ADDRESSING THE BENEFITS CLIFF: RECOMMENDATIONS FOR FURTHER ACTION

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Part I - Introduction

In April, 2009, Governor Douglas convened the "Governor's Summit on Pathways to Economic Stability". The number one recommendation from that conference was to further tackle the "benefits cliff" phenomenon. Governor Douglas charged Secretary Hofmann and Commissioner Dale with the task of further analyzing current benefit programs and making recommendations to minimize and mitigate benefit cliffs. This report summarizes our analysis to date and recommends possible courses of action for consideration in FY'11 and ongoing as the economy improves.

The "benefits cliff" phenomenon can best be characterized as a benefits structure which results in a beneficiary who is receiving multiple economic benefits losing those benefits more rapidly than the rate of increased earnings. At its worst, the "benefits cliff" creates a huge disincentive to work.

Vermont is committed to structuring its system to encourage employment as the primary path out of poverty to self sufficiency for all those who can work. Using a model put forth by the National Center for Children in Poverty (NCCP), Vermont believes that a comprehensive work support system should: incentivize work; provide adequate family resources for all full-time workers; and reward progress in the workforce.

An initial review of Vermont's current system was completed by the NCCP in its December, 2008 report entitled "Work Supports in Vermont - An Analysis of the Effectiveness of State Policies Supporting Work". It helped galvanize political will to address this issue across political parties and branches of government. NCCP commended Vermont for its demonstrated commitment to supporting work and helping low-wage workers make ends meet. It noted that Vermont is one of only a few states that offer subsidized public health insurance to parents with incomes up to 300% of the federal poverty level and that other notable policy achievements include expanded eligibility for SNAP (food stamps) benefits, multiple refundable tax credits for low-income families, and a state minimum wage that is significantly higher than the federal minimum. NCCP asserts however, if the state's goal is to use work supports to help workers adequately meet their basic family needs and to reward increased work effort and higher earnings, there is room for improvement. It demonstrated that from the time a family of 3 is earning $17,000/year until that same family earns approximately $42,000/year, the family economic situation is not really gaining because of the rate of loss of benefits.

While NCCP's analysis focuses only on families with children and primarily on a "prototypical" single-parent family of three, the cliff effect impacts all household configurations across federal and state poverty programs as such programs were not conceived of as a comprehensive interrelated whole but were developed and put into place independently of one another over decades. Therefore, the policy lessons and implications revealed by NCCP's work can also inform other benefit programs, both financial and service-delivery based, across all populations in Vermont's public human service system.

This report addresses issues relative to the "benefits cliff" in three areas. First, it reviews action steps taken within the past year, some specifically recommended by NCCP and which are in the midst of implementation. These actions are narrow in scope and address specific programs in the short term. Second, it reviews the various other recommendations made by the NCCP in its December, 2008 report, providing further analysis and specific recommendations regarding moving forward. Most of these recommendations are similar in nature. They affect tax or spending policy related to "benefits cliffs" and the issues discussed can be addressed singularly or in concert with one another. Following each area, we provide recommendations for any immediate action. Finally, the report describes a project that the agency has begun to undertake to more comprehensively look at all benefits programs across AHS and perhaps state government to determine if there is a more comprehensive approach to addressing this issue. Ideally, this would lead to a broad waiver from federal requirements. The scope of this task far exceeds the time available to complete this report. We hope to have a product by June, 2010.

Part II—Specific Actions Underway to Make Immediate Impact

Over the past year, Vermont has undertaken three major tasks related to the structure of "benefits cliffs". One item was driven by broad-based community advocacy and strong support from the federal government. The latter two items described were recommended in the NCCP study. Neither is simple. Both have great promise to begin to help make a dent in this problem.

3 Squares Eligibility—

In January, 2009, Vermont expanded its eligibility requirements to 185% of the Federal Poverty Level (FPL) and it removed the assets test for most households. That, combined with the general worsening of the economy has resulted in a 40% increase in the numbers of households receiving the benefit. Although benefits for the upper end of the eligibility scale are not large, every little bit helps to temper the loss of benefits as earnings increase.

Recommendation: No recommendation is needed. The change has been made and implemented. Processing of increased applications will be made sustainable by a modernized eligibility system.

Home Heating Assistance—

During the 2009 legislative session, the structure of Vermont's home heating assistance was the subject of H 456. The bill passed the house and has moved on to the senate for further consideration in the second year of the biennium. Reduction of the benefits cliff needs to be the goal of any restructuring. Currently, Vermont provides the third most generous benefit in the United States, but is very restrictive in eligibility. In 2009,

Vermont's average benefit was $1,565, nearly twice the benefit of other New England states. At the same time, Vermont limits seasonal benefits to households whose income is below 125% of the Federal Poverty Level. 44 states have a more generous eligibility level. Debate has centered around the fact that this is, and should remain, a federally funded program and the challenge is to structure benefits to provide adequate support for those with very low incomes while stretching benefits to avoid a huge cliff at 125% of the FPL. The bill would make it possible to expand eligibility to 150% of FPL, but by necessity, would reduce the benefits on the lower end of the spectrum.

The benefit recipient population from such changes is projected to increase from 27,400 households assisted to 36,500 households. Applications for assistance will increase from 40,000 in the current year to 56,000. There is minimal financial impact to the state as no general fund dollars are used for Seasonal or Crisis Fuel benefits.

Existing clients will experience a decrease in their benefit levels if there is an expansion of the caseload to 150% of poverty. For FFY'10, the average full season fuel benefit is projected at $1,143. With an eligibility expansion to 150% of poverty the benefit might be between $870 and $930.

The outcome of this bill is uncertain, but we should strongly support it as an effort to impact in a small way the serious benefits cliff involved.

Recommendation: We recommend passage of H456. It does not require the expansion, but makes it possible. We will work with the various advocacy groups who have varied opinions. Advocates for the elderly clearly would like to see the expansion. Advocates for low income Vermonters are concerned about the reduced benefits for lower income Vermonters. Passage of the bill allows those debates to be brought to conclusion in the rules process.

Child Care Financial Assistance—

Vermont's current child care financial assistance program has been woefully out-of-date, both in terms of eligibility requirements (based on FPL in 1999) and benefits level (providing access to 41% of regulated providers in the state). The NCCP study identified child care as an area ripe for restructuring. Commissioner Dale and the Child Development Division have been working on a total restructuring plan since May, 2009. It was successfully implemented on January 3, 2010. The plan will bring eligibility standards up to the 2010 FPL and will set rates that allow access to 75% of higher quality care. These gains will make child care significantly more affordable for lower income Vermonters and will make access to care much more equitable. It will provide significant incentives for providers to reach higher quality standards. However, they do not radically alter the shape of the "benefits cliff". This is largely driven by the fact that from 100% to 200% of FPL, the percentage of benefit drops until a person at 190% of the FPL receives only a 10% benefit. This issue will need to receive continued attention over time.

Recommendation: No immediate recommendation is needed. The new system was implemented on January 3, 2010. We do recommend continued study to determine how best to phase out benefits more gradually.

Part III—Analysis of NCCP Recommendations for Future Action

The NCCP identified a number of areas for further analysis which they viewed as options for addressing the "benefits cliff". This section outlines each of their proposals, provides further analysis, and provides recommendations for action now and in the future, subject to resource availability.

Temporary Assistance for Needy Families (TANF) Income Disregard—

NCCP recommends that Vermont consider increasing the amount of income that is disregarded in calculating eligibility for TANF benefits. The purpose of Vermont's TANF cash assistance program (Reach Up) is to help families afford basic necessities, while supporting the transition to work and self-sufficiency. NCCP notes that in calculating a family's TANF benefits, the first $200 a month of a parent's earnings are disregarded, but as earnings rise above that level, families' TANF benefits are cut $0.75 for every additional dollar earned. Further, working TANF families may face substantial expenses for child care and commuting. As a result, parents in the TANF program may have little financial incentive to enter the workforce, even if the family faces a sanction for not working. Thus the prototypical family's budget shortfall is greater with a half-time job than without one. Reductions in TANF benefits and increases in work-related expenses more than offset the increase in the parent's earnings. NCCP suggests that Vermont could better incentivize work by increasing the TANF program's earned income disregard. Nineteen states have TANF programs with disregards of 50% or more. If Vermont doubled its earned income disregard from 25% to 50%, TANF families would lose only $0.50 in benefits (as opposed to $0.75) for every additional dollar in earnings.

Implementing this proposal would have a positive affect on Reach Up participants. It would carry an immediate increased cost, in that participants who work would be contributing less to the cost of the program. However, one would have to assume that a more effective program will result in successful outcomes for more participants, ultimately reducing program benefits costs.

For example, if this change was implemented today, impact of FY'11 reductions, including full family sanction goal, 748 families and 1330 children in the Reach Up caseload would be directly affected. Applying the current disregard of $200 and 25% to families receiving maximum Reach Up grants and working a minimum wage job, a family of two loses eligibility when a member works 30 hours per week, a family of three loses eligibility when a member works 35 hours per week, and families with more than three members lose eligibility when a member works 40 hours per week. The effect of changing the earnings disregard as proposed would

result in only families with two members losing eligibility when working 40 hours per week at minimum wage. All other families working 40 or fewer hours per week at minimum wage would remain eligible for Reach Up financial assistance. In looking at the current 748 cases in the Reach Up caseload that would be affected by this change, implementation of the recommended disregard would cost the state $67,261.00 per month or $807,132.00 yearly over the costs of the current earnings disregard. A change to the disregard will also require a law change, a rule change and IT changes. Another approach to give families a more eased transition off of Reach Up by disregarding earning while not costing as much to the state is to increase the flat part of the disregard instead of the percentage of the remainder. For example, increasing the earnings disregard to $225 and 25% for the same group of families would only cost the state $188,652 a year.

As a result of this change, Reach Up families would remain on the program longer than they would when applying the current disregard. However, they would be more likely to be meeting their work requirement.

Recommendation: At a time of serious financial shortfalls in government, it is difficult to consider this type of program expansion, despite the fact that it incentivizes positive behavior and reduces the "benefits cliff". This is something that can be kept on the agenda for future consideration.

Vermont's Refundable Child Care Tax Credit—

NCCP recommends that Vermont consider restructuring its Child Care Tax Credit. Currently, Vermont's refundable child care tax credit is worth 50% of the federal Child and Dependent Care Tax Credit. To be eligible, family income cannot exceed $30,000 a year ($40,000 for married filers) and child care expenses must be for a "qualified" provider: one with national accreditation or with three or more stars from the state's rating system, the Step Ahead Recognition System (STARS). The federal Child and Dependent Care Tax Credit is nonrefundable, so while it subsidizes care for some families, it provides no benefits to families whose income is too low to owe federal income tax. Since Vermont's credit is refundable, its value is not limited by the family's state tax liability; families who owe little or no state taxes can theoretically receive the credit as a tax refund. However, it is limited by the family's federal income tax liability. That is, families can only claim 50% of the (nonrefundable) federal credit that they actually received, after comparing that credit to their federal tax liability. Vermont could follow the lead of several other states that calculate their child care tax credits based on the federal credit for which a family is potentially eligible before that amount is limited by federal tax liability. This, in effect, would make Vermont's "refundable" child care tax credit truly function as a refundable credit and greatly increase its value.

This proposal, while having conceptual appeal, presents a number of very practical challenges. The Commissioner of the Vermont Department of Taxes does not have the ability to de-couple from the federal government solely based on his authority. There are significant administrative savings associated with following the federal government on this and even if they were to de-couple, it would take considerable staff and IT work to accomplish.

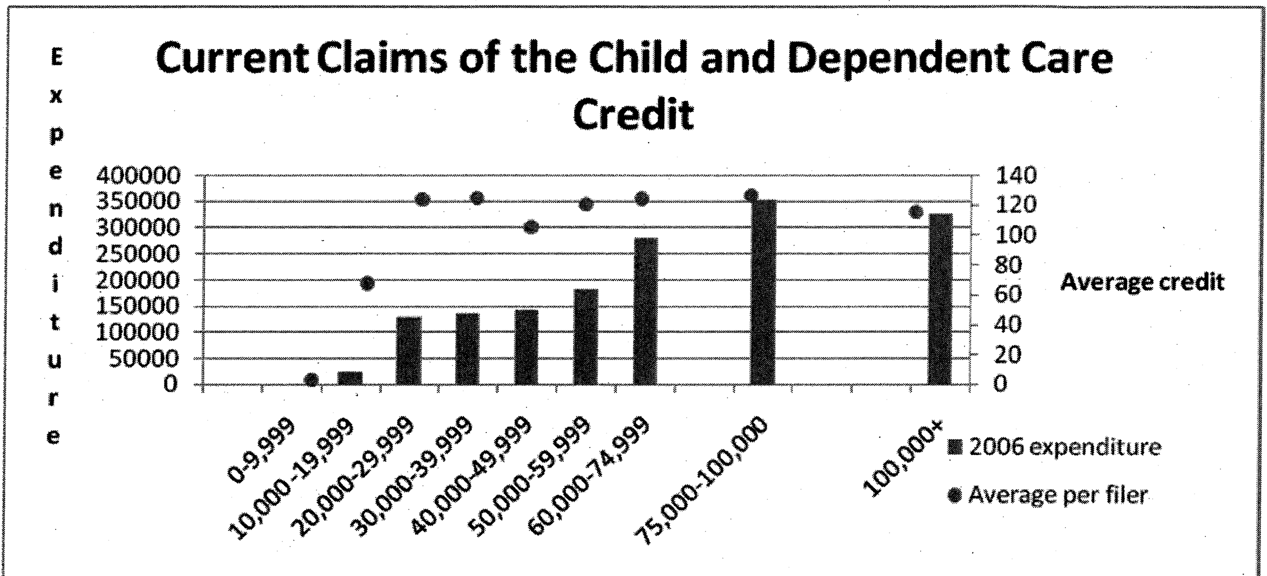
Recommendation: We recommend continuing to research this concept, but not trying to implement this type of change in the near term.

Child and Dependent Care Tax Credit—

Vermont also has a second child care tax credit worth 24% of the federal Child and Dependent Care Tax Credit. This credit is nonrefundable and is available to all families who qualify for the federal credit, without income limit and regardless of the type of care used. Vermont could consider making this credit refundable as well, at least for lower income families. Only a small minority of the state's child care providers qualifies for the state's refundable child care credit and low-income families are generally unable to benefit from nonrefundable provisions. Since this second credit is worth less than half of the first, there would still be a financial incentive to use a "qualified" provider.

The following information is provided by the Tax Department and demonstrates the impact of restructuring.

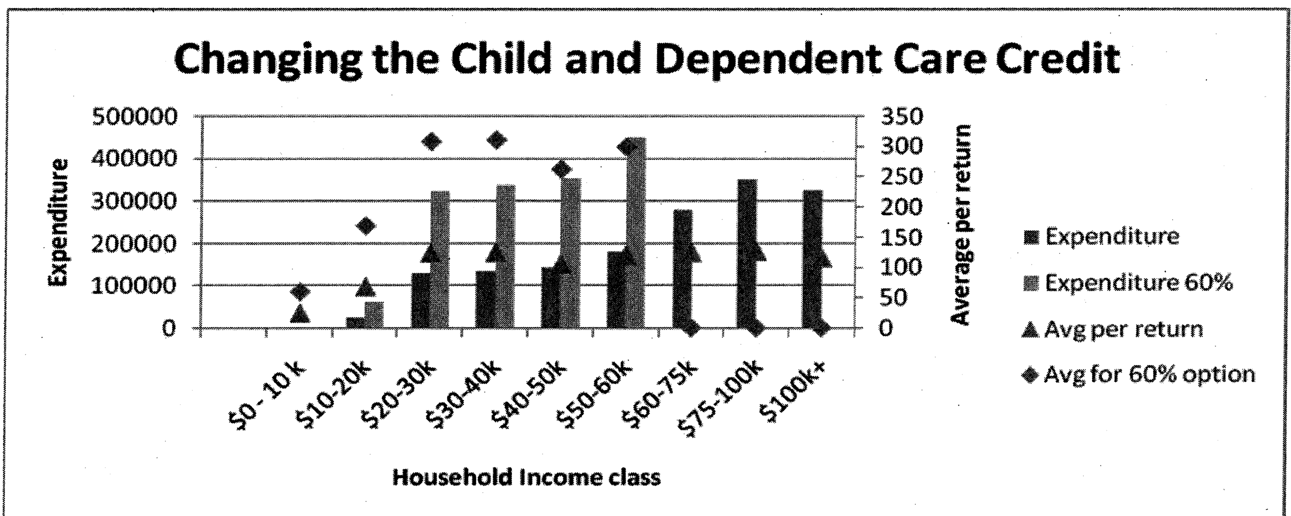
The Vermont Child and Dependent Care Tax Credit provides a reduction in tax to Vermont households based on a federal credit. The expenditure for the credit in 2006 was $1.64 million distributed to 14,590 households. "Tax Expenditure" is the value of the credit and is the revenue no longer available to the Vermont General Fund. Both the federal and state credits are provided to households of at all income levels and the 2006 distribution of benefits is shown below.



This graph shows that the child care tax credits provide a relatively constant benefit to households with an income greater than $20,000 (average per filer). The graph also shows that a significant proportion of the credit is claimed by households with income greater than $50,000.

A possible change to the Vermont credit program

The benefit can be shifted to remove the credit from higher income households (> $60,000) and distribute the reduced expenditure ($950,000) to households with an income <$60,000. The changed distribution is the result of changing the credit value from 24% to 60% of the federal credit. For most eligible households, this results in an increased benefit of almost $200.



Recommendation: We strongly recommend that the Legislature further consider this adjustment in the Child and Dependent Care Credit. It is cost-neutral to the State but would have an impact on some middle income Vermont households. Ultimately however, it would make a small step toward impacting the "benefits cliff" and is worthy of further discussion.

Vermont's Renter Rebate Program—

NCCP recommends that Vermont revisit its Renter Rebate Program. Currently, Vermont's income sensitivity provision for property taxes provides much more generous rebates for homeowners who make up to $90,000 in household income. Currently, renters receive a benefit only up to $47,000. If the target population for reduction of "benefits cliff" is 100%-200% of the Federal Poverty Level, a change in the overall income sensitivity program should consider reducing benefits for the higher income earners and shift those benefits toward the target population, including those who are renting. An increase in the income limit to which renters rebate would apply would assist in smoothing the benefits cliff.

Recommendation: The whole matter of income sensitivity is part of the Governor's overall proposal regarding education funding reform. We recommend that the Legislature adopt an adjustment in the Renter Rebate Program.

Child Support Benefits/Child Support Disregard—

NCCP also recommends looking at policy relative to child support. Child support is critical for many families, but these payments can also lead to significant reductions in benefits, particularly those receiving TANF cash assistance. By federal law, TANF families are required to sign over their rights to child support to the state. Most states then withhold most or all of the child support money collected as reimbursement for the state's TANF payments. Vermont is one of only two states in the country that pass on the full amount of child support payments to families in the TANF program. But while passing through child support income allows families to see the contribution that noncustodial parents are making to their children's care, it does not necessarily make the families financially better off. In Vermont, only the first $50 a month of child support income is disregarded when calculating TANF benefits; every $1 of child support above that amount results in a $1 reduction in TANF assistance. The end result is that child support payments may make little financial difference for the families who receive them.

Increasing the TANF child support disregard would increase noncustodial parents' incentive to pay child support and ensure that those payments truly benefit the children for whom they are intended. Important changes in federal policy went into effect in October, 2008 that makes it less costly for states to increase child support disregards in their TANF programs. When states withhold child support payments made on behalf of TANF families, part of the payment is forwarded on to the federal government. Prior to

October, even if a state passed through and disregarded a portion of a family's child support payment, the state still had to send the federal government its share of the full amount. Now, the federal government will waive its share of collections on support that is disregarded, up to $100 a month for one child and up to $200 for two or more children.

For state FY'11, the estimated number of families affected by the proposed increase in their child support disregard is approximately 1,040 families and at least 1,847 children. The financial effect on recipients is the potential for an increase of monthly family income of $50 - $150. The state would bear the bulk of costs related to the increased disregard. The net increase in costs for Vermont would be in the neighborhood of $556,164. Although it provides better incentive for the non-custodial parent to pay additional child support and makes life better for children, it could have the impact of families remaining on Reach Up for a longer period of time.

Recommendation: Given the increased costs in these times and the unclear relationship to work supports, we do not recommend pursuing this recommendation at this time.

Part IV – A More Comprehensive Review

The specific recommendations analyzed in this document are focused on particular programs or tax policies. They do not attempt to analyze the total of all benefit programs nor do they propose a global systemic solution to the phenomenon of "benefits cliffs". Therefore, AHS, with DCF and DAIL as co-leads, has also just embarked upon an additional work effort designed to put forward budget neutral, if not budget saving, proposals to align and simplify benefit eligibility criteria across all financial benefit programs.

Benefits "simplification" will perfectly complement benefits "modernization" efforts already underway. A simplified process would allow for a more logical benefits structure, would increase public understanding, would reduce errors, and would reduce processing time and complexity by staff. Over time, it should reduce costs. The required legal, financial, and operational analysis will take place over the next several months with a second recommendations report anticipated by July, 2010.

As articulated by a majority of the Governor's Summit attendees in April, 2009, a primary goal and hope of this benefit simplification and alignment effort is that Vermont may be able to secure waiver or demonstration authority from our federal partners to pilot a unified, aligned and simplified approach, that is comprehensively designed across all public benefit poverty program areas and populations, which can save money in order to then be able afford to expand programs, as minimally and reasonably necessary, to incentivize work, reward advancement in the workforce, and provide adequate resources to individuals and families as they proceed on a graduated path to truly sustainable self-sufficiency.