

Working Families Assistance Systems in Wisconsin: A Critical Analysis

Or

When a Raise Becomes a Pay Cut for Low- Income Workers

Prepared by:

Kathleen Mulligan Hansel (Institute for Wisconsin's Future)

John Tapogna and Tara Witt (ECONorthwest)

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Overview

For many low-income families, increased earnings quickly result in the loss of food stamps, health insurance, childcare subsidies and tax credits, even while the family is not yet financially capable of covering these costs independently. Thus, the marginal tax rates for many of Wisconsin's low-wage workers at times exceed 100%. The loss in benefits and tax credits in the climb up the wage ladder often erases the worker's additional earnings gained from a raise, and in so doing also erases the worker's financial incentive to gain skills and responsibility.

This is a problem for Wisconsin, which needs to increase its supply of skilled workers. Changes in public assistance policies (implemented in W-2) have produced a new population of workers. These workers' entry into the labor force may provide an important new pool of labor to fuel Wisconsin's expansion. Yet, current state policies impede these workers' abilities to move into higher skilled jobs that pay more. These conditions provide a mandate for discussions about policy solutions to the structural problems that threaten to hinder Wisconsin's economic expansion and undermine the working and living conditions of low-wage workers

Federal and state policy changes are designed to help low-income families move from welfare to work. However, these work support programs are highly front-loaded, so while the incentives are strong to seek that initial low-wage job, there is considerably less incentive to seek higher paying jobs, since subsidies are phased out so rapidly. Once low-wage workers begin to advance up the wage ladder, under the current system of assistance, they encounter a series of income "cliffs" which cause the workers to lose discretionary income as their wages rise above certain levels. Moving from a minimum-wage job to a higher-paying job can actually leave the family economically worse off. Improving these incentives will require a restructuring of federal and state tax credit and childcare-subsidy programs.

Utilizing the FIRST Model (Family Income Resource Simulation Tool – an interactive computer program), it is now possible to demonstrate how different families' income, tax credits or liabilities, and subsidies (child care, health insurance, Food Stamps) change as that family moves from minimum wage through hourly wages up to \$20 per hour in any of Wisconsin's 72 counties.

With this information, business leaders, policymakers and labor organizations can determine those policies that act as a barrier to worker mobility and availability to meet employment gaps.

The benefit and tax calculator shows a family's eligibility for a number of government benefits and the amount of aid received based upon family income from wages and child support. It additionally calculates federal and state tax credits minus payroll taxes and tax liabilities based on federal and state laws published as of December 1999. (Federal and State tax laws are for the year 2000.) In this section, we provide brief summaries of the programs included in the model and illustrate how the program benefit levels decrease as family earned income rises.

ELIGIBILITY CRITERIA OF THE MODELED PROGRAMS

FOOD STAMP PROGRAM

The Food Stamp Program supplements food budgets of low-income households with children, as well as the working-poor, elderly, and disabled individuals. The maximum benefit for a household of three is \$335 per month. After certain deductions and allowances, a household's food stamp benefit declines by \$0.30 for each \$1.00 of earned or unearned income.

BADGERCARE/EMPLOYER-SUBSIDIZED HEALTH INSURANCE

Families with monthly incomes up to 200% of the federal poverty threshold are eligible for BadgerCare coverage¹, which expands Medicaid (Title 19) coverage to low-income workers and their families. Families with incomes below 150% of poverty pay no premium. Families with incomes between 150% and 200% of poverty pay a premium equal to 3% of countable income, as defined by the program.

For families with employer-provided insurance, the reported medical "subsidy" equals total health care expenditures minus the worker's share of premiums and out-of-pocket expenses. Estimates of a family's premium costs and out-of-pocket expenses are calculated using data from the National Medical Expenditures Survey, the Families USA report and the Wisconsin Office of the Commissioner of Insurance.

CHILDCARE ASSISTANCE-WISCONSIN SHARES

The Wisconsin Shares program subsidizes work-related, childcare expenses for families with incomes up to 200% of poverty. The state pays a portion of the family's total childcare bill, which declines as family income rises. Moreover, the state subsidizes expenses only up to a maximum-payment standard. If a family chooses a provider whose rates exceed the standard, the family must pay the excess amount in addition to the income-based co-

¹ Eligibility for BadgerCare differs for applicants and on-going participants. For applicants, BadgerCare establishes an income limit at 185% of the federal poverty level. However, on-going participants, who entered the program with income below 185% of poverty, remain eligible for BadgerCare until their income reaches 200% of poverty. The program defines countable income as a family's gross income less work expenses (up to \$90/month), childcare expenses (up to \$175-\$200/month), and a \$50/month child support disregard.

payment. The program bases a family's share of childcare payment on the family's total income. For example, a single mother with two children moving from 100% to 200% of poverty would see her co-payment rise from about 8% to 12% of her total income. The subsidy ends when the family's income surpasses the 200% of poverty.

FEDERAL TAXES AND THE EARNED INCOME TAX CREDIT

At lower earnings levels, families are eligible for the Earned Income Tax Credit (EITC), which typically offsets any tax liability. Families with two or more children are eligible for a refundable credit of up to \$3,888 per year². Families receive the EITC even if they do not owe taxes. In addition, families can deduct out-of-pocket childcare expenses from their federal tax liability through the Child Care Tax Credit (CCTC). Unlike the EITC, the CCTC is not refundable so families do not receive it unless they have a tax liability.

STATE TAXES

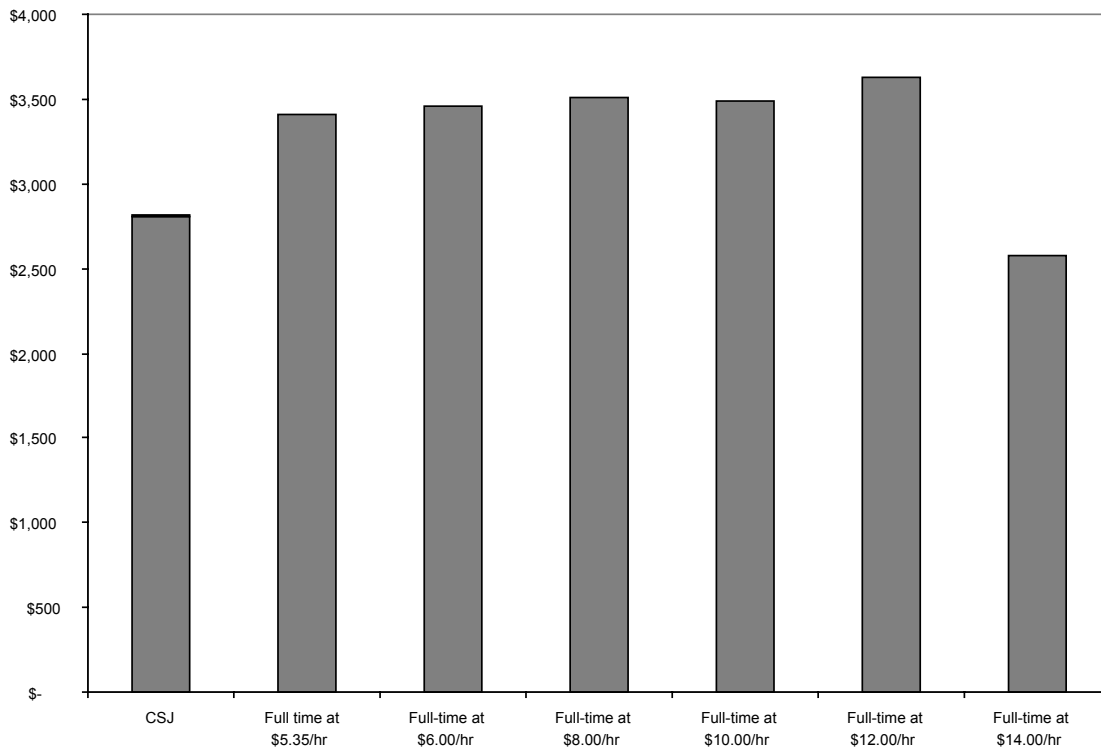
Two refundable tax credits offset liabilities: the state earned income tax credit (EITC) and the Homestead Tax Credit program. The state EITC equals a percentage of the federal EITC, depending on the number of children in the household. The state EITC equals 4% of the federal credit for households with one child, 14% for households with two children, and 43% for households with three children or more. Wisconsin does not extend the credit to childless families. The credit is refundable so that families receive the credit even if they do not have a tax liability.

INTERACTIONS OF EARNINGS AND THE FAMILY ASSISTANCE PROGRAMS

The incentive to increase earnings declines considerably once a worker moves from W-2 and attains the full-time, minimum wage job. Figure 1 shows the decline in net income for a Milwaukee County family of three. The family includes an infant and a preschooler using paid childcare through the Wisconsin Shares (childcare) program.

² US Congressional Budget Office estimates for Tax Year 2000.

Figure 1: Value of Monthly Earnings and Subsidies, Post-Tax (Milwaukee County Family of Three Participating in W-2, Food Stamp, BadgerCare, Wisconsin Shares, and Tax Credit Programs)



Source: Calculated by ECONorthwest based on program rules as of December 1999.

Note: Calculations assume family consists of one adult, one infant, and one pre-school aged child and that the family selects a childcare provider who charges the maximum rate reimbursable by the state.

The childcare subsidy decreases as earnings increase. Assuming childcare costs of \$1,425 per month³, even workers who earn \$12.00/hour are eligible for some state assistance. But childcare availability at higher wage rates affects the incentive to seek higher-paying jobs. The family's total income decreases as the child subsidy ends. A worker can mitigate this disincentive by choosing lower-cost or unpaid care, which many do.

Section 3 Basic-Needs Budget

The basic-needs budget is based on the Wisconsin Self-Sufficiency Standard, as developed by Dr. Diana Pearce, former Director of The Women and Poverty Project of Wider Opportunities for Women, Inc⁴. The method draws on expenditure data from federal and

³ In Section IV, we consider the economic circumstances of a family that pays less than the maximum rate reimbursable by the state.

⁴ See Pearce, Diana and Jennifer Brooks. *The Self-Sufficiency Standard for Pennsylvania: Selected Family Types*. Wider Opportunities for Women. Washington, DC. 1997.

state government sources for six essential categories of family spending: housing/utilities, food, childcare, transportation, medical care, and miscellaneous expenditures. The budgeted amounts for housing and childcare vary by county while the food, medical, transportation and miscellaneous budgets do not.

It is important to note that the budget allows for necessities only, and it does not take into account savings, emergency expenditures that arise, a child's school-related expenses (i.e. field trips, book/activity fees), entertainment, vacation, restaurant meals, or even leisure-related automobile use. In the following sections, we describe the specific data sources underlying estimated costs for each category and report budgets for different counties and family compositions.

DATA SOURCES FOR THE BASIC-NEEDS BUDGET

HOUSING AND UTILITIES

The basic-needs budget uses the Fair Market Rent (FMR) for housing and utility costs, as calculated annually by the U.S. Department of Housing and Urban Development (HUD). The rates vary with the number of bedrooms and geographic location.

FOOD

We based the food budget on the U.S. Department of Agriculture (USDA) low-cost food plan⁵. The food budget varies by family size and age of children but does not vary by county. The low-cost plan for a family of three—consisting of an adult, an infant, and a preschooler—costs \$337 per month.

MEDICAL

The medical budget reports a family's total consumption of health services, which we estimated using data from the Wisconsin-based Prime Care insurance plan and from the National Medical Expenditure Survey. (NMES)⁶. A family's estimated budget varies by the number of members and their ages but not by place of residence⁷. Out-of-pocket expenses (which are delineated in the budget) were also estimated using data from the National Medical Expenditure Survey and the Family USA report.

CHILDCARE

The budget uses the state's childcare co-payment standards to determine the family's total childcare expenditures. The Wisconsin Department of Workforce Development (DWD)

⁵ September 1999 version.

⁶ See Agency for Health Care Policy and Research. *Data from the 1987 NMES Household Survey Projected by Type of Service and Payment Source, Demographics, and Poverty and Insurance Status*. December 1997. Rockville, MD.

⁷ We have assumed single-parent households are headed by females. We further assumed adults are 22 years older than the oldest child in the family.

based these standards on a market survey of childcare providers and has since converted them to reflect approximately the 75th percentile of the rate distribution. The Wisconsin Shares standards vary by age of child served, type of provider, and location of the provider. The budget assumes children under age three receive full-time care in licensed day care homes and that preschoolers go to day-care centers full-time. The budget also assumes school age children receive part-time care in a group facility.

TRANSPORTATION

The transportation budget is based on estimates from the American Automobile Manufacturers Association and the Consumer Expenditure Survey. These costs are based on the costs of owning and operating an eight-year old car, and include estimates of both fixed and variable costs such as: insurance, license, registration, gas, oil changes and other maintenance-related expenses. The budget assumes that cars are used for work-related travel five days per week, plus one trip per week for shopping and other errands.

MISCELLANEOUS NECESSITIES

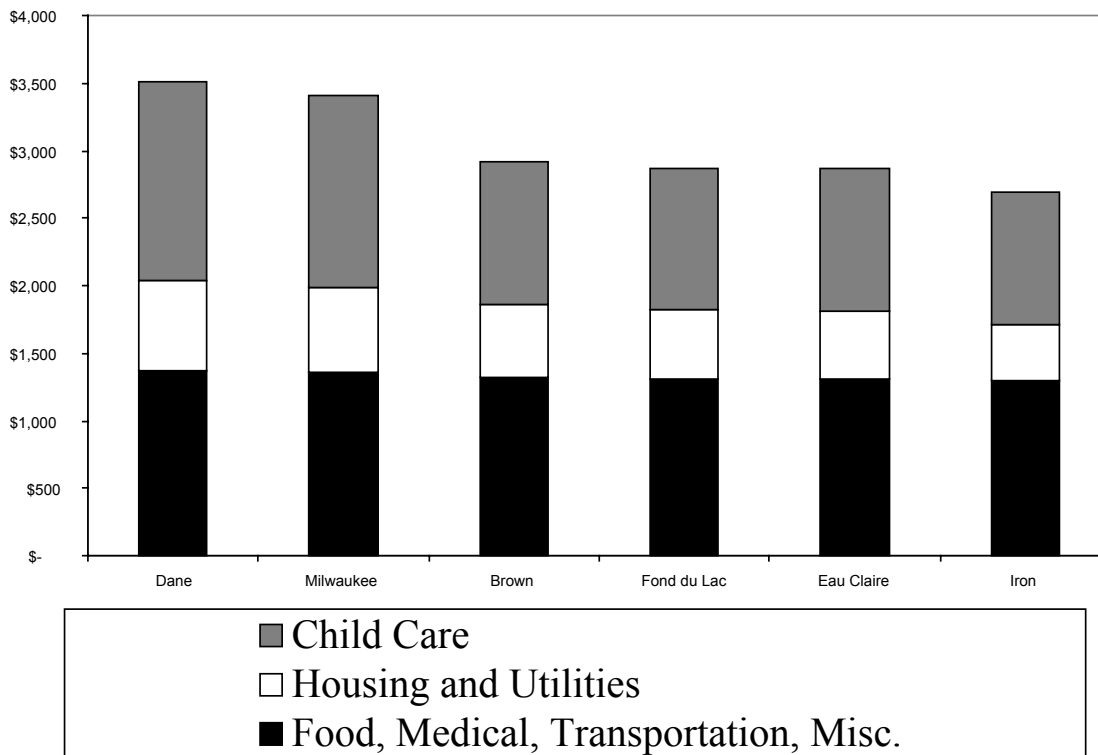
In addition to the major categories discussed above, the basic-needs budget allows for items such as clothing, shoes, diapers, paper products, household items, personal hygiene items, cleaning supplies and telephones. These miscellaneous expenses are calculated by taking 10% of all other costs and could be seen as a rather conservative estimate of a family's monthly miscellaneous costs. The budget does not take into consideration expenses such as: savings, entertainment, emergency expenses, school-related fees, eating out, travel, or vacations.

LOCAL VARIATION IN THE BASIC-NEEDS BUDGET

Figure 2 reports the model's calculated budgets for a family of three in six counties. Only housing and childcare costs vary significantly across counties. While our method allows for variations in transportation costs, the differences tend to be small.

As expected, the budgets are higher in metropolitan areas. Dane County, shown in Figure 2, is the most expensive place to live, with a family of three needing \$3,512 per month to balance its basic-needs budget. Iron County and a number of other less-populated counties are the least expensive. Higher childcare costs explain much of the \$825 difference between the Dane and Iron County budgets. Housing and miscellaneous costs comprise the balance of the difference.

Figure 2: Estimated Basic-Needs Budget for a Family of Three in Six Wisconsin Counties



Source: ECONorthwest

Note: Family of three consists of one adult, one infant, and one pre-school aged child. Family chooses a childcare provider who charges the maximum rate reimbursable by the state.

Section 4 The Work Transition

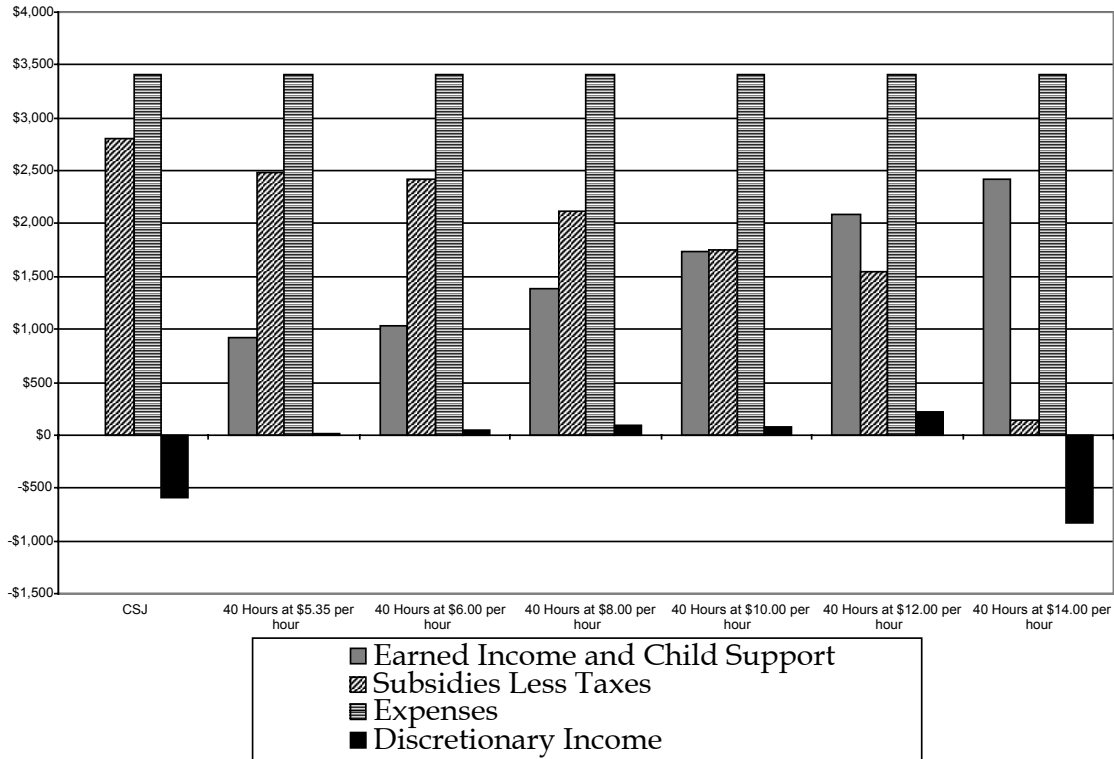
The chief objective of this study is to explore by how much a family’s economic position improves by increasing their work effort and wage levels. By combining outputs of the benefit/tax calculator and basic-needs budget, we illustrate changes in the three major components of our family’s finances: 1) Income comprised of earnings, child support and benefits, 2) tax liability, and expenses. Furthermore, by subtracting expenses (the basic-needs budget) and taxes from the income components, we can estimate how much discretionary income the family has for family needs, activities or savings.

TRANSITION TO WORK FOR A MILWAUKEE COUNTY FAMILY OF THREE

Working full-time at the minimum wage allows the family to meet its basic needs, but leaves it with just \$7 in discretionary income for savings or leisure activities. Moving up the wage scale, discretionary income peaks at about \$218 at \$12.00 per hour and then falls sharply as the hourly wage continues to increase. The phasing-out of the childcare subsidy

explains the decline. Clearly, families in this position must seek lower cost childcare to balance their budgets.

Figure 1: Monthly Income and Expenses for a Milwaukee County Family of Three



Source: ECONorthwest

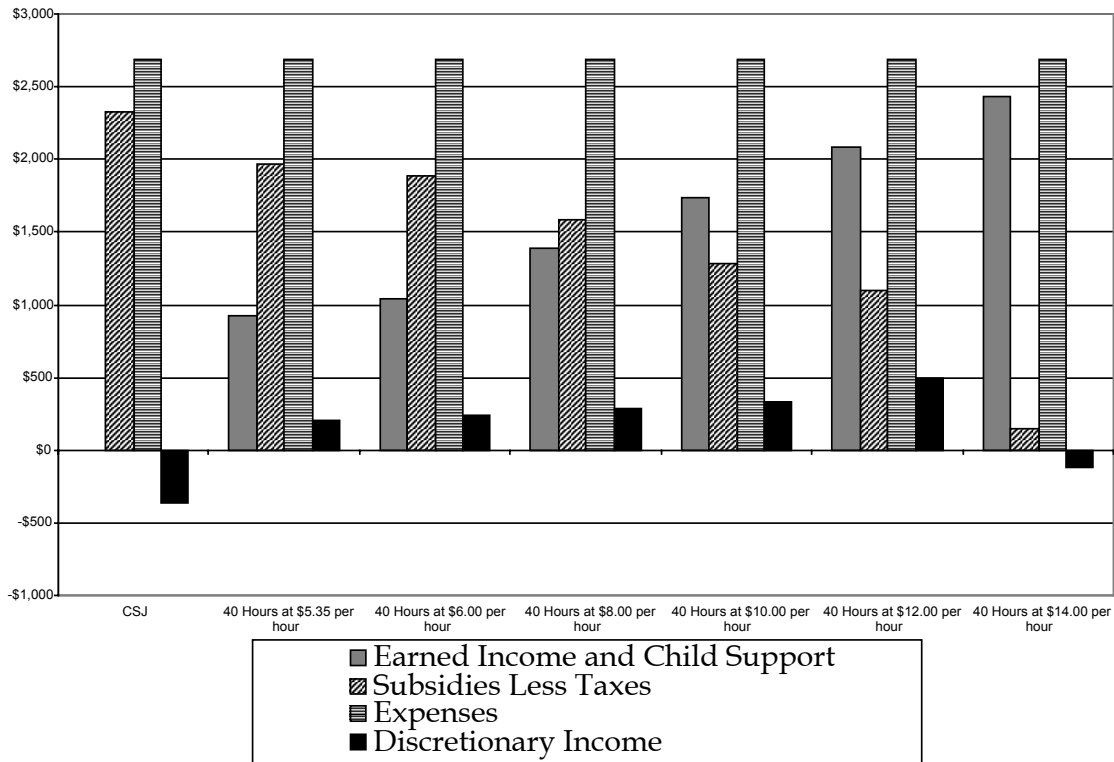
Note: Family consists of one adult, one infant, and one pre-school-aged child. Family chooses a childcare provider that charges the maximum rate reimbursable by the state. Family participates in W-2, Food Stamps, BadgerCare, Wisconsin Shares and federal and state tax credit programs. Estimated subsidies are net of payroll taxes and federal and state tax liabilities.

EFFECT OF CHANGING THE PLACE OF RESIDENCE

If our family of three moves from Milwaukee County to Iron County, the lower cost of living translates into additional discretionary income (see Figure 2). (In this example, we using the model’s standard assumptions for childcare and housing costs). In Iron County, a full-time worker can generate up to \$493 in discretionary income. As with the other examples, however, the phasing-out of the childcare subsidy creates a financial shortfall at wage rates between the \$12.00/hour and \$14.00/hour wage level.

This analysis suggests an Iron County family with a full-time worker earning minimum wage actually may be better off than a Milwaukee County family whose worker earns \$10.00/hour. The Iron County family is officially poor but has about \$206 in discretionary income while the Milwaukee County family has escaped poverty but has only \$85 in discretionary income. In other words, the availability of higher-paying jobs in Milwaukee County may not necessarily translate into a family's being better off economically.

Figure 2: Monthly Income and Expenses for an Iron County Family of Three



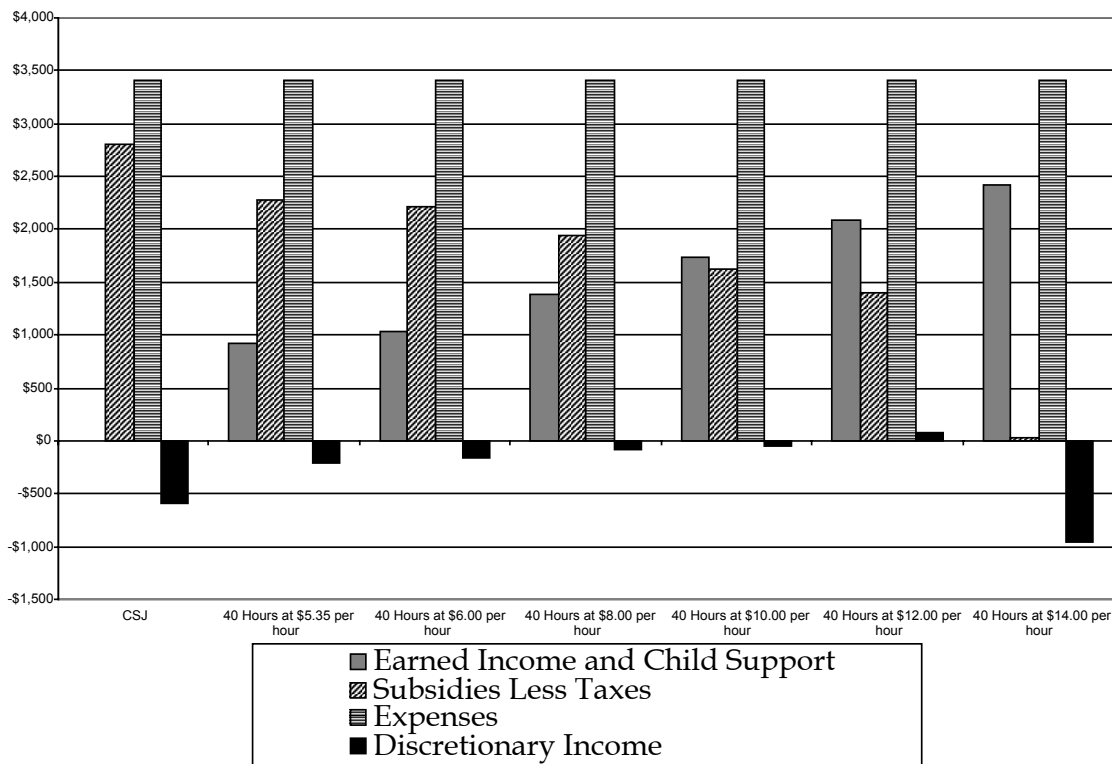
Source: ECONorthwest

Note: Family consists of one adult, one infant, and one pre-school-aged child. Family chooses a childcare provider that charges the maximum rate reimbursable by the state. Family participates in W-2, Food Stamps, Badger Care, Wisconsin Shares and federal and state tax credit programs. Estimated subsidies are net of payroll taxes and federal and state tax liabilities.

EFFECT OF TAX CREDITS

The model's standard output assumes families receive all the federal and state tax credits for which they are eligible. In previous examples, we calculated the credits by estimating the value of the annual tax credit and dividing that amount by 12. Very few people actually receive tax credits on a monthly basis, and even if they do, they are not eligible for exactly one-twelfth of the annual amount each month. For example, a recipient of the Advanced Federal EITC can receive no more than \$116/month under federal rules even though she can effectively earn a credit worth \$304. The State of Wisconsin makes no advanced payments of its tax credits. Consequently, some researchers argue that reporting the credits as one-twelfth of the annual amount produces a misleading picture of the budget realities faced by low-income families⁸.

Figure 3: Monthly Income and Expenses for a Milwaukee County Family of Three Assuming Federal and State Rules on Advanced Payment of Tax Credits



Source: ECONorthwest

Note: Family consists of one adult, one infant, and one pre-school-aged child. Family chooses a childcare provider that charges the maximum rate reimbursable by the state. Family participates in W-2, Food Stamps, BadgerCare, Wisconsin Shares and federal and state tax credit programs. Estimated subsidies are net of payroll taxes and federal and state tax liabilities.

Figure 9 illustrates the transition to work for our Milwaukee County reference family and assumes partial monthly receipt of the federal EITC and no advanced receipt of state tax

⁸ See Oregon Center for Public Policy. Welfare and Work Assumptions: A Guide to Comparing Spendable Income. Silverton, OR. 1998.

credits. The loss in the credits eliminates discretionary income at most wage levels. To remedy the situation, the family would need to carefully budget the lump-sum tax refund or seek lower cost housing and childcare.

Section 5

Conclusion

Federal and state policy changes have been designed to help low-income families move from welfare to work. However, these work support programs are highly front-loaded, meaning that while the incentives are strong to seek that initial low-wage job, there is considerably less incentive to seek higher paying jobs, since subsidies are phased out so rapidly. Once low-wage workers begin to advance up the wage ladder, under the current system of assistance, they encounter a series of income “cliffs” which cause the workers to actually lose discretionary income as their wages rise above a certain level. Depending on which benefits the family receives and how much it pays for childcare, moving from a minimum-wage job to a higher-paying job can actually leave the family economically worse off. Improving these incentives will require a restructuring of federal and state tax credit and childcare-subsidy programs. The model’s policy option component allows for a number of policy changes, which could have varying degrees of impact on the discretionary income of low-income families. By exploring policy options, such as altering the phase-out rates of programs to lessen the severity of current “cliff” effects, working families will experience a much less dramatic drop in income when they become ineligible for valuable support services.

Even for families working full-time at levels above the minimum wage, meeting a basic-needs budget is extremely difficult. Wage levels previously thought to allow families to be self-supporting, even when combined with available subsidies and tax credits, do not allow families the economic “cushion” necessary to save, prepare for emergency expenses, or cover even a bare-bones set of expenses.

For many families, increased earnings quickly result in the loss of food stamps, health insurance, childcare subsidies and tax credits before the family is financially capable of covering these costs independently. The marginal tax rates for many of Wisconsin’s low-wage workers at times exceed 100%; in other words, the loss in benefits and tax credits in the transition between certain wage levels often erases the worker’s additional earnings (gained from a wage increase) and then some.

At wage levels over \$12.00 per hour, most low-wage workers must reduce childcare costs, and possibly quality, to secure any increase in disposable income.

The value of family earnings varies widely in the state depending on the cost of living, meaning that higher wages are required for families residing in high-cost, metropolitan areas.

Wisconsin's efforts to increase child support payments from non-custodial parents are critical to family income security since child support does not automatically decline as a custodial parent's earnings rise. These payments stabilize a family's budget and ensure that the family will have some discretionary income after having covered their necessities in the low-wage market.

Results of this analysis underscore the degree to which Wisconsin's work support programs are highly front-loaded: while the incentives are strong to seek initial low-wage employment there is a real disadvantage to seek higher paying jobs, since subsidies are phased out rapidly at wage levels over \$7.50 per hour. Under current rules, depending on which benefits the family receives and how much it pays for childcare, moving from a minimum-wage job to a higher-paying job can actually leave the family economically worse off. Improving these incentives will require a restructuring of federal and state tax credit and childcare-subsidy programs.

The model's policy option component allows for a number of policy changes, which could have varying degrees of impact on the discretionary income of low-income families. By altering the phase-out rates of programs to lessen the severity of current "cliff" effects, low-income families will experience a less dramatic drop in income when they become ineligible for valuable support services. This model points clearly to the need for more realistic transition rules to economic independence, which would ensure medical and child care security for the hundreds of thousands of workers who are passengers on this experimental journey.

If we are to truly reward work and ensure that all Wisconsin families are moving towards self-sufficiency, the following policy adjustments are necessary:

Reexamine the structure of Wisconsin's work supports. The existing structure of low-wage worker subsidies acts as a disincentive to move up the employment ladder or to seek a pay raise because workers can lose needed benefits before they have the capacity to purchase these services.

In the short term, state policymakers and administrators must reexamine the structure of Wisconsin's support programs and tax credits. It is crucial to determine the viability of

expanding these subsidies beyond current levels to mitigate the severe “cliff effects” which currently occur when family earnings surpass eligibility before self-sufficiency is actually possible. A great deal of flexibility exists about these programs (particularly the Wisconsin Shares childcare and BadgerCare subsidies, where federal rules allow states to provide these benefits to families at higher income levels than Wisconsin Policy currently allows).

Longer term, policymakers and advocates must direct their attention to federal issues such as the Food Stamp phase-out rate and federal tax policy and address the numerous disincentives built into both the federal tax and benefit programs.

Expand outreach efforts and improve applicant access to critical subsidies. The FIRST model illustrates how difficult it is for families to meet their basic-needs, even with the receipt of all available credits and subsidies. Yet there are a multitude of families who lack information and/or access to these programs, perceive the system as too complicated, or have been discouraged from seeking assistance. Comprehensive efforts must be made to expand outreach regarding state and federal subsidy and tax credit programs to increase worker awareness of these support systems. In addition, service providers must improve access to these support programs by providing hours that are more flexible and more community registration sites.

Expand opportunities for the working poor to obtain additional skill training and education. Job skills training, retention and advancement programs and further educational attainment are all critical to ensuring that families are able to reach higher-level wage positions. For families with extremely low skill or education levels, moving from a near-minimum wage position to wages in the \$10-\$15/hour range requires a concentrated effort at targeted skill development programs during the 40-hour work week. Policymakers can use the re-authorization of federal TANF funding to address the shortage of skilled workers and assist the working poor. It is a critically needed opportunity to establish partnerships between employers, education institutions, and state agencies such as the Department of Workforce Development. Through such partnerships, groups can plan and implement technical education projects, on-the-job training and a range of higher education options that enhance the skills and professional capacities of workers currently locked in entry-level positions.

Reevaluate what constitutes a “living wage.” The FIRST model reveals that for most families, especially those headed by a single parent, the standards for a living wage must be re-examined in relationship to government tax and support subsidies such as childcare and health care. Policymakers, employers and advocates must work to redefine working family policies that coordinate wages and broad-based public support systems for employees to ensure that there is a viable trajectory for men and women toward family security and self-sufficiency.

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