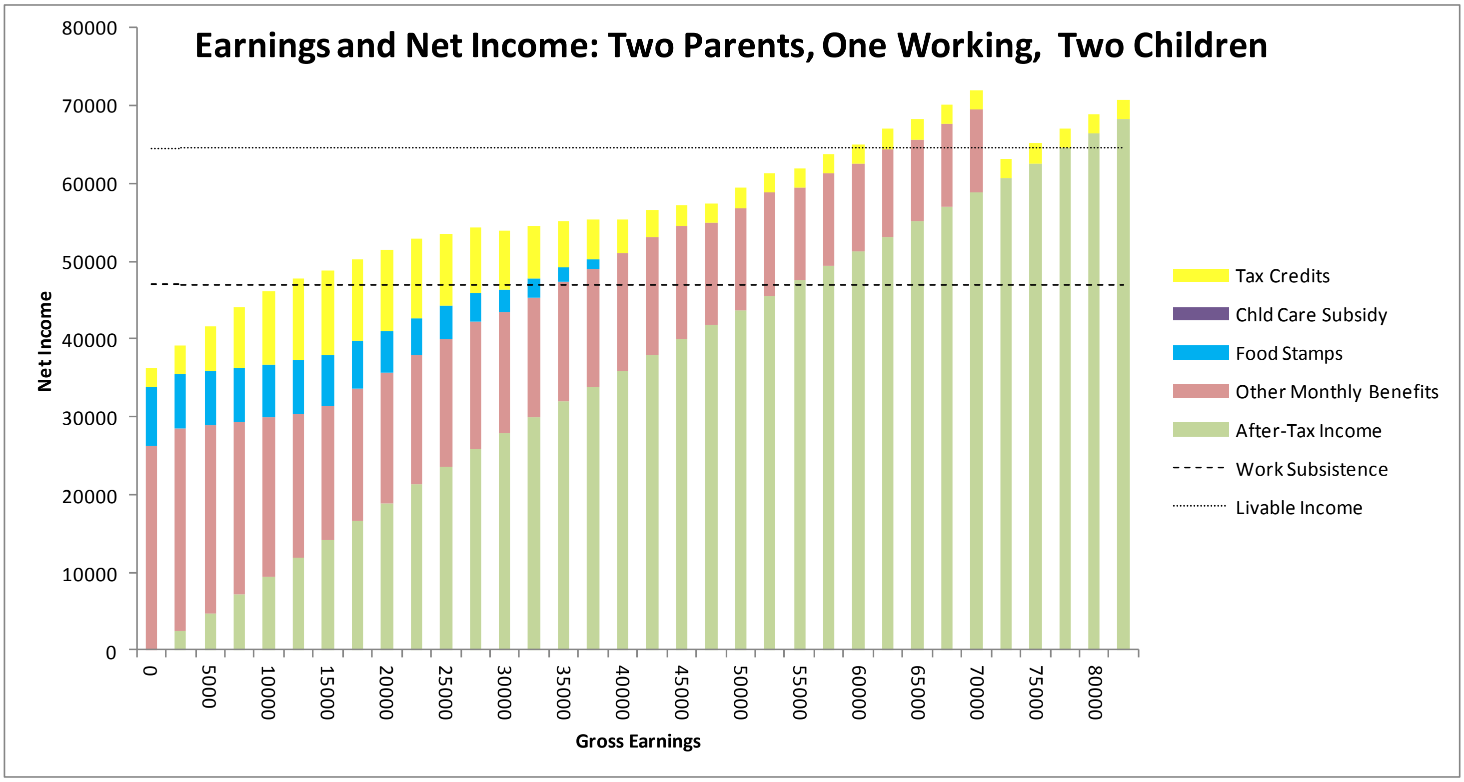

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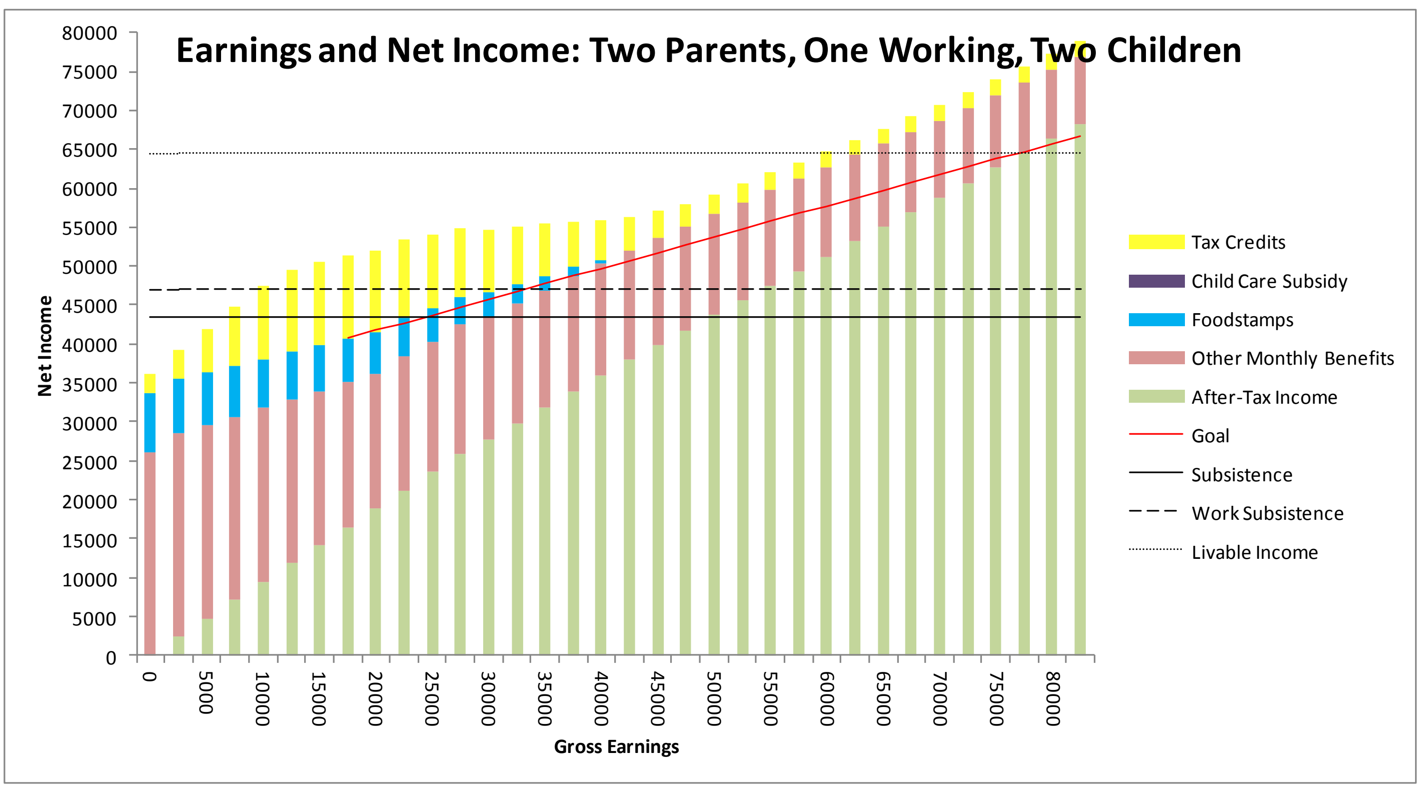

Assumptions:

The family configurations, including the ages of the children, the cost of rent, and the cost of child care are consistent with the 2010 Basic Needs Budget. The Legislative Fiscal Office determines the budget needed to meet basic needs for six different household configurations.

The assumptions involved in creating the Basic Needs Budget are:

- *Single persons and single parents are women between 20-and 50-years-old and work outside the home; all other adults are between 20-and 50-years-old*

- *All families live independently (i.e., not as sub-families living with others)*

- *One child is 4-years-old; two children are 4-and 6-years-old*

- *The younger child is a boy, the older child is a girl*

- *Housing estimates are for rental units with 1 bedroom for singles and married with no children; two bedrooms for all other family configurations*

- *Single parents receive no child support*

The benefits cliff/work incentive analysis uses the same assumptions as the Basic Needs Budgets with the following exceptions:

- An average of urban (Chittenden County) and rural (the rest of the state) is assumed
- The Basic Needs Budget calculation assumes employer-assisted health insurance, with the employee contribution equal to the 2007 average, trended. This study assumed a private-pay premium for Catamount Blue health insurance in calculating the basic needs budget used in the charts.

Additional assumptions:

- Child care subsidy based on 1 star
- Workers are full time (need full-time child care or school)
- All family members will have health insurance
- The only income is earned income
- The family takes advantage of all programs shown on the charts
- The family does not have Section 8 or other housing subsidies
- The family does not have employer-assisted health insurance