NCCP National Center for Children in Poverty
Columbia University
MAILMAN SCHOOL OF PUBLIC HEALTH

WHEN WORK DOESN'T PAY

WHAT EVERY POLICYMAKER SHOULD KNOW

Nancy K. Cauthen ▪ June 2006

DEFINING THE CHALLENGE

A full-time job at low wages is often not enough to support a family, and many parents cannot get ahead simply by earning more. Consider the situation of Becky Evans, a single mother with two small children living in Philadelphia, Pennsylvania. Becky works full-time at $8.00 an hour—nearly $3.00 above the federal minimum wage—which gets her family to the poverty level for a family of three, $16,600 a year. But the poverty level is widely acknowledged to be an outdated and inadequate standard of need. The National Center for Children in Poverty's Family Resource Simulator[1] shows that Becky needs to earn $40,600 a year to cover her family's most basic expenses without the help of government benefits.[2] At $8.00 an hour, Becky would have to work 98 hours a week just to make ends meet!

To assist low-wage workers and their families, the federal and state governments provide a set of "work supports"—benefits such as earned income tax credits, child care subsidies, health care coverage, food stamps, and others. These benefits are means-tested, so as earnings increase—particularly as they rise above the official poverty level—families begin to lose eligibility even though they are not yet self-sufficient. The result is that parents can work and earn more without their families moving closer to financial security.

Basic Needs Budget for Becky's Family

	Annual	Monthly
Rent and Utilities	$10,704	$892
Food	$4,978	$415
Child Care	$11,700	$975
Health Insurance	$1,656	$138
Transportation	$1,272	$106
Other Necessities*	$4,234	$353
Payroll and Income Taxes	$6,037	$503
TOTAL	**$40,581**	**$3,382**

* Examples of "other necessities" include clothing, school supplies, household items, and personal care expenses.

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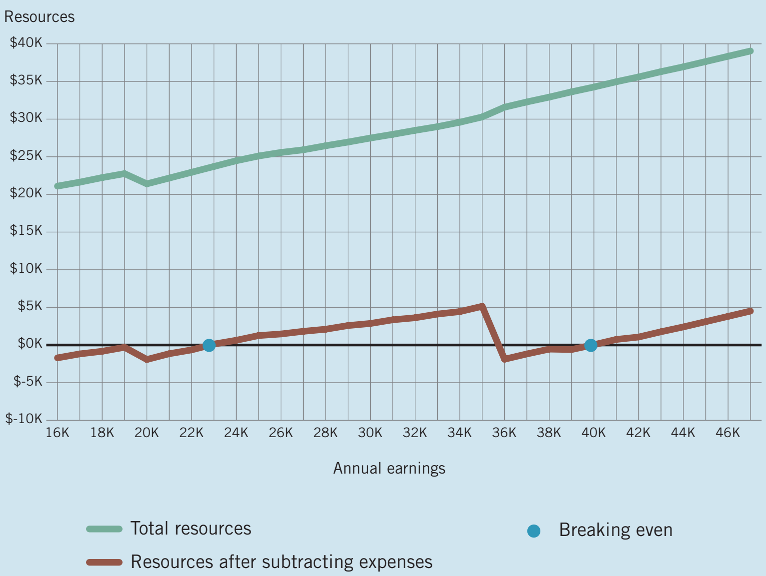
Assume, for example, that Becky's family receives the federal Earned Income Tax Credit (EITC), public health insurance, child care subsidies, and food stamps, when financially eligible. The figure below shows how the family's financial resources would change if Becky gradually increased her earnings from the poverty level, $16,600, to $46,000. The top line shows Becky's total cash resources (including food stamps). The bottom line shows what's left after subtracting the cost of housing, food, child care, health insurance, transportation, other necessities, and payroll and income taxes.

Becky's Resources Before and After Subtracting Expenses



The line illustrating what's left after Becky pays her bills tells a troubling story. Even with the help of government work supports, Becky can't cover her family's basic expenses until her earnings reach about $23,000, which would require full-time work at $11.05 an hour. She can almost make ends meet at about $19,000 in earnings, but by $20,000, her family is no longer eligible for food stamps and falls farther behind.

If her earnings increase beyond $23,000, Becky will have a small cushion in her budget that could be saved or used to cover an emergency. But if her income reaches $36,000, she will lose her child care subsidy. Subsequent earnings gains will be reduced as her children lose their health insurance, and Becky begins to pay premiums.[3] Becky's earnings will have to increase to $40,000 before she breaks even again. The bottom line is that Becky's family is no better off financially if she earns $40,000 than if she earns $23,000.

What Happens When Families Can't Make Ends Meet?

When families have to get by on less than an adequate amount, they face tough choices:

- Select cheaper child care that may be less safe or less stable?
- Go without health insurance or needed medical care?
- Live in an unsafe neighborhood or in overcrowded housing?
- Go hungry at the end of the month?

DIAGNOSING THE PROBLEM

Cliffs and Phase-Outs

Why is it that additional earnings don't guarantee financial relief and can even leave a family with less? The answer lies in the structure of current work support programs. Although each program is different, most can be characterized by the following elements:

- **Cliff:** The benefit is completely terminated when the family reaches the eligibility limit.
- **Phase out:** The benefit is gradually reduced as earnings increase.

Some work support benefits have both elements. The amount of a family's food stamp benefit is reduced as earnings increase, but the family eventually faces a cliff. For example, an additional $1,000 in yearly earnings—from $19,000 to $20,000—led Becky's family to lose $2,125 a year in food stamps because they were no longer eligible, leaving her family worse off.

Likewise, in some subsidized child care programs, there is a gradual increase in copayments and then a complete termination of benefits when the family reaches an eligibility limit, which often forces the family to choose lower quality or less reliable care. In other programs, such as Medicaid, an additional dollar of earnings results in a complete loss of the benefit once the family reaches the eligibility limit.[4]

High "Marginal Tax Rates"

Since eligibility and phase-out rules for different programs are typically designed independently from one another, they can have a cumulative effect far more severe than policymakers likely intended. For example, if three benefits each phase out at a rate of $.30 for each $1 of earnings, the cumulative effect could be that an additional dollar of earnings results in a loss of $.90 in benefits, leaving only a $.10 gain. This is the equivalent of a 90 percent "marginal tax rate." Although not really a tax, the concept of a marginal tax rate is useful because it conveys the net value of additional earnings.

The impact of marginal tax rates may be less severe if a family is not receiving multiple benefits. But these aggregate effects will become increasingly important if efforts to promote participation in work support programs continue and more families receive the benefits for which they are eligible.[5] Without multiple benefits, many low-wage earners will be hard pressed to provide adequately for their families, despite hard work.

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Becky's Resources and Expenses as Earnings Increase

	$16,600 (100% FPL*)	$33,200 (200% FPL)	Net change
Resources			
Post-tax Earnings	$14,583	$26,959	$12,376
Federal EITC	$3,600	$104	($3,496)
Child Tax Credit	$610	$2,000	$1,390
Food Stamps	$2,623	$0	($2,623)
Expenses			
Rent and Utilities	$10,704	$10,704	$0
Food	$4,978	$4,978	$0
Child Care	$1,040	$3,120	$2,080
Health Insurance	$580	$580	$0
Transportation	$1,272	$1,272	$0
Other Necessities	$4,234	$4,234	$0
Net Resources after Expenses	**($1,392)**	**$4,175**	**Net gain: $5,567**

* Federal poverty level

The chart helps illustrate the dilemma facing low-income parents. It breaks down the components of Becky's resources and expenses at two levels of earnings: $16,600 annually, which is the federal poverty level for a family of three, and $33,200, twice the poverty level. (Twice the poverty level is widely accepted as a reasonable definition of "low income," that is, having less income than is needed to meet basic needs.[6])

With earnings at the poverty level ($16,600) and multiple work supports—the federal EITC, the Child Tax Credit, food stamps, child care subsidies, and health insurance for her children—Becky is only about $1,400 (about $120 a month) short of being able to meet her family's basic needs budget. Despite her low wages, these work supports make it possible for Becky to come very close to making ends meet.

If she doubles her earnings to twice the poverty level ($33,200), Becky will have $464 a month above her basic budget. But even though her wages have doubled, Becky's net gain is only about $5,600. In other words, $16,600 in additional earnings leave Becky with only a $5,600 improvement in her financial bottom line. This represents a "marginal tax rate" of 66 percent—Becky's net gain is only 34 percent of her increase in earnings.

WHAT CAN BE DONE

Here is the dilemma: although our nation highly values work, parents working full-time cannot always provide adequately for their families. Nearly 30 million Americans—a quarter of the U.S. labor force—work in jobs that pay poverty-level wages and provide few prospects for advancement and wage growth.[7] Some 24 million children live in low-income families despite having at least one parent who works; 16 million of these children have a parent who works full-time, year-round.[8] In other words, this is no small problem.

If, as a nation, we believe that parents who work full-time ought to be able to provide their families with a minimally adequate standard of living, we must address the needs of the large numbers of low-wage workers whose incomes are above the federal poverty level but below self-sufficiency. It is arguably these workers and their families who are the least well served by our current work support system.

A comprehensive work support system should have two key goals:

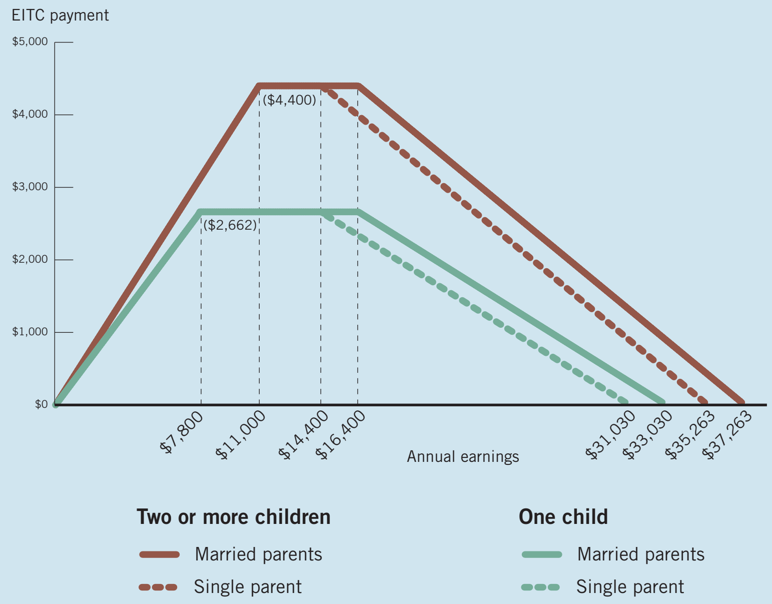
1) **Ensure adequate family resources.** The combination of full-time work and public benefits should provide the minimum resources necessary to cover a family's basic needs.

2) **Reward progress in the workforce.** Earning more should always improve a family's financial bottom line.

Here are four ways to work toward achieving these goals:

1) **Phase benefits out gradually to avoid steep cliffs.** The federal EITC provides an example: the benefit initially grows with earnings, reaches a "plateau" (at which point the benefit is not reduced as earnings increase), and then phases out gradually. By the time the family loses eligibility, the benefit loss is small.

Federal EITC Payment Structure, Tax Year 2005



2) **Raise eligibility limits.** In the absence of higher wages, expanded eligibility levels that are well beyond the federal poverty level are one way to help low-wage workers achieve resource adequacy.

3) **Serve a greater share of eligible families.** Some benefits, such as child care subsidies, reach only a fraction of eligible families. Few working families outside the welfare system get child care subsidies, despite relatively generous eligibility levels on paper.

4) **Be mindful of program interactions.** Coordinating eligibility rules and phase-outs across programs can help ensure that families receiving multiple benefits don't lose them simultaneously because of small increases in earnings.

All of these solutions cost money, which means tough choices for policymakers who are responsible for balancing state budgets, even as demands grow. But there are manageable ways of making work pay if states, the federal government, and the private sector work together to do so.

NCCP Can Help Policymakers Find Solutions

NCCP's *Making "Work Supports" Work* initiative is designed to help policymakers explore policy challenges and identify feasible solutions.* In collaboration with state partners, the initiative seeks to:

- Highlight aspects of the current structure of work support policies that lead to high marginal tax rates.
- Identify policy alternatives that would better meet the needs of low-wage workers supporting families.
- Illustrate trade-offs among various policy options.
- Estimate the costs of different policy reforms.

For more information about the initiative and how NCCP can help, see *Making "Work Supports" Work* <nccp.org/mwsw_index.html> or contact us at info@nccp.org.

* *Making "Work Supports" Work* builds on NCCP's Family Resource Simulator. See Endnote 1.

Endnotes

1. The Family Resource Simulator (FRS) is a state-specific, web-based tool that calculates family resources and expenses as earnings increase, taking public benefits into account. See <nccp.org/modeler/modeler.cgi>. The FRS is available for 10 states—Alabama, Connecticut, Delaware, Georgia, Illinois, Maryland, Massachusetts, Pennsylvania, New York, and Texas—and the District of Columbia. Additional states will continue to be added.

2. This budget assumes that Becky has a preschool-aged child and a school-aged child who are cared for in a center-based setting while she is at work. It also assumes that Becky has access to health insurance coverage through her employer. For information about how the FRS calculates expenses, see the FRS User Guide at <nccp.org/modeler/modeler.cgi>.

3. This scenario assumes that Becky has access to employer-based health coverage. If she did not, the cost of health insurance would be much higher.

4. Parents typically lose eligibility for health insurance at dramatically lower income levels than do children. Eligibility limits for children sometimes vary by age.

5. For an analysis of the potential role of employers in improving access to work supports, see Frank, A.; Greenberg, M.; & Zdenek, R. (2006). *Getting connected: Employer engagement in work supports* (Workforce Development Series, Policy Paper 1). Washington, DC: Center for Law and Social Policy.

6. Research shows that it takes an income of one and a half to more than three times the federal poverty level for a family to make ends meet without government benefits, depending on the local cost of living.

7. Shulman, B. (2003). *The betrayal of work: How low-wage jobs fail 30 million Americans*. New York, NY: The New Press.

8. See NCCP's national demographic profile at <nccp.org/state_detail_demographic_low_income_US.html>.

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The National Center for Children in Poverty (NCCP) is the nation's leading public policy center dedicated to promoting the economic security, health, and well-being of America's low-income families and children. Using research to inform policy and practice, NCCP seeks to advance family-oriented solutions and the strategic use of public resources at the state and national levels to ensure positive outcomes for the next generation. Founded in 1989 as a division of the Mailman School of Public Health at Columbia University, NCCP is a nonpartisan, public interest research organization.

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This brief seeks to inform policymakers and others about the difficulties faced by low-income working parents as they strive to make progress in the workforce. Using data from NCCP's Family Resource Simulator, it highlights ways in which the current structure of work support policies often leads to unintended consequences. As low-wage workers increase their earnings above the federal poverty level, their families begin to lose eligibility for government work supports. Given that some of these benefits drop off quickly, earning more does not always improve a family's financial bottom line.

AUTHOR

Nancy K. Cauthen, Ph.D., is Deputy Director at NCCP, where her current research examines the effects of state and federal policies on the ability of low-wage workers to achieve economic security for their families. She has written extensively on low-wage work and child poverty in the United States, the inadequacies of the federal poverty measure, and current policy debates affecting low-income children and families.

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