

## SEVERAL SUGGESTIONS FOR IMPROVING THE WORK-BASED SAFETY NET AND REDUCING CHILD POVERTY<sup>1</sup>

*Wendell Primus and Kristina Daugirdas*

### **Background and Introduction**

The federal 1996 welfare legislation was primarily about two things: cutting spending and promoting work. Out of ten reconciliation bills enacted during the 1980s and 1990s, this was the only reconciliation bill whose provisions saved money exclusively from programs designed to assist poor households. According to Congressional Budget Office estimates at the time of enactment, the bill would reduce outlays by \$55 billion between fiscal years 1997 and 2002. The primary savings in the bill were reductions in food stamp spending (about \$27.4 billion<sup>2</sup>) and welfare benefits for legal immigrants. Most of the immigrant savings were reductions from elderly and disabled immigrants receiving Supplemental Security Income benefits and Medicaid. The reductions affecting legal immigrants who were present in the country on or before August 22, 1996 and were elderly or disabled at that time have, for the most part, been reversed through a series of legislative acts (primarily the 1997 budget agreement). However, nearly all of the reductions that apply to immigrants arriving in this country after enactment of the welfare bill continue to apply.

Ironically, many of the food stamp reductions came at the expense of the working poor. The two provisions that saved the most money were cutting the thrifty food plan by three percent and reductions in the standard deduction. The impact on the working poor from just the thrifty food plan cut can best be illustrated by the following. For a family that receives the maximum allotment, the benefit reduction equals three percent. For a family that receives a benefit equal to half of the maximum allotment, the benefit cut from this change equals 6 percent. For a family that receives a benefit equal to one quarter of the maximum allotment, the benefit cut equals 12 percent. Since working poor families tend to have higher incomes than families receiving primarily welfare assistance, it is working families who would see the largest cuts. These reductions could be a factor contributing to the food stamp caseload declines — especially among the working poor — for some of whom the transaction costs of securing food stamps may now be more nearly equal to the benefit that can be secured.

The third largest savings component of the welfare bill was the reduction in SSI benefits for disabled children. The number of children receiving SSI disability benefits had grown rapidly from 264,000 in September 1990 to 958,000 by September 1996. The definition was tightened, and about 100,000 children were removed from the roles. For those families, the average reduction in benefits was about \$4,000 per family.

The changes in the AFDC program hardly saved any money. With the benefit of hindsight, we can see that there is substantially more federal funding available to states today under TANF (and the welfare-to-work block grant enacted as part of the 1997 budget agreement) than there would have been under the former AFDC program.

The aspect of the bill that was its saving grace with the American public was the emphasis on work. There is no doubt the public was fed up with stories about adults who were able to work but could receive substantial amounts of government assistance without having to work. Never mind that it was the Reagan AFDC reforms in 1981 that made it much more difficult for working mothers to receive AFDC and never mind that the 1990 recession distorted the public impression of the impact of the Family Support Act and its move to participation requirements.

This emphasis on work justified the federal time limits, the flexibility given to state and local government by the block grant financing structure and the removal of the legal entitlement to benefits under the program. It was a brilliantly orchestrated campaign. The clearest evidence of this emphasis on work in the bill itself is the work requirements enforced with substantial fiscal penalties upon states. To a large extent, the emphasis on work was also at the heart of most of the state waivers that were approved by the Clinton administration prior to enactment of the 1996 federal legislation.

We can applaud the emphasis on work without endorsing or implying that all of the provisions cited above necessarily achieve this objective. The emphasis upon work resonates with the American public, middle class values and our religious heritage. In fact, we have spent a considerable amount of time thinking about how work effort can be increased for non-custodial parents and what policies we should adopt or modify to assist low-income males in meeting their parental responsibilities.

Given the heterogeneity among parents in low-income families with respect to employment skills and aptitudes, learning and other disabilities, the number of children they have, parenting time needs, child care barriers, transportation and discrimination barriers, and personal behavior and attitudes, the amount of investments needed to achieve employment of 20 hours per week or more varies widely. The critical but very difficult question to answer is where does our public investment achieve the greatest work/employment outcome and at what cost.

The research and academic community needs to explain and carefully sort out which policies achieve greater work effort. Was it the culture shift in welfare offices? Was it time limits? Was it sanction policies and if so, which sanction policies? Was it the economic incentives in the earned income tax credit and/or the provision of health coverage to more children? This research process has only begun.

### **Making Work Pay**

The concept of the "iron triangle" in poverty policy means that it is impossible for programs simultaneously to be generous (have a large guarantee level), be well targeted (limited only to those in need), and have low effective tax rates. Achieving two of the goals always requires compromising on the third. As Table 1 illustrates, the value of the TANF cash grant plus the food stamp benefit has been reduced by about 27 percent in real terms over the past 25 years. As a result of this reduction in the guarantee level and the significant improvement in the earned income tax credit, the average tax and benefit reduction tax rates were lowered by one-half since 1984. As a result, the gains from working have increased. The marginal tax rate for families has been lowered significantly for earnings levels near or below 75 percent of poverty, but very little for families with earnings above that level.<sup>3</sup>

The Congressional Budget Office has carefully documented that changes in policy since 1984 have greatly increased federal assistance for low-income families with children who do not receive cash welfare payments. CBO estimates that these payments increased by \$46 billion between 1984 and 1999, with \$28 billion of this increase due to expansions of the earned income tax credit, another \$3.5 billion due to the child credit, and most of the remaining increase in spending explained by expansions of health insurance coverage of children in the Medicaid and the Children's Health Insurance Programs.

However, if 1972 is used as a baseline for comparison, the degree of expansion is less clear. The expansions of the EITC have just brought total disposable income for a mother and two children with earnings between 75 and 125 percent of the poverty line back to 1972 levels.

Table 1 presents examples of what happens to income as a mother with two children enters the work force and earns different levels of wages for three selected years: 1972, 1984 and 1996. In constructing these examples, a consistent set of assumptions are made. The major assumptions are that no work expenses were incurred by the mother while she worked (or alternatively those work expenses were entirely reimbursed by government throughout the entire earnings range) and that she obtains all the benefits to which the family was entitled, namely food stamps and the earned income tax credit as she enters the labor force.

The table clearly shows that for earnings at 75 percent of poverty, the net gain from working in 1996 has increased substantially compared to 1984. In 1984, 31 (100 minus the 69 shown in the table under the average tax and benefit reduction rate) percent of the wages she earned increased family income. By 1996, primarily as a result of significant expansions of the earned income tax credit, 74 percent of the mother's wages increased family income. That is a significant increase in the gains to working and is partially responsible for the increased labor force participation among low-income single women with children.

But the returns from working will not result if the family does not continue to receive food stamps when she enters the work force or if she has significant work expenses that are not reimbursed by government.

Our national policies should continue these efforts to make work pay. We will argue in this paper that in too many instances families are not getting food stamps and/or child care expenses are incurred but not reimbursed and therefore the returns from working are not nearly as great as implied in Table 1. As a result, families are not as better off from working as they could be and many children remain in poverty as a result. Participation in the food stamp and medicaid programs should increase. Further suggestions for policy changes in the EITC, food stamp and child support programs that would promote work and reduce child poverty are made.

For those adults with earnings levels at or near the minimum wage, those implied returns from working shown in Table 1 need to be realized. To realize these income gains, the family must continue to participate in the food stamp program and work expenses, particularly child care costs, must be reimbursed. If that were accomplished, many more families would be able to escape poverty. Given payroll taxes and the fact that child care and transportation expenses can range from \$2,000 to \$5,000, the public cost for someone earning \$10,000 can actually be higher than if that individual did not work at all.<sup>4</sup> For example, given the average guarantee level of about 64 percent of the poverty line for a family of three as shown in Table 1, annual

work expenses of \$3,500, and an average tax rate of 25 percent implies that for a family earning \$10,000, the government cost will be about \$9,000.

Assuming that goal has been accomplished, we also believe that effective marginal tax rates on earnings above \$10,000 should never exceed 50 percent or about the same marginal tax rate on income for the highest income earners currently in the federal tax code. For some families with housing subsidies or higher child care costs because of additional children or a higher child care price, the marginal rate will have to be higher. Given the payroll tax and some state and federal income taxes, this implies that a work-based system must subsidize earnings up to around \$36,000 or so.<sup>5</sup>

If the criteria above were met, many more children in working poor families would escape poverty. That is essentially the premise of the Clinton Administration's goal that if you work full time, you shouldn't be poor. In his first State of the Union address in 1993, President Clinton stated that if a family works full time throughout the year, the family should not have to live in poverty. This goal shaped the Administration's historic EITC expansion enacted in 1993. The EITC expansion was designed so full-time year-round minimum-wage earnings plus the EITC and food stamps would bring a family of four to the poverty line.

For 1999, the poverty line for a family of four is estimated to be \$17,072. Combined income from full-time minimum wage work, the EITC, and food stamps brings a family of four close to the poverty line. This achievement — bringing these families nearly out of poverty — is secured, however, only if low-income working families do receive food stamps. Indeed, food stamps are nearly as significant to such families as the EITC. In tax year 1999, a family with full-time minimum wage earnings qualifies for \$3,816 from the EITC; such a family's food stamps for 1999 would total approximately \$3,650.

## **Plan of Paper**

The paper begins by summarizing what we know about welfare reform. While there are some positive signs that work has been enhanced, there are also some less promising signs which suggest that incomes of single-mother families may have actually decreased and progress in reducing child poverty between 1995 and 1997 has stalled despite a strong economy. A significant part of the reason is that many families do not receive food stamps as they enter the work force. Not all of the declines in participation are necessitated by the 1996 welfare law. This emphasis on caseload reduction is more closely connected with how the law is being implemented.

Using illustrative hypothetical families, the paper demonstrates that marginal tax rates for earnings levels from \$12,000 to \$25,000 remain well above 50 percent and that non-custodial parents essentially face 100 percent tax rates when they pay child support. Child care copayments, state taxes, and health insurance premiums that increase with income can push the marginal tax rate even higher in many instances. The efforts during the late 80s and early 1990s that have made work pay have been successful in bringing many children much closer to the poverty level.<sup>6</sup>

The paper then describes five policies that would build upon this effort and coincide with the concerns described earlier. By no means is this list meant to be exhaustive. The paper concludes

by showing that these policies, if enacted would increase work effort and payment of child support and consequently would move many children out of poverty.

### **Preliminary Assessments of the Impacts of Welfare Changes**

Dramatic declines in the number of people receiving cash welfare benefits and food stamps have contributed to the conventional wisdom that the new welfare reforms are working well. Recent studies have shown that many of those leaving the program have obtained work, at least for a short period of time. But caseload reductions are not adequate measures of the success of changes in the welfare system. Even aggregate level earnings increases, a very positive sign, do not tell us enough about the effect of these changes on the economic well-being of poor families with children.

Based upon surveys of families who have left cash assistance and the Current Population Survey, there is preliminary evidence that

- The employment of welfare recipients has increased;
- Caseload declines have exceeded declines in poverty;
- The disposable income of the poorest single-mother families has fallen recently;
- Erosion of means-tested programs has affected child poverty; and
- TANF declines have contributed to declines in food stamp and Medicaid participation

### *Some Evidence of Increases in Employment Status*

The table below is probably the strongest evidence that the employment status of the welfare population has significantly improved over the past few years. For recipients on welfare during the previous year, the top row illustrates the percent employed in the March CPS. As the table illustrates, these increases were much greater for single mothers than for married mothers with children.

We also know from many different state studies, using administrative data and surveys of recipients that leave cash assistance, that about 55 percent to 65 percent of former recipients are employed at a point in time within 12 months after leaving cash assistance. About 35 to 40 percent of these former recipients are working full-time (over 30 hours per week) and that about 75 to 85 percent had worked at some point within the first 12 months. Their average wage was around \$6.50 to \$7.00 per hour. About two thirds have earnings levels below poverty.<sup>7</sup>

The extent to which welfare policy changes are responsible for the increases in employment shown in the table above is unclear. Strong economic growth, unusually low unemployment rates, continued expansion of the Earned Income Tax Credit (EITC), and welfare policy changes all appear to have contributed to an increase in employment and earnings among poor families.

*Caseload declines have exceeded declines in poverty*

One trend that has become clear is that while poverty rates have dropped in recent years, caseload declines in both the TANF and food stamp programs since 1995 have greatly exceeded declines in poverty.

From 1995 to 1997, the number of people receiving AFDC/TANF benefits fell by three million, or 22.2 percent. But the number of people in single-mother families that were poor before receipt of means-tested benefits declined only 770,000, or 5.4 percent.

Similarly, between 1995 and 1997, the number of people receiving food stamps fell 16.6 percent, while the number of people below the poverty line before receipt of means-tested benefits fell 2.9 percent.<sup>8</sup>

In 1995, some 57 children received AFDC cash assistance for every 100 children who were poor before receipt of benefits from means-tested government programs. In 1998, only an estimated 40 children received cash assistance for every 100 such poor children, the lowest proportion of poor children receiving cash aid for any year since 1970.

In the food stamp program, 88 children received food stamps for every 100 who were poor before receipt of means-tested benefits in 1995. By 1998, only an estimated 70 children received food stamp assistance for every 100 such poor children.

#### *Trends in the incomes of poorest single-mother families*

Largely because of the loss of benefits from means-tested programs, the incomes of the poorest single-mother families dropped between 1995 and 1997 (the most recent data available), in spite of increases in earnings. This is contrast to an overall increase in income among single mothers in the same income strata between 1993 and 1995.

A study by the Center on Budget and Policy Priorities of the incomes of low-income single-mothers in families with children shows that between 1993 and 1995, the average earnings and incomes of single-mother families rose substantially.<sup>9</sup> Increases were particularly large among the bottom 60 percent of people in single-mother families, who experienced double-digit percentage gains in average disposable income. For the poorest 20 percent of individuals in single-mother families, disposable income increased an average of 13.7 percent per family between 1993 and 1995, after adjusting for inflation, or a little over \$1,000. (Each fifth of single-mother families consists of approximately two million families or six million people.) Earnings rose an average of \$430 per family among these families, an increase of one-third. Income from means-tested benefit programs also increased. (All figures are adjusted for inflation, expressed in 1997 dollars, and rounded to the nearest ten dollars.)

Between 1995 and 1997, by contrast, the poorest single-mother families experienced a significant decline in their average disposable incomes, largely due to sizeable decreases in assistance from means-tested programs. These families also experienced a drop in earnings. Among the poorest 20 percent of persons in single-mother families — a group with incomes

below 75 percent of the poverty line — average disposable income fell \$580 per family between 1995 and 1997, a decline of 6.7 percent. About \$460 of this income loss — or about 80 percent of it — was due to declines in means-tested assistance.

The next-to-the poorest fifth of single-mother families, which had incomes between 75 percent and 112 percent of the poverty line in 1997, experienced an average increase in earnings of \$900 from 1995 to 1997 and an average EITC increase of \$400. Nevertheless, their overall disposable income failed to rise. Their gains in earnings and the EITC were offset by an average loss of \$1,460 per family in means-tested benefits. As a result, their average incomes remained statistically unchanged despite strong economic growth.

Some reduction in means-tested aid would be expected when earnings rise. But it is unusual for the decline in average means-tested benefits in the next-to-poorest fifth of single-mother families to exceed the increase in their average earnings. This suggests that many of these families worked harder but did not advance economically because of large declines in means-tested benefits.

For the poorest 10 percent of persons in single-mother families, average income declined \$810, between 1995 and 1997, a reduction of 14.3 percent.<sup>10</sup> Slightly over three-fourths of this income decline, or \$610, was due to a decrease in the average amount of means-tested assistance these families received. These families' average incomes equaled 35 percent of the poverty line in 1995 but only 30 percent of the poverty line in 1997.

#### *Erosion of means-tested programs affects child poverty*

Certain parts of the safety net for poor children weakened significantly between 1995 and 1997 despite continued improvement in the economy. Between 1993 and 1995, the number of poor children fell by 2.4 million. By contrast, between 1995 and 1997, this number decreased only 360,000, less than one-sixth as much. Part of the reason for the smaller decline in the more recent period is that unemployment fell less sharply between 1995 and 1997 than between 1993 and 1995. This factor, however, can explain only a portion of the slowdown in the reduction in child poverty. A major reason that child poverty declined so much less in the 1995-1997 period than between 1993 and 1995 is that between 1995 and 1997 the proportion of children that means-tested programs lifted from poverty declined significantly. Census data show that if means-tested benefits had been as effective in reducing child poverty in 1997 as in 1995, some 700,000 fewer children would have been poor in 1997.<sup>11</sup>

This decline in the number of children lifted from poverty by means-tested programs was partially offset by an increase in the number of children lifted from poverty by the Earned Income Tax Credit. The EITC removed approximately 400,000 more children from poverty in 1997 than in 1995, as a result of EITC expansions enacted in 1993 that phased in through 1996. The poverty-reducing effects of these EITC expansions offset a little more than half of the poverty-increasing effects of the weakening of the means-tested benefits programs. (Had there not been a decline in the proportion of children removed from poverty by means-tested benefit programs between 1995 and 1997, the effectiveness of government safety net programs in reducing child poverty would have reached an all-time high in 1997.)

Another way to look at the impact of changes in government programs on child poverty is to examine changes in the depth and severity of poverty among families with children, as measured

by the “poverty gap.” The poverty gap, which many analysts consider the single best measure of child poverty, is the total amount by which the incomes of all poor families with children fall below the poverty line. As Table X shows, this measure of child poverty failed to improve between 1995 and 1997 despite the improvement in the economy. In both 1995 and 1997, the incomes of all poor families with children fell below the poverty line by a total of approximately \$25 billion.

These data on the poverty gap demonstrate that although the number of poor children decreased modestly between 1995 and 1997, children living in poverty were, on average, somewhat poorer in 1997 than in 1995. The deepening of poverty among the children who remained poor offset the modest decline in the number of children below the poverty line, with the net result being no lessening of the depth and severity of child poverty despite strong economic growth.

These poverty gap data also highlight the pivotal role that the decline in means-tested programs has played. *Before* counting means-tested benefits, the poverty gap among families with children shrank substantially between 1995 and 1997, just as it had between 1993 and 1995. The drop in the poverty gap, as measured before means-tested benefits are counted, primarily reflects the effect of the economy in reducing poverty through increases in employment and earnings among parents.

But when the benefits of means-tested programs (and federal tax policy) are taken into account, the picture changes, and the poverty gap is found to be as large in 1997 as in 1995. These data strongly support the conclusion that the sharp declines in the numbers of children receiving means-tested benefits between 1995 and 1997 are directly linked to the disappointingly modest reductions in these years in the number of poor children and the lack of progress in easing the overall depth and severity of poverty among families with children.

#### *TANF Declines Contribute to Reduction in Food Stamp and Medicaid Participation*

While TANF and food stamps have seen dramatic declines in caseloads, participation in Medicaid has failed to increase despite significant expansion in eligibility. Research evidence indicates that the decline in TANF caseloads may be driving down participation in these other means-tested programs. In some cases, when families no longer receive cash assistance or are deterred from applying for cash aid, they may be unaware of, or not informed of, their continued eligibility for food stamps and Medicaid.

Researchers at Mathematica Policy Research reported in 1998 that about half of the decline in food stamp participation between 1994 and the beginning of 1998 appears to be associated with the reduction in AFDC/TANF participation.

The Congressional Budget Office similarly has found that the growth in the economy and the food stamp eligibility changes contained in the 1996 welfare law can account for only part of the reduction in food stamp participation and that some or all of the remaining decline may be linked to welfare reform.

The Urban Institute recently released results from a comprehensive study of nearly 1,300 families that have left the welfare rolls. The study found only 31 percent of these families were

receiving food stamps. Nearly two-thirds of the families leaving welfare that also ceased to receive food stamps had incomes low enough to continue to qualify for food stamps.

In Medicaid, the number of children and parents enrolled in Medicaid declined in 1996 for the first time in almost a decade even as states continued to expand Medicaid eligibility for children. As with food stamps, this development cannot be explained solely by the strong economy.

A study by researchers Leighton Ku of the Urban Institute and Marilyn Ellwood of Mathematica Policy Research found that the number of parents and children on Medicaid declined for the first time in nearly a decade between 1995 and 1996. They conclude that "falling welfare caseloads are leading to unexpected declines in Medicaid enrollment" and suggest that adults will lose Medicaid coverage in the future as welfare caseloads continue to fall.

A review of studies that considered the health insurance status of families that have left welfare found that at least one-third of children and most adults lose their Medicaid coverage after leaving welfare. At the same time, many of those who are no longer receiving Medicaid do not have employer-based coverage; the studies typically show that among families that are employed after leaving welfare, the share reporting employment-based coverage is 25 percent or less.

Similarly, a recent analysis the Urban Institute published of Medicaid enrollment patterns in California and Florida during 1995 found that half of the children leaving cash assistance in both states lost Medicaid. The same pattern held for adults in California, while in Florida, two-thirds of the adults who left AFDC lost Medicaid coverage. During the period evaluated by the study, both states used waivers to alter their welfare programs and experienced declines in their cash assistance caseloads.

The Urban Institute study found only 34 percent of former adult welfare recipients — and 47 percent of children in families formerly on welfare — reported Medicaid coverage. The study also found that these former recipients had relatively little access to coverage through their employers. As a result, more than 40 percent of former adult recipients were uninsured, as were a quarter of the children who had left welfare.

Although data on receipt of child care assistance are more limited than data on participation in food stamps and Medicaid, the available information indicates that few mothers leaving TANF received assistance with child care costs.

According to the Urban Institute study, in the first three months after leaving welfare, only 20 percent of former recipients received child care assistance.

### **Marginal Tax Rates on Working Poor**

At the heart of both the federal and state welfare reform efforts is the goal of moving people off the welfare rolls and into the workforce. Accomplishing that involves using both carrots (rewards for work) and sticks (sanctions for not complying with participation requirements). If the aim is to induce people to seek work, then there should be logical incentives for making work

more attractive and rewarding work. Both the federal and some state governments have attempted to provide a series of work-based monetary incentives, including using the income tax structure, to entice those at the bottom rung of the economic ladder to climb toward the top.

However, one example of unintended consequences are the cumulative effects upon income when these various forms of means-tested assistance are combined. As incentives phase out, families can face very high marginal tax rates, in this case defined as the percentage of each extra \$1,000 in earnings that a hypothetical family or individual would lose in the form of taxes or benefits. When marginal tax rates are high, families are penalized significantly for each extra dollar they earn. In these cases, the desired behavior — work — is not rewarded adequately and does not make the families much better off.

For example, the table below shows marginal tax rates on a single mother living in Maryland for 1998 with one school-age child and one preschool child who is enrolled in a day care center subsidized by the state on a sliding scale. As the mother's earnings increase, her TANF and food stamp benefits decline and her co-payments for child care assistance increase.

As a result of phasing out all of these combined benefits, this single mother in Maryland faces an average marginal tax rate of 40 percent as her earnings increase from \$0 to about \$12,000. This means that on average for every dollar she earns in this income range, her disposable income increases by about 60 cents. Her highest marginal tax rates occur in the income range between about \$12,250, when the federal EITC credit begins phasing out, and about \$20,000, when she loses eligibility for food stamps and the state EITC. At an earnings level of \$12,000, her total disposable income is \$16,639, including food stamps, and the refundable federal and state EITCs. But earning an additional \$8,000 brings her total disposable income to only \$16,189 — only about \$687 more than she had when she was earning \$12,000. Marginal tax rates in this income range for this particular single mother exceed 90 percent.

Some state organizations have done similar analyses of the impact of marginal tax rates on the working poor in their states. For example, an analysis by the Public Policy Forum in Wisconsin that examined tax rates on low-income families in many states found the same pattern of high marginal tax rates, especially on families with children in roughly the same earning range.<sup>12</sup>

### ***High Effective Tax Rates on Child Support Payments***

As welfare reform encourages families to rely on earnings and eventually moves them off of public assistance, income from the child support system will become an increasingly important mechanism for providing income to children in single-parent, low-income families. However, high effective tax rates also act as a disincentive for the payment of child support — another activity which, like work, most people agree should be encouraged rather than discouraged.

Many noncustodial fathers (and custodial mothers) are discouraged and frustrated by the fact that child support payments in many instances yield little or no benefits for their children. When their children live in households that receive public assistance, most or all of the child support paid by noncustodial fathers typically is kept by state and federal governments as reimbursement for the cost of that assistance. While understandable from the vantage point of state and federal policymakers, the corrosive result is that noncustodial fathers often have no real incentive to meet their child support obligations.

The 1996 federal welfare law repealed a requirement that states “pass through” the first \$50 in child support payments to custodial parents and their children every month rather than retaining the full amount as reimbursement for cash assistance. While 16 states have chosen to preserve a pass-through and two states have adopted a more generous pass-through in their TANF program than previously required under federal law, the remaining 33 states have eliminated the pass-through completely.<sup>13</sup> In these states, child support payments are counted dollar for dollar against TANF benefits, effectively resulting in a 100 percent tax rate.<sup>14</sup> Only one state — Wisconsin — now passes through the entire amount of child support paid by the noncustodial father to the custodial mother and their children.

The disposable income of low-income custodial families is negatively affected even more when these child support policies are considered in conjunction with the phase-out rates and high marginal taxes associated with other benefits. Even in the minority of states that have retained the \$50 pass-through, the income gain for custodial families typically is reduced further by an offsetting reduction in food stamp benefits (since most TANF households also receive food stamps). For example, if a noncustodial father pays \$250 in child support and a state passes through \$50 to the custodial family, food stamp benefits to the custodial family are reduced by \$15 as a result of the increase in income. Thus, the noncustodial father’s children will gain only \$35 in additional income as a result of his \$250 child support payment.

This high rate of effective taxation (86 percent) leaves the noncustodial parent with little incentive to meet his child support obligations and make payments through the formal child support enforcement system.<sup>15</sup> As one observer noted, “to many low-income noncustodial parents of children on public assistance, the biggest incentive for making regular and timely payment of child support (assuming that they actually had income from which to pay such support) would be knowing that their paying child support makes a real difference in their children’s lives.”<sup>16</sup>

### **The Incomes of Poor Children in Relation to the Poverty Line**

Lifting a substantial number of children out of poverty is not an impossible task. As the table below illustrates, about one-third of all poor children live in families with incomes within \$3,000 of the poverty line. Half of all poor children live in families with incomes within \$5,000 of the poverty line.

Table 7 is based upon CPS data and uses a comprehensive measure of income which includes all near-cash benefits like food stamps, housing benefits and the earned income tax credit. State and federal income and payroll taxes are subtracted from income. Receipt of food stamp and other benefits are substantially underreported and the table has not been adjusted to compensate for that underreporting. Adjusting for this underreporting would further reduce the number of children in poverty. Receipt of EITC benefits are simulated and the underreporting problem is less significant for this benefit. However, there is no accounting for work-related expenses. This would increase the number of children in poverty and the distance children fall below the poverty line.

The table also shows that many of these children are not receiving benefits that could move their families closer to the poverty line. Between 35 percent and 55 percent of poor children, depending on the income group, are not receiving food stamps. Food stamp participation is very

low among married couples. Most families with incomes below the poverty line are eligible for food stamp benefits. Among poor children in single-mother families, most of whom should receive child support, 75 percent to 85 percent do not receive it.

### **Work-Based Policies That Would Strengthen the Safety Net**

The previous sections of this paper have demonstrated that while employment of single-mother families has increased somewhat, average incomes have fallen or stagnated for single-mother families near or below the poverty line. Thus, to insure that work pays as a mother enters the labor force, the first priority should be to insure that families receive food stamps and child care assistance. Making work pay could also be enhanced by increasing the minimum wage. The next priority should be more effective child support policies. The paper also has shown that marginal taxes on earnings in the \$12,000 to \$20,000 dollar range are excessively high. Public policy for low-income families should continue to build upon policies that encourage work by reducing marginal tax rates on earnings and the payment of child support. These efforts would have the additional benefit of lowering child poverty significantly. Finally, there is one policy that should not be adopted. The financing structure of federal means-tested programs should not change. Neither should demonstrations of block granting the food stamp program be considered.

This paper will not propose a specific set of proposals but a range of options that should be examined. These include:

- Increasing the participation rate within the food stamp program and enhancing benefits for the working poor;
- Increasing access to and financing of child care services;
- Increasing the minimum wage and indexing it to inflation;
- Providing economic incentives to pay child support and adding additional staff to improve the probability of obtaining child support; and
- Strengthening the earned income tax credit.

### **Adopt Policies That Would Help the Food Stamp Program Promote Work**

As cited earlier in this paper, there is a substantial body of evidence from studies of families leaving cash assistance and from CPS data that shows that many working poor families do not receive food stamps even though they are eligible. While we do not have an exact knowledge of why many families do not participate, we do know that for many families the transaction costs of applying for benefits appears to outweigh the benefits the family would receive.

Participation in food stamps by low-income working families is low and appears to be dropping. Some working poor families are ineligible for food stamps for reasons such as the rule governing the value of a car they may own; for some of these families, a modest car needed to commute to work disqualifies them from food stamp benefits. Many other working poor families are eligible for food stamps but are not enrolled, in part because of complexities and procedural and other barriers that make it harder for working than non-working families to participate in the program or discourage them from participating.

Not only does the lack of food stamp receipt cause many families earning low wages to be several thousand dollars below the poverty line rather than out of poverty, it also can undermine welfare reform goals. Depending upon the size of the state's TANF cash grant, if families do not receive food stamps while they are working, families leaving welfare for work can be worse off on a monthly basis when they are working than when they are on welfare. In particular, if families are working part-time (such as 20 hours per week) at a low wage and not receiving food stamps, their monthly disposable income is likely to be lower than when they were on welfare.<sup>17</sup>

Many factors have contributed to the part of the decline that exceeds what eligibility changes and the economy can explain. These include the side-effects of the decline in cash assistance rolls and possibly a greater philosophical inclination to associate receipt of food stamps with "dependency" on the part of some states, and perhaps an increase in food stamp "stigma". It appears likely that another significant portion of this change results from state practices, many of which have been designed to reduce food stamp error rates among working families in response to pressures from USDA. Because current food stamp policy makes it difficult for states to serve working poor households and households receiving child support without risking errors (since those households' incomes fluctuate), many states seeking to reduce their error rates have targeted the working poor for increasingly burdensome procedures that apparently cause some to drop off of, or not to apply for, food stamps.<sup>18</sup> For example, states increasingly require working poor households to come in to food stamp offices every three months to reapply, forcing them to miss time from their jobs.

Between 1994 and 1998, a number of states sharply increased the proportion of working families with children required to reapply every three months. Nationally, data gathered through the food stamp quality control system show that the proportion of working families with children required to come into food stamp offices at intervals of three months or less more than tripled between 1994 and 1998, rising from 9 to 31 percent.

- All five states with the largest declines in food stamp participation between 1994 and 1998 dramatically expanded their use of three-month certification periods during those years.

Poor families must weigh lost wages from time taken off work, fear of irritating their employers, the difficulty of applying, and the cost of getting to and from the food stamp office against the benefits the food stamp program provides. Many may elect to leave the program or not to enter it in the first place because of the costs of participating. In addition, studies in the late 1980s found that when the administrative hurdles required to receive food stamps become more burdensome, working poor families are more likely to judge that food stamps are not worth pursuing. It should be noted that in 1997 Congress enacted legislation encouraging states seeking to expand enrollment in Medicaid by children to take precisely the opposite course: *extending* certification periods for children to 12 months as a way of reducing burdens on working families.

Barriers to participation are not limited to repeated, often-lengthy, office visits. For example, some states have begun to call a worker's employer every three months to verify the family's earnings. Low-wage workers who are concerned this may alienate their employers may

conclude they do not wish to continue receiving food stamps. Data are not available with which to measure the effects of these additional efforts.

More generally, it appears that when states have responded to USDA's pressure to achieve rapid reductions in their food stamp error rates, some of the policy changes they have implemented have had adverse effects on food stamp caseloads. The seven states that reduced their payment error rates by more than three percentage points between 1994 and 1997—Arizona, Florida, Idaho, Indiana, New Hampshire, Ohio, and Texas—accounted for 37 percent of the total national caseload reduction during that period, even though they had only 24 percent of the national caseload in 1994.<sup>19</sup> Arizona and Ohio experienced declines in food stamp participation during this period that *exceeded* the declines in their cash assistance programs. By comparison, states achieving more modest declines in food stamp error rates tended not to have as sharp declines in participation. It appears that improved management can bring about significant improvement in many states' payment accuracy, but that when states seek to bring about large reductions in error rates rapidly, they may resort to practices that deter participation, particularly among working families.

A series of changes should be instituted that would lower the transaction cost of obtaining food stamps. These might include:

- Simplifying reporting requirements;
- Making error rate measurements and sanctions more realistic insofar as they relate to serving working poor families;
- Creating incentives for states that enroll the highest percentages of working poor families;
- Ensuring that more working poor families have knowledge about food stamp eligibility; and
- Make it easier for working poor families not on welfare to apply jointly for Medicaid and food stamps by encouraging states to develop simplified joint Medicaid/food stamp applications, to provide applications points outside the welfare office, and to provide some evening and weekend office hours, where possible.

In addition to these efforts, several changes in food stamp eligibility should be considered. For example:

- The asset rules surrounding cars should be simplified and liberalized. States could be given the option of conforming their food stamp vehicle rule to the rules they use in TANF or Medicaid so long as those rules are no more restrictive than the federal food stamp rules; and
- Food stamp benefits could be set at a level that equals the current value of the thrifty food plan. Benefits now often are a few percent below the cost of purchasing a minimally adequate diet at present food prices.

### ***Increasing Access to and Financing of Child Care Services***

Many families with low earnings do not receive child care. The strongest evidence is provided by a study of families leaving cash assistance by the Urban Institute, which found that only 20 percent of these families were receiving government-funded child care. State studies of families leaving cash assistance reinforce that finding. Typically only 10 to 40% of the families leaving TANF receive child care assistance based upon information from these surveys. Thus, for many families that work after leaving welfare and incur child care costs, such costs are not being reimbursed. (Nor do these families receive a child care subsidy through the tax system since the Dependent Care Tax Credit is not refundable. The proportion of low-income working families receiving a government child subsidy may be lower than the proportion of middle-class working families receiving such a subsidy.)

Many working poor families do not receive child care assistance but nevertheless have child care costs. Many of the same problems that plague the delivery of food stamp benefits also prevent child care assistance from reaching many single-mother families. More efforts need to be expended to insure that families know child care assistance is available. Informal child care arrangements often fall apart. Eligibility processes need to be simplified. And if we really ensured that work paid for low-income single mothers, child care funding would have to be increased. Most states do reimburse for child care provided by relatives but sometimes families are unaware that this is possible. If we expect these mothers to work, child care should be reimbursed appropriately for all child care arrangements. This would also increase the flow of funds to many low-income neighborhoods and perhaps stabilize child care arrangements. When states adopt sliding fee schedules based upon income for child care benefits, states should examine the combined marginal tax rates from all benefit and tax policies to ensure that marginal tax rates are not excessive.

It is not clear by what mechanism funding should increase. The advantages of additional dollars in the block grant rather than through the child care tax credit are several: the monies are available on a monthly instead of an annual basis and child care quality can be monitored. The disadvantage is that child care block grant funding levels are more susceptible to change than subsidies provided through the tax code.

### ***Increasing and indexing the minimum wage***

Discussion in Congress is underway over whether to increase the federal minimum wage from its current level of \$5.15 to \$6.15. This increase in the minimum wage should be enacted. If the minimum wage remains at \$5.15 in 2000, its purchasing power will be over nine percent lower than in late 1997, when the \$5.15 minimum wage level was first implemented

In addition, steps should be taken to maintain the real value of the minimum wage over time by indexing it either to overall inflation — to maintain its purchasing power over time — or to some wage index — to keep the minimum wage trend in line with overall wage trends. However, if the minimum wage is indexed, debates over new increases will be difficult to mount, and the minimum wage in effect may be frozen at its indexed value. At \$6.15, this may be below the historic value of the minimum wage. For example, the federal minimum wage would need to be \$6.43 an hour in 2000 to match the purchasing power it averaged in the 1970s.

Nevertheless, approximately 11.8 million workers (10.1% of the workforce) would receive an increase in their hourly wage if the minimum wage were raised to \$6.15. Opponents of minimum wage increases frequently argue that the policy prices low-wage workers out of the labor market, forcing employers to lay them off after the increase takes effect. This claim has been carefully studied by labor economists interested in testing the actual impact of increases in the minimum wage among low-wage workers. Research over the past decade has generally found the job-loss effect to be either small or nonexistent, and that the benefits to low wage workers of increasing the minimum wage substantially exceed the costs.<sup>20</sup>

One recent study, that focused on the impact of minimum wage increases in Oregon on the well-being of welfare recipients moving to work, found that the earnings of parents who moved from welfare to work were boosted significantly by these increases.<sup>21</sup> As a result of a successful ballot initiative, the Oregon minimum wage rose from \$4.75 an hour to \$5.50 an hour in January 1997, to \$6.00 an hour in January 1998, and then to \$6.50 an hour in January 1999.

- The average starting wage of Oregon parents leaving welfare fell five percent, adjusting for inflation, during the three years prior to the January 1997 increase in the state minimum wage.
- This trend reversed itself immediately after the increase. The average starting wage jumped from \$6.15 an hour in the last quarter before the 1997 minimum wage increase took effect to \$6.43 an hour in the first quarter following the increase. By the fourth quarter of 1997, the average starting wage reached \$6.65 an hour, an increase of more than five percent, adjusting for inflation, over the same quarter of the prior year. The wage increases are unlikely to have occurred simply as a result of the state's strong economy. Economic growth in Oregon was solid prior to the state's minimum wage increase in 1997, but real wages for welfare recipients still declined during that period.
- The average starting wage for welfare recipients rose again following the second increase in the minimum wage. By the fourth quarter of 1998, welfare recipients who found work earned an average of \$7.09 an hour, up substantially from the end of 1997. Overall, the average wage for these workers was 94 cents an hour higher than before the state minimum wage increase took effect.

The minimum wage increase in Oregon boosted the earnings both of welfare recipients who found jobs at the minimum wage and many who found jobs paying slightly above the minimum wage. For example, among welfare recipients who found full-time jobs, the proportion earning more than \$6 an hour rose from roughly half in 1996 to two-thirds in 1997. In addition, consistent with other research, the available evidence does not suggest a negative change in employment opportunities for these workers.

## **Improving Child Support Policies**

An earlier section described one of the major problems with the way that the child support system is implemented for low-income families. When custodial families are receiving public assistance, the payment of child support orders usually does not make children better off. In

addition to addressing this problem, four policy options are described here that should improve the operation of the child support program significantly for fragile families. They are:

- Simplify distribution rules and pass-through all child support through to the family,<sup>22</sup>
- Disregard a substantial portion of child support when calculating TANF benefits,<sup>15</sup>
- Subsidize the payment of child support, and
- Increase child support staffing.

*Simplifying Distribution Rules and Pass-Through All  
Child Support Collected to the Family*

When a single-mother family applies for TANF assistance, she must cooperate with the child support office in identifying who the father(s) of her children are and she must assign all child support rights over to the state. Failure to cooperate with child support officials will result in at least a 25 percent reduction in her TANF grant.

Outside of perhaps Medicaid eligibility rules, nothing is more complicated than the rules surrounding the distribution of child support collections. In order to work properly, the system requires constant, immediate, and substantial flows of information in both directions between the TANF/Medicaid eligibility and benefit determination processes and the child support office. For example, in most states, the child support office must withhold all child support collections while the family is on TANF and send a portion of those collections to the federal government. But the moment the family leaves TANF, child support must send all current child support collections to the family. In cases where the child support payment repays an arrearage, the amount the custodial family gets depends upon when the arrearage was accumulated — specifically whether it occurred while the family was receiving AFDC. In some cases it also depends upon how the child support office got the collection — collections through federal income tax withholding are treated differently than collections by other methods.<sup>23</sup>

To determine benefit levels accurately, the TANF and food stamp offices must know whether the custodial family has cooperated (in terms of establishing paternity and assigning child support rights to the state), as well as the amount of child support that has actually been collected. A related problem is that families receiving cash assistance may actually have current child support payments that would make them ineligible for cash assistance if the payment was passed-through. This has a very adverse consequence for the family; they use months of time-limited assistance when they shouldn't have.

There is substantial anecdotal information and reports from state advocates that this system is not working well because the child support office is unaware of when families no longer receive TANF. Many times a family that leaves TANF does not receive current child support collections to which it is entitled until 3 to 6 months later. Further evidence of this phenomenon is that child support TANF collections remain very high despite the enormous decline in TANF caseloads.

State Child Support Directors and advocates could probably agree upon adopting a very simple rule — collect from the noncustodial parent (NCP) and pass-through the entire amount to

the family. This would eliminate the need to have any information flow from the TANF office to the child support office about changes in TANF case status. It would also mean that families would no longer experience delays in getting child support when they leave TANF. In addition, it would promote better government budgeting in the sense that TANF expenditures currently include money actually paid by NCPs. The cost would also be relatively modest. The administrative savings from straightening out mistakes, explaining and defending these incomprehensible rules to both custodial and non-custodial parents and reducing information flows would offset a corresponding portion of additional payments to custodial parents that would occur under this policy.<sup>24</sup>

### *Disregard a Substantial Portion of Child Support When Calculating TANF Benefits*

Another option available to states is to disregard a substantial portion of the child support payment when calculating welfare (TANF) payments to custodial families, thus ensuring that the child's well-being increases when child support is paid. In calculating the TANF payment, the state could establish a fixed flat amount to be disregarded (e.g., \$100 or \$200 per month), provide a disregard equal to a specified percentage of the monthly child support collections (e.g. 50 percent), or combine these two approaches. States also could choose to treat payments received from noncustodial parents in the same manner as they now treat the earnings of custodial parents.

Expanding the amount of child support that is actually received by custodial families — either the entire amount or a greater proportion through more generous disregards — would do a great deal to restore incentives for payment of child support and to improve children's well-being. At the same time, this approach by itself has substantial limitations. First, the low earnings of many noncustodial fathers still will prevent them from providing financial support at a level commensurate with their children's needs. Second, expanding child support disregards will improve the well-being of children in TANF households but have no effect on the income available to support low-income children living in non-TANF households.

### *Subsidize the Payment of Child Support*

Economists often argue that positive incentives — subsidies provided directly or through the tax system — can influence individual behavior and encourage desired activities by rewarding them financially. The federal tax code contains a number of effective provisions that promote work effort by custodial parents and help them meet the basic needs of their children (including Earned Income Tax Credit, dependent exemptions, and child tax credits), and federal benefit programs also offer help to low-income custodial parents to improve the well-being of their children. No similar incentives currently exist to promote work effort and encourage child support payments by noncustodial parents<sup>25</sup>. Of course, there would be little policy rationale or political support for extending similar tax incentives or earnings subsidies to noncustodial parents in circumstances in which they fail to meet their legal obligations to pay child support. However, a plan to match or subsidize child support payments could be effective in increasing the amount of child support paid by low-income noncustodial parents and serve as an important complement to current public policies designed to improve children's well-being. A plan to match or subsidize child support payments could be effective in increasing the amount of child

support received by low-income custodial families regardless of whether the family was receiving welfare.

In theory, incentives for child support payments by noncustodial parents could be structured within the federal tax code in a manner similar to those available to promote work among low-income custodial parents. In practice, any attempt to provide such incentives would require a high level of coordination between the federal tax and child support enforcement systems, leading to complicated new tax forms and an incentive system that would be extremely difficult to administer.

A more practical and potentially effective option for states to consider is the provision of matching payments or subsidies directly to custodial parents based on the income of noncustodial parents and the level of child support payments they make. While there are many alternative designs that states might consider, the basic elements of such an approach would include:

- A structure of matching payments to be made by the state to custodial families for every dollar of child support paid by low-income noncustodial parents, with matching rates reduced for noncustodial parents with higher incomes and subsidies eventually phasing out completely for noncustodial parents with incomes above a specified level;
- Administrative arrangements (most likely within state or county child support enforcement agencies) for verifying child support payments by eligible noncustodial parents and issuing matching payments to custodial families in an accurate and timely manner; and
- Provisions within the state TANF program to ensure that a substantial portion of child support payments are passed through to custodial families and that receipt of matching payments by custodial families does not affect their TANF benefit levels or eligibility for other services and support provided by the state to such families. (These payments will result in food stamp reductions for such families.)

There are a myriad of possible subsidy levels and phase-out rates that could be used as a structure for child support matching payments. The key decisions to be made by the state in establishing this structure are: (1) the maximum rate at which matching payments will be provided; (2) the range of noncustodial parent income over which this maximum rate will be applied; and (3) the phase-out rate, or how quickly the matching rate will be reduced as the income of the noncustodial parent increases. These parameters will then determine the income level beyond which noncustodial parents will no longer qualify for matching payments.

Table 1 illustrates one possible option describing how this Child Support Incentive Payment program might work, with a matching rate that is a function of the noncustodial parent's net income and based on a reduced child support order. The matching rate starts at a 1.5 rate and remains constant until the subsidy reaches a maximum of \$1,500, at which point the rate decreases while maintaining a constant subsidy amount over a \$3,000 gross income range, and then phases out at a 30 percent rate. This phase-out rate determines how rapidly the matching rate can be reduced. The 30 percent phase-out rate can be illustrated as follows. Suppose that between \$13,000 and \$14,000 of gross income, the child support order increases by \$253. The subsidy would be \$1,462 at 13,000 and \$1,386 at \$14,000, thus the order plus the subsidy would increase by 70 percent of \$253, or \$177. To always provide an incentive to pay child support,

one should not design a system with a high phase-out rate. One should always ensure that as the order increases the total amount received by the family (order + subsidy) increases as well.

The benefit level under this alternative is determined in much the same manner as the current federal Earned Income Tax Credit (EITC). As the income of the non-custodial parent rises from zero to a level approaching that generated by full-time work at the minimum wage, the matching rate remains constant. Within this range, however, the *amount* of matching payments to custodial families typically would rise because child support orders would increase as the income of noncustodial parents grows. Beyond this income range, the matching rate as well as the amount of matching payments declines and eventually phases out completely.

This is just one example, involving a 1.5 matching rate at the bottom of the income scale and a phase-out of matching payments where the income of the non-custodial parent reaches about \$32,000. Less generous matching schemes that do not match at more than a 1:1 rate and phase out well below \$32,000 also can be designed.

Local child support enforcement offices appear to be the logical choice for administering this system of matching payments in each community. Under current law, these agencies establish the initial amount of the child support order (with the consent of the court) and they also collect child support payments from noncustodial parents. It should be administratively feasible for these agencies to determine the amount of any matching payment based on the type of structure outlined above and then to send both child support and matching payments to the custodial family.<sup>26</sup>

Within the broader framework of their TANF programs, states could proceed with these new initiatives on a statewide basis or undertake demonstration projects to test the feasibility of this approach. If a state revises its TANF eligibility criteria to include children who have noncustodial parents with incomes below specified levels (and who meet other criteria set by the state to ensure that they reside in a needy family), it is free to use either federal TANF funds or state “maintenance of effort” (MOE) funds for matching payments and the costs of administering these programs or demonstration projects. To the extent that low-income custodial families who are working receive only these matching payments and no other cash assistance under TANF, they might constitute child-only assistance that is not subject to the time limits or work requirements imposed by the 1996 federal welfare law.

This strategy for subsidizing child support payments would be a supplement to, and not a substitute for, vigorous and effective child support enforcement efforts that hold noncustodial fathers legally responsible for the provision of financial support for their children. The strategy is likely to be most successful if accompanied by: employment services (including publicly-funded transitional jobs when needed) to bolster the earnings of low-income noncustodial fathers; a broader range of counseling, peer group support, parenting, case management, and mediation services to promote noncustodial fathers' involvement in the lives of their children; and accompanying changes in the culture of child support enforcement offices to assist noncustodial fathers in securing employment and becoming or remaining involved with their children. In addition, when appropriate for low-income fathers, issues of child support arrearages, the size of child support orders, and more flexible modification of those orders need to be addressed. Strategies to assist NCPs directly so that they participate also need to be included. One of these strategies might be crediting the CSIP against child support arrearages.

The individual elements of this strategy, including child support subsidies and expanded employment services for noncustodial parents, could be implemented immediately by states. States may choose to begin work on these more ambitious reforms by mounting pilot projects in one or several communities to demonstrate the feasibility of the approach and to assess whether it seems promising as a means of increasing child support payments and improving the well-being of children.

In a substantial number of other states, the size of child support orders poses an additional and sometimes overwhelming barrier to the payment of child support by such fathers on a regular basis. For example, a noncustodial father in California with an income of \$10,000 would have an annual child support order of \$3,216 under current state guidelines; the same father in Maryland would have a child support order of \$2,940. When low-income fathers are expected to pay such a large proportion of their earnings for child support, they are likely often to view this obligation as either unreasonable or impossible to meet and other incentives for child support payment are likely to be of limited ineffectiveness. Child support orders tend to be regressive. They are a higher percentage of income for low-income NCP's relative to higher-income NCP's.

Because child support orders are established in accordance with guidelines established by the state, every state can and should review the level of payments expected of *low-income* noncustodial parents to ensure they are reasonable. Excessive child support orders can be counterproductive; they can lead noncustodial fathers to move into the underground economy and avoid all payments on behalf of their children. Proposals to reduce child support orders for low-income fathers — even when they are very high — can be controversial because such revisions have the effect in some cases of reducing child support payments made to poor custodial families. These policy tradeoffs, seemingly pitting noncustodial parents against custodial families, frequently stymie progress in reviewing state child support guidelines.

This proposal is designed to address this problem. States concerned about the size of child support orders for low-income fathers and the difficult choices they pose could cap at a reasonable level the proportion of income that low-income fathers will be expected to pay in child support, and tie this change to the promise of child support matching payments so that custodial families come out ahead, and the income of the children in these families is not reduced by the capping of the child support orders. The examples that follow use the following illustrative formula to calculate a reduced, somewhat more reasonable child support order: 5 percent of the noncustodial father's net income up to \$5,000; 25 percent of net income between \$5,000-\$10,000, and 35 percent on net income above \$10,000.<sup>27</sup> In the California example cited earlier, this formula would reduce the child support order for a noncustodial father with an income of \$10,000 from nearly one-third of his income to slightly more than 10 percent. How much child support orders can be reduced should depend in part on the nature of the child support matching payments provided.

To illustrate the subsidy approach described earlier, the table on the next page shows the effects of a plan combining child support subsidies and a cap on child support orders for two sets of hypothetical families in the state of California. In these examples, the matching rate for child support payments as illustrated in Table 9 is utilized. Child support payments received by custodial families are treated under TANF as though they all were earnings of the custodial parent (i.e., the state's TANF earned income disregard is applied to the combined total of child support payments and earnings). The child support subsidy payments are excluded from the TANF benefit calculations but are included in calculating food stamp benefits.<sup>28</sup> Finally, child

support orders are capped according to the 5%/25%/35% formula described earlier. The effects of this subsidy plan as reflected in Table 10 demonstrate some of the potential benefits of this approach.

- The income of the custodial family in these two hypothetical cases would increase substantially. Depending upon the amount of the custodial parent's earnings and whether one assumes that child support actually would be paid under current law, the rise in incomes shown in Table 10 reflects gains of between 6 and 18 percent.
- Incentives for noncustodial parents to pay child support are dramatically improved. Under current law in California, effective tax rates on child support payments to custodial parents on TANF reach nearly 90 percent (i.e., every \$1 in child support paid yields only 11 to 13 cents in additional income for the custodial family, with the bulk of such payments retained by state and federal governments). Under the proposed subsidy plan, every \$1 in child support payments would raise the income of the custodial family by between \$1.33 and \$1.68 as a result of the state matching payments.
- Noncustodial fathers who meet their child support obligations also would end up substantially better off financially than they do under current law. In these hypothetical cases, the noncustodial father's income (after subtracting the child support payments to the custodial family) rises to 86 percent of the poverty line.

The formula illustrated in Table 10 will not necessarily be appropriate in other states. Some states still have inadequate earned income disregards for custodial parents, and if these low disregards also are applied to child support payments, the formula outlined above will not generate the intended benefits for custodial families. In any plan that includes a provision to cap child support orders, each aspect of the plan's formula and the interactions must be examined carefully to ensure that they yield the intended results. The details of any plan must be tailored specifically to respond to the circumstances and needs of each individual state.

### *Increasing Child Support Staff*

Advocates and state child support directors can also probably agree that the biggest bottleneck holding back further increases in the amount of child support collections is the lack of adequate staff. A recent study<sup>29</sup> found that while state spending is not the only factor affecting performance, the data confirm the direct connection between performance and program investment. The data also suggest that most state child support programs are substantially underfunded and understaffed relative to other human services programs, and that performance may be enhanced with increased investment.

Child support offices no longer lack enforcement tools. Some of the tools a child support office has are the issuing of wage-withholding orders on the employer, taking away a driver's license and in some states hunting and fishing licenses and other professional licenses, garnishing of assets, denying a passport to an NCP with at least a \$5,000 arrearage, and modifying the credit history of a delinquent NCP. With the passage of the 1996 federal welfare act (and its requirement to establish a new hire directory, a child support registry and state disbursements), and past efforts where the federal government paid a large percentage for

automation systems, state computer problems — while not fully solved — are diminishing in importance.

There have also been substantial efforts over the years to make the child support processes more administrative in nature and less subject to judicial delays. Finally, there has been a substantial effort to establish paternity with considerable success. In 1984, there were 219,000 paternities established. Last year for the first time, more paternities were established than there were non-marital births. Outside of economic barriers, inadequate staffing seems to be the largest barrier to increasing child support collections.

One illustration of the impact of staff shortages is the national new hire directory. The new hire directory had one million matches against the child support registry in the first six months of operation. This apparently means that one million NCPs have become employed in a job, and probably in a different state from the state in which the NCP's children live. But when many of these matches were transmitted to states, many states did not act on them. Even though the federal government would finance 66 percent of any additional child support enforcement staff hired, other obstacles have prevented the acquisition of adequate staff at the local and state level. These obstacles include overall bans on state hires and the lack of sufficient clout by child support agencies in internal state budgeting decisions. In addition, more enforcement probably means more complaints from some elements of the public to elected officials that have to make the ultimate funding decisions.

One idea for overcoming these barriers is to institute a temporary three-year federal matching block grant of sufficient size to increase state child support staffing by 10 to 20 percent. The block grant would be financed at a 90 percent rate by the federal government. (A modestly lower match rate could be considered, but the lower the match rate, the greater the number of states that would not take advantage of these funds.) The states would have complete flexibility over which staff to hire and where those staff would be deployed. The only requirement would be to show that these are new staff. At the end of the three-year period, the matching would return back to the 66 percent rate. This is similar in design to the federal government's incentives to hire community police. Presumably one could then study and evaluate how effective these additional staff were in collecting additional support from NCPs.

### ***Strengthening the Earned Income Tax Credit***

As demonstrated earlier, many families may face very high marginal tax rates as annual earnings increase from around \$12,000 to \$20,000. States should be mindful of these tax rate issues when designing state income tax policies as well as child care co-payments and health insurance premiums that increase with income.

The federal government has essentially two policy alternatives for lowering this marginal tax rate. One could either lower federal EITC phaseout rates or the food stamp phaseout rate. For several reasons, lowering the EITC rate seems preferable. The EITC participation rate, particularly among families earning \$15,000 or more, is substantially higher. Lowering the food stamp phaseout would expand eligibility among low-income working families, which would miss a number of these families due to lower food stamp participation rates in this income range; it also would face greater obstacles politically than addressing these issues through the EITC.

The table below illustrates the earned income tax parameters for families with children in calendar year 1999. These parameters could be modified in any of several ways to lower marginal tax rates, particularly on families with earnings between the level at which the EITC begins to current phaseout and the income level at which food stamp eligibility ends.

One option would be to extend the plateau for all families with children (but to extend it for married couples filing jointly by several thousand dollars more than for single heads of household, which would have the added advantage of reducing the marriage penalty).<sup>30</sup> In addition, or in lieu of extending the plateau for all families with children, one could reduce the phaseout rate from 21 percent to around 10 percent or so until food stamp eligibility has ended for a family of four and then return the phaseout rate to a higher level.

In addition, one could establish an additional EITC tier for families with three or more children. Large families are more likely to be below the poverty line and in need of the earnings subsidy. As we increasingly replace welfare benefits (which were adjusted by family size) with earnings that do not vary by family size, adding a third tier to the EITC takes on greater importance. One could either simply extend the 40 percent phase-in rate to an earnings level that increases the EITC for families with three or more children, or preferably, increase both the phase-in rate (to, say, 44 or 45 percent) and increase the earnings level sufficiently to increase the EITC for larger families by the desired amount.

### **Effectiveness of these Policies in Reducing Child Poverty**

These five policies, especially if enacted together, hold promise for lowering child poverty significantly. They also would enhance efforts to continue to “make work pay” by alleviating some of the disincentives to work inherent in the high marginal tax rates described earlier.

The table below illustrates a very simple point. As the family moves from welfare to work, retains food stamps and gets reimbursement for reasonable child care expenses, the family gains a considerable amount of income, which places the family well above poverty. But if the family enters the labor force, has child care and other work expenses that are not reimbursed and no longer receives food stamps, the family is financially worse off. If welfare to work policies are ultimately going to judged successful, they must increase disposable income. Therefore our delivery of food stamps, child care and health insurance benefits needs to be improved; especially for the working poor.

Assuming that is accomplished, further steps should be taken to improve the EITC and insure that gains from work continue as the family moves from earnings around full-time full-year minimum wage employment up to \$20,000 or \$25,000. As you can see from the third column in the table, this was accomplished.

While much has been done to encourage labor force participation by single-mothers with children, more attention needs to be paid to the non-custodial parent. This parent needs also needs assistance in entering the labor force. The culture of the child support office also needs change. If as a society we believe that low-income NCPs should pay child support, then our policies should reflect that value and this behavior should be subsidized, rather than discouraged by taxation. NCPs paying child support should know that their children are better off as a result of that payment. The guarantee level from TANF and food stamp benefits has been lowered

sufficiently over the last 25 years so that most child support payments could be disregarded when calculating TANF benefits. Enforcement and child support staffing also need attention. If this were done, child poverty could be further reduced.

### **Experimenting with the Financing Structure of the Food Stamp Program is Extremely Unwise Policy<sup>31</sup>**

Given the apparent success of the TANF block grant, some have suggested that the food stamp program should also be turned into a block grant program. This proposal was part of the House reconciliation bill that was passed in early 1995 in the House of Representatives. If this idea is too radical, an alternative suggestion that on the surface seems rather innocuous would convert the food stamp program in several states to a block grant structure.

Given what we know thus far about the implementation of TANF, this is an unwise policy. The evidence presented earlier in the paper was that the primary problem concerning the food stamp program is the lack of participation in the program. This lack of participation hinders the effectiveness of the program in reducing child poverty. It causes many families to face high marginal tax rates as they leave cash assistance. The decline in TANF caseloads appears to be reducing food stamp caseloads. Given what has happened to TANF caseloads, this effect would probably accelerate if the food stamp program were converted to a block grant, compounding further the participation problem.

Another question emerging from the TANF experience is whether funding under a block grant program can be sustained. Even though the TANF program is just three years old, there are increasing calls to reduce the level of funding. One of the older block grant programs is the Social Services Block Grant that is authorized under Title XX of the Social Security program. On an inflation-adjusted basis, funding for this block grant between 1977 and 1999 has been cut from \$7.8 billion to 1.9 billion, a 75 percent reduction. It is difficult to find a major social program whose funding has been so radically altered over the past two decades.

Changing the financing structure of the food stamp program is a radical change. Problems with the current administration of the program can be addressed with incremental changes within its current financing structure. It also is unclear what would be studied under an experimental block grant approach and whether valid results could actually be obtained.

Converting the food stamp program into a block grant would mean the program loses its national character. Families will be treated differently in different parts of the country. The current program is a largely uniform national program that provides nutrition assistance. It is an excellent safety net program with low benefits and a low tax rate. Economists would be hard pressed to design a better approach. It complements the earned income tax credit in that it delivers nutrition assistance to families in need on a monthly basis, instead of an annual basis. It also narrows the disparity in TANF benefits among the different states. These points are examined in more detail below.

#### *Program Would Lose its Ability to Respond to Need*

The food stamp program responds to changes in need. If more households qualify for food stamps because poverty increases — such as during a recession or when a state's population grows rapidly — the program expands so households that apply and meet the eligibility criteria

may receive assistance. When poverty subsequently declines, as it does during most economic recoveries, the program tends to contract.

The food stamp program is especially responsive to increases in unemployment, far more so than the AFDC program is. Between June 1990 and June 1992 as the national unemployment rate climbed from 5.1 percent to 7.7 percent, the number of people receiving food stamps rose more than five million.

Under a block grant, the ability of the program to respond to fluctuations in the economy and changes in need would be lost. States would receive a fixed amount of funding at the start of the year. The amount would not rise if need increased. *If unemployment or population rose, states would have to bear 100 percent of the added food assistance costs themselves.*

This would present states with dilemmas during recessions. State revenues shrink during economic downturns. If the food stamp program is converted to a block grant and poverty subsequently rises, states would have to choose between such courses as: raising taxes or cutting other programs more deeply during a recession to free up funds for mounting food assistance needs; denying the newly unemployed poor entry into the food assistance program; placing the newly poor on waiting lists for extended periods; and cutting benefits across-the-board.

These problems would not be limited to periods of national recession. Individual states or regions often experience high levels of unemployment at times when the national economy is not — or not yet — in recession. In addition, wages for low-paid jobs have eroded in some areas, in part due to international competition. This can push more working families in the state below the poverty line and make them eligible for food assistance. Some states are also experiencing substantial population growth that raises the number of poor people needing food aid. While the current food stamp benefit structure responds fully and automatically to economic and demographic factors that increase or decrease with poverty, a block grant would not.

These concerns are intensified by a related problem — any formula used to allocate block grant funds among states would have to be based on outdated data. The most recent state-by-state poverty and income data are several years old.

If, for example, one wished to use state poverty data to allocate block grant funds for fiscal year 2000, the allocation would have to be based on a three-year average of state poverty data for 1995, 1996, and 1997; those are the most recent such data available. But these data would be three to five years old by 2000. Significant variation in state economic conditions and population growth can occur during such a period.

During recessions, unemployment and poverty levels climb sharply in some states; these states would be heavily disadvantaged by a block grant allocation formula tied to a prior distribution pattern. At the same time, other states less sharply affected by the economic downturn could receive a share of block grant funds that substantially exceeded their share of the number of poor people nationwide. The states hardest hit by the recession would simultaneously face large declines in state revenues and be among the states least able to provide state funds to respond to the additional need the downturn created.

Moreover, If a recession hit, it would almost certainly swamp whatever modest amounts states had been able to accumulate in reserve funds, with state reserves likely being exhausted in

the first few months of a recession. Over the three fiscal years from 1990 through 1992 — when recession set in and unemployment rose — federal food stamp funding climbed \$17.9 billion above the fiscal year 1989 level. Any state reserves would be quickly washed away in such a circumstance.

#### *Automatic Stabilizing Function Would Deteriorate*

The conversion of food stamps to block grant status — and the consequent loss of an automatic federal response during recessions — also would have another noteworthy effect. It could weaken the national and state economies. The food stamp program functions as what economists call an “automatic stabilizer” — a federal program that helps to moderate economic downturns by infusing more purchasing power into state and local economies when recession sets in. As the single means-tested program that responds most strongly to economic downturns, the food stamp program is one of the more important automatic stabilizers in the federal government’s recession-fighting arsenal. The automatic stabilizer role played by the program would be lost under a block grant structure. Converting to a block grant that does not respond to cyclical downturns in the economy could contribute to making recessions somewhat deeper and more protracted.

#### *Ability to Narrow TANF Benefit Disparities Would be Weakened*

Another important issue is that converting food stamps to a block grant would end the program’s ability to help prevent the state variations in benefit levels provided to poor children from growing substantially larger than they already are. Under current law, food stamp benefits rise when a state reduces AFDC benefits and decline when a state increases AFDC benefits, an aspect of the food stamp program that helps keep state disparities from growing too wide.

The program’s strong role in reducing disparities among states can be seen by comparing a state like Vermont, which pays high AFDC benefits, to a low-payment state like Mississippi. The AFDC benefits paid to a family of three with no other income are five times higher in Vermont than in Mississippi. But when food stamps are taken into account, the benefit ration falls from 5:1 to 2:1.

If the food stamp program is converted to a block grant, however, its benefits would no longer rise when a state reduced AFDC benefits and no longer decline when cash benefits increased. The almost-certain result would be a widening of disparities among states over time.

#### *Other Policy Changes to the Safety Net Should Also Be Considered*

As the title of the paper implies, these are a few suggestions that improve the work-based safety net. By no means is this list of policy options exhaustive. The subject of those who are unable to work or have very severe employment barriers is not addressed by the paper.

Even within the work-based safety net, other changes that should be considered were outside the scope of this paper. These include further improvements in access to health benefits, particularly for low-income working parents, additional housing vouchers to help low-income

working families afford decent, stable housing, reforms to the unemployment insurance program and programs to help eliminate transportation barriers.

### *Conclusion*

This paper has argued that a few policy changes that would enhance our work-based safety net hold promise for significantly reducing poverty among children. Under an expanded definition of poverty, about half of our poor children are within \$5,000 of being above poverty. If we further improved the earned income tax credit, enforce better and subsidize the payment of child support, enhance the food stamp program for the working poor and increase participation, raise the minimum wage, and expand access to child care assistance for low-income working families, many of those children would no longer be poor. (Many others would be less poor.) These changes also probably would increase earnings and child support payments significantly.

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<sup>1</sup> This paper is a working draft that is undergoing revision and does not necessarily reflect the views of the Center on Budget and Policy Priorities. The authors wish to thank Bob Greenstein and Kathy Porter for their invaluable assistance and Lynette Rawlings for creating several of the tables in the text from CPS data.

<sup>2</sup> This includes about \$3.7 billion of savings from denial of food stamp eligibility to legal resident aliens.

<sup>3</sup> Throughout this paper, the term average effective tax and benefit reduction rate is used somewhat interchangeably with the concept of the net returns to work. The net return to work or the percent of wages that increase family income, is simply one hundred minus the average tax and benefit reduction rate shown in Table, less any out-of-pocket work expenses (these expenses are assumed to be zero in Table 1).

<sup>4</sup> Outside of demonstrating that the Medicaid caseload has fallen as a result of the TANF caseload declines, this paper will not discuss the provision of and financing of health insurance coverage. This is an important topic but outside the scope of this paper.

<sup>5</sup> To phase out government benefits of \$9,000 at \$10,000 of earnings with payroll tax of 7.65 percent and a constant marginal tax rate of less than 50 percent implies government benefits will end at \$31,250. If one further assumes that a marginal federal and state income tax rate of 18 percent begins at approximately \$25,000 of earnings, it implies government benefits must continue until \$35,870 of earnings. For families without child care costs, the marginal tax rate can be 10 to 15 percentage points lower.

<sup>6</sup> These calculations assume families continue to receive food stamps after entering the labor force. In reality, many families do not receive food stamps with earning levels near poverty as

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illustrated in Table 7. This implies that instead of facing a very low average tax for the first \$12,516 of earnings as shown in Table 1, the family faced a very high marginal tax rate upon entering the labor force. If they have any significant work expenses, they are only slightly better off than if they had no earnings.

<sup>7</sup> Based on a presentation and review of state “leaver” studies by Robert Haveman to the Ways and Means Welfare Seminar in mid-July, 1999.

<sup>8</sup> A similar pattern is found if one examines the change in food stamp participation between 1994, when food stamp participation peaked, and 1997. The number of poor people fell 6.5 percent between 1994 and 1997, while the number of people receiving food stamps in an average month fell 19.8 percent.

<sup>9</sup> Wendell Primus, Lynette Rawlings, Kathy Larin, and Kathryn Porter, *The Initial Impacts of Welfare Reform on the Incomes of Single-Mother Families*, Center on Budget and Policy Priorities, August 1999. This analysis is based on administrative data and data from the Census Bureau’s Current Population Survey (CPS). In this study, disposable income is defined to include all major means-tested benefits other than health insurance — including AFDC/TANF, food stamps, housing, and Supplemental Security Income, as well as earnings, the EITC, and other sources of income. In addition, the study adjusts family income for family size so the families ranked lowest on the income scale were those that had the lowest incomes in relation to the poverty line. It also adds to the income reported by these families in the Census data a substantial amount of additional income to correct for problems that otherwise would be caused by the underreporting of cash assistance and food stamp income in the data. It should be noted that the data used for this analysis are cross-sectional, rather than longitudinal, so the study examines a different group of families in each year, rather than following the same families over several years.

<sup>10</sup> This is statistically significant at the 90 percent confidence level. Several other statistical tests show this finding to be robust and not a product of data anomalies at the bottom of the income distribution.

<sup>11</sup> If means-tested benefit programs had lifted from poverty in 1997 the same percentage of children who would have been poor without these benefits as the programs lifted from poverty in 1995, some 700,000 more children would have been lifted above the poverty line in 1997.

<sup>12</sup> Public Policy Forum, *Making Work Pay in Wisconsin: An Evaluation of Tax-Based Work Incentives and Their Impact on Welfare Reform and the Working Poor*, July 1999.

<sup>13</sup> Paula Roberts, *State Action Re \$50 Pass-Through and Disregard*, Center for Law and Social Policy, January 1998.

<sup>14</sup> Normally, a tax rate is defined as the percentage of earnings or income that must be paid to the government. In this case, the effective tax rate refers to the percentage of child support that is claimed by government as opposed to being available to the child.

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<sup>15</sup> This interaction with the food stamp program also creates some disincentive for states to expand their child support disregards, but the benefits of such a policy far outweigh its costs.

<sup>16</sup> Margaret Stapleton. *The Unnecessary Tragedy of Fatherless Children: Welfare Reform's Opportunities for Reversing Public Policies that Drove Low-Income Fathers Out of Their Children's Lives*. Clearinghouse Review, January-February 1999, p.499.

<sup>17</sup> The EITC they receive after the year is over can make them better off by working, but the EITC does not come on a monthly basis and many families initially leaving welfare for work may not be aware of the EITC benefit they will receive.

<sup>18</sup> Under the Food Stamp Act, states are held liable when the incorrect amount of food stamps is issued, without regard to whether the state originally made a proper benefit determination and was unaware of a subsequent change in a household's circumstances. Thus, when a family's source of income is not fixed — *e.g.*, when the family receives earnings or child support — states worry that the family will not understand the need to quickly report events the household may not see as significant changes in its circumstances, such as a few additional hours of work. New procedures USDA unveiled in July 1999 should ameliorate these problems to some degree.

<sup>19</sup> Although some of these states had large numbers of legal immigrants that were terminated under the welfare law, other states with large immigrant populations, such as California, Illinois, New Jersey, and New York, had lower-than-average caseload declines during this period.

<sup>20</sup> Jared Bernstein, *The Next Step: The New Minimum Wage Increase and the Old Opposition*. Economic Policy Institute: April 27, 1999.

<sup>21</sup> Ed Lazere, *New Findings from Oregon Suggest Minimum Wage Increases Can Boost Wages for Welfare Recipients Moving to Work*, Center on Budget and Policy Priorities, May 1998 and Jeff Thompson, *Oregon's Increasing Minimum Wage Brings Raises to Former Welfare Recipients and Other Low-Wage Workers Without Job Losses*, Oregon Center for Public Policy, June 2, 1999.

<sup>22</sup> The use of the terms pass-through and disregard are two related but different concepts in the child support enforcement community. The term pass-through means the child support office receives a child support payment from a non-custodial parent and gives (passes-through) 100 percent of that payment to the custodial parent. If the custodial family is receiving cash assistance, there is a second policy issue of how much of this payment should be disregarded (not counted) in determining the TANF cash benefit. In most states today when a family is receiving TANF cash assistance, the child support check is retained (not passed-through) by the child support office and the family receives the same TANF check regardless of whether a child support payment was actually made by the non-custodial parent. This also means that none of the child payment is disregarded in calculating the TANF benefit.

<sup>23</sup> For a complete description of assignment rules and distribution of child support, the readers is referred to pages 587, 591-594 of the 1998 Green Book as well as OCSE Action Transmittals of (October 21, 1997 and August 19, 1998).

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<sup>24</sup> There would be some additional costs because families receive all the child support payments to which they are entitled in a more timely manner and because more child support collections from IRS refunds would go to the custodial family.

<sup>25</sup> Only families who live with their children receive the *family* EITC. Parents who do not live with their children do not qualify for the family credit. They may be eligible for the small EITC for workers without a child in the home if their income is below \$10,030 for 1998, but this credit is very small.

<sup>26</sup> The success of a child support subsidy plan administered by local child support enforcement agencies also may depend on the ability of state and local officials to change the culture of the child support office. Just as welfare reform during the early 1990s aimed to transform the culture of welfare offices from cash disbursement offices into agencies that focus on placing mothers in the workforce, child support offices must begin to help noncustodial fathers become employed and develop stronger ties to their children. This represents a major challenge, as the first priority of child support offices must continue to be the vigorous enforcement of child support obligations and the effective collection of child support payments. Through partnerships with other public and private agencies, however, these offices can help to bolster the capacity of noncustodial fathers to meet their child support obligations and thereby improve the well-being of their children.

<sup>27</sup> This illustrative formula of how much low-income non-custodial fathers should pay is precisely that. It is illustrative and should not be cited as reflecting the judgment of the Center on Budget and Policy Priorities as to what the “right” amount is or what the ideal formula should be. This illustrative example is also used in the context of other child support policies. What is reasonable must be judged in the context of the entire situation confronting both the custodial family and the non-custodial parent.

<sup>28</sup> The subsidy payment is excluded from the food stamp gross income limits that would require a change in federal law. This change in food stamp law could not be implemented by the states.

<sup>29</sup> V. Turetsky, *You Get What You Pay For: How Federal and State Investment Decisions Affect Child Support Performance*, Center on Law and Social Policy, 1998.

<sup>30</sup> Iris J. Lav, *Extending Marriage-Penalty Relief to Working Poor and Near Poor Families*. Center on Budget and Policy Priorities, June 10, 1999.

<sup>31</sup> Some also suggested that the Medicaid program could also be block granted. Congress considered this concept during 1995 and 1996. Many of the arguments against a food stamp block grant also apply to a Medicaid block grant, which is also a very unwise policy. Further discussion of the concept is outside the scope of this paper.

**Table 1**

**Average Disposable Income at Various Wage Levels for a Mother and Two Children: Selected Years, 1972 to 1996**

	Earnings (as a percent of poverty threshold)			
	0	75	100	125
<b>Wages (1996 dollars)</b>	0	\$9,387	\$12,516	\$15,645
<b>Average Disposable Income (1996 Dollars)</b>	<sup>1</sup>			
1972	\$10,869	\$15,078	\$16,201	\$17,329
1984	\$8,688	\$11,604	\$12,843	\$14,262
1996	\$7,977	\$15,155	\$16,743	\$17,766
<b>Percent Change</b>				
1972-96	-26.6	0.5	3.3	2.5
1972-84	-20.0	-20.1	-20.7	-17.7
1984-96	-8.2	30.6	30.4	24.6
<b>Average tax and benefit reduction rate (in percent)</b>	<sup>2</sup>			
1972	n/a	55	57	59
1984	n/a	69	67	64
1996	n/a	24	30	37
<b>Marginal tax and benefit reduction rate (in percent)</b>	<sup>3</sup>			
1972	n/a	61	64	64
1984	n/a	59	60	55
1996	n/a	20	49	67

<sup>1</sup> Disposable income is wages plus AFDC plus Food Stamps less Federal income and payroll taxes. Income is a weighted average across the 48 contiguous States and the District of Columbia with each State's weight for all years being the number of persons under 18 in 1990. Dollars adjusted for inflation using the CPI-U-X1. EITC enacted in 1975. The AFDC earnings disregard is assumed to be \$120 and the shelter deduction assumed in calculating food stamp benefits is assumed to be 50 percent of the shelter deduction cap. This table assumes either the family has no work or child care expenses or that these costs are completely reimbursed by government throughout the entire range of earnings shown in the table.

<sup>2</sup> This set of numbers show the average tax and benefit reduction rate over the entire earnings range, (i.e. from zero to the earnings level denoted in the column heading). The lower this number, the greater the incentive to join the labor market. One hundred minus the number in the table illustrates the percentage of wages that increases the disposable income of the family.

<sup>3</sup> This shows the marginal tax rate and benefit reduction rate from increasing earnings by 25 percent of poverty. If data for 1998 were available, the marginal tax rates would be lowered by 5 to 10 percentage points. The enactment of the child tax credit essentially offsets the income tax marginal rate until federal income taxes exceed the value of the credit.

Source: APSE & Ways and Means Committee staff based upon data compiled by CRS on State AFDC benefit levels.

**Table 2**

<b>Category</b>	<b>Percent Employed</b>						
	<b>1992</b>	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>
All Previous Year AFDC recipients	19.9	21.5	23.0	23.7	26.5	31.8	33.8
Single mothers under 200% of poverty							
with children under age 18	44.1	46.0	46.1	48.2	51.1	54.4	56.6
with children under age 6	34.8	39.1	39.4	42.6	44.4	50.4	51.1
Married mothers under 200% of poverty							
with children under age 18	41.0	41.8	43.7	44.2	44.2	44.4	44.5
with children under age 6	35.3	36.0	38.5	39.1	39.0	39.7	41.2

Source: Department of Health and Human Services, *Temporary Assistance to Needy Families (TANF) Program: Second Annual Report to Congress*, August, 1999. Tables 4:1

**Table 3**

<b>Change in Income Amounts by Source for Single-Mother Families</b> <i>(1997 dollars)</i>				
	<b>Poorest Quintile</b>		<b>Second Quintile</b>	
	<b>1993-95</b>	<b>1995-97</b>	<b>1993-95</b>	<b>1995-97</b>
Earnings	\$435**	(\$182)**	\$1,642**	\$901**
EITC	\$228**	\$73**	\$517**	\$398**
Means-tested Income	\$291	(\$458)**	(\$34)	(\$1,463)**
Other	\$82	(\$10)	\$189	\$274
<b>Disposable Income</b>	<b>\$1,036**</b>	<b>(\$577)**</b>	<b>\$2,314**</b>	<b>\$110</b>
** statistically significant, $\alpha=.01$				

**Table 4**

<b>Key Child Poverty Statistics</b>				
	<b>Number of Poor Children When Non-cash Benefits and Taxes are Taken into Account<sup>1</sup></b>	<b>Poverty Rate, Counting Non-Cash Benefits and Taxes<sup>1</sup></b>	<b>Number of Children Removed from Poverty by Means-tested Benefits<sup>2</sup></b>	<b>Percentage of Children Poor Before Means-tested Benefits Who are Lifted from Poverty by these Benefits<sup>2</sup></b>
1993	13,853,000	20.0%	2,811,000	16.8%
1995	11,443,000	16.2%	3,241,000	20.6%
1997	11,080,000	15.6%	2,379,000	16.0%

<sup>1</sup> This poverty measure counts as income the benefits from food stamps, school lunches, and low-income housing subsidies, as well as other cash income. It also counts the EITC as income and subtracts federal and state income and payroll taxes.

<sup>2</sup> This figure does not include the impact of federal taxes.

Table 5

<b>Child Poverty Gap Data</b> <b>(in billions of 1997 dollars)</b>		
	<b>Poverty Gap</b> <b>Before Means-</b> <b>Tested Benefits</b>	<b>Poverty Gap After</b> <b>Means-Tested</b> <b>Benefits and Federal</b> <b>Taxes</b>
<b>Year</b>		
<b><i>All Families With Children</i></b>		
1993	\$71.7	\$34.0
1995	\$59.8	\$24.8
1997	\$56.2	\$26.5
<b><i>Married Couple Families With Children</i></b>		
1993	\$21.3	\$13.4
1995	\$16.9	\$8.2
1997	\$15.9	\$8.5
<b><i>Female-Headed Families With Children</i></b>		
1993	\$47.3	\$18.6
1995	\$39.9	\$14.9
1997	\$37.1	\$16.0

**Table 6**

**Change in Components of Disposable Income as Earnings Increase by \$1,000 Increments for a Single-Mother  
Family with Two Children and Child Care Expenses in Maryland, 1998,**

<b>Earnings</b>	<b>TANF</b>	<b>Food Stamps</b>	<b>EITC</b>	<b>Other Federal Taxes</b>	<b>State Taxes</b>	<b>Transportation &amp; Child Care Copay</b>	<b>Disposable Income</b>	<b>Total Disposable Income</b>	<b>Marginal Tax Rate</b>
<b>Level of Benefits and Taxes at Earnings of Zero and \$6,000:</b>									
\$0	\$4,656	\$3,852	\$0	\$0	\$0	\$0	\$8,508	\$8,508	
<b>\$6,000</b>	\$96	\$2,902	\$2,400	(\$459)	\$240	(\$399)	\$10,780	\$10,780	
<b>Change in Benefits/Taxes from a \$1,000 increase in earnings:</b>									
\$7,000	(\$96)	(\$240)	\$400	(\$77)	\$40	\$0	\$1,028	\$11,807	-2.8%
\$8,000	\$0	(\$240)	\$400	(\$77)	\$40	\$0	\$1,124	\$12,931	-12.3%
\$9,000	\$0	(\$240)	\$400	(\$77)	\$25	\$0	\$1,109	\$14,039	-10.9%
\$10,000	\$0	(\$209)	\$156	(\$77)	(\$8)	(\$104)	\$758	\$14,797	24.2%
\$11,000	\$0	(\$116)	\$0	(\$77)	(\$20)	(\$412)	\$375	\$15,173	62.5%
\$12,000	\$0	(\$240)	\$0	(\$77)	(\$42)	\$0	\$642	\$15,814	35.9%
\$13,000	\$0	(\$128)	(\$156)	(\$77)	(\$45)	(\$372)	\$223	\$16,037	77.7%
\$14,000	\$0	(\$92)	(\$211)	(\$77)	(\$46)	(\$492)	\$82	\$16,119	91.8%
\$15,000	\$0	(\$49)	(\$211)	(\$77)	(\$40)	(\$636)	(\$12)	\$16,107	101.2%
\$16,000	\$0	(\$240)	(\$211)	(\$77)	(\$70)	\$0	\$403	\$16,510	59.7%
\$17,000	\$0	(\$222)	(\$211)	(\$77)	(\$53)	(\$756)	(\$318)	\$16,191	131.8%
\$18,000	\$0	(\$884)	(\$211)	(\$77)	(\$21)	(\$924)	(\$1,116)	\$15,075	211.6%
\$19,000	\$0	\$0	(\$211)	(\$77)	\$0	\$0	\$713	\$15,788	28.7%
\$20,000	\$0	\$0	(\$211)	(\$77)	\$0	\$0	\$713	\$16,501	28.7%
\$21,000	\$0	\$0	(\$211)	(\$77)	\$0	\$0	\$713	\$17,214	28.7%
\$22,000	\$0	\$0	(\$211)	(\$77)	\$0	\$0	\$713	\$17,927	28.7%
\$23,000	\$0	\$0	(\$211)	(\$77)	\$0	(\$804)	(\$91)	\$17,836	109.1%
\$24,000	\$0	\$0	(\$211)	(\$77)	(\$18)	\$0	\$695	\$18,530	30.5%
\$25,000	\$0	\$0	(\$211)	(\$134)	(\$162)	\$0	\$493	\$19,023	50.7%

**Summary of What this Table Shows**

<b>As Earnings Increase from:</b>	<b>Disposable Income Increases By:</b>	<b>Yielding an Effective Marginal Tax Rate Of:</b>
\$0 to \$12,000	\$7,306	39.1%
\$12,000 to \$20,000	\$687	91.4%
\$20,000 to \$25,000	\$2,522	49.6%

NOTE: "0" indicate that income declines by the amount in parentheses. The first row in the table is the amount of income from various sources at an earnings level of \$6,000 for a mother with two custodial children, one of school age and one aged 3 who requires child care. Some child care expenses are subsidized by the State of Maryland. Co-payments depend on income and hours worked; they are based on daycare center care in the Metro region. State taxes, which also vary by location in Maryland, assume residence in Baltimore.

**Table 7**

<b>Characteristics of Families by Distance Income is Below the Poverty Threshold, 1997</b>						
<b>Distance from Poverty Threshold</b>	<b>Number of Children (in thousands)</b>	<b>Percent with Earnings</b>	<b>Percent Receiving Food Stamps</b>	<b>Probability of Receiving Food Stamps if Earnings Present</b>	<b>Percent Receiving ETC</b>	<b>Percent Receiving Child Support</b>
<b>All Families with Children</b>						
\$1-1,000	1,138	76.1%	46.9%	37.8%	67.7%	13.8%
\$1,001-2,000	1,114	73.6%	50.3%	42.5%	65.3%	14.4%
\$2,001-3,000	1,167	67.8%	58.7%	48.8%	59.0%	16.7%
\$3,001-4,000	1,193	68.5%	56.0%	41.9%	57.0%	11.6%
\$4,001-5,000	1,024	62.3%	64.5%	53.5%	52.9%	14.2%
\$5,000+	5,289	55.7%	42.8%	37.0%	39.5%	10.7%
<b>Children in Female-Headed Families</b>						
\$1-1,000	702	68.1%	58.7%	48.5%	57.0%	19.9%
\$1,001-2,000	669	63.9%	63.2%	54.5%	53.3%	21.9%
\$2,001-3,000	741	61.9%	62.8%	52.3%	51.2%	23.5%
\$3,001-4,000	756	55.1%	69.4%	55.0%	43.5%	16.7%
\$4,001-5,000	647	53.5%	74.4%	59.3%	40.5%	20.5%
\$5,000+	3,247	45.5%	51.1%	47.9%	29.2%	15.0%
<b>Children in Married Couple Families</b>						
\$1-1,000	382	90.5%	27.3%	24.5%	87.7%	4.5%
\$1,001-2,000	388	87.6%	33.1%	31.6%	84.0%	1.7%
\$2,001-3,000	347	81.9%	48.9%	44.2%	76.0%	6.0%
\$3,001-4,000	401	89.7%	35.2%	31.4%	82.7%	2.9%
\$4,001-5,000	320	77.5%	45.6%	44.1%	76.4%	2.5%
\$5,000+	1,565	71.3%	27.4%	25.0%	59.3%	3.8%
<p>Source: All of the data in the table came from the March, 1998 Census Bureau, Current Population Survey conducted by the Census Bureau. These data have significant under-reporting problems, for which no adjustment has been made.</p> <p>Note: The measure of income used in this table includes the value of non-cash benefits such as food stamps and housing assistance, but does not account for child care and other work expenses for working poor families.</p>						

**Table 8**  
**States with the Five Largest Declines in**  
**Food Stamp Participation, 1994-1997**

<b>State</b>	<b>Proportion of Working Families with Children Required to Reapply Every Three Months</b>		<b>Decline in Participation 1994 to 1998</b>
	<b>1994</b>	<b>1998</b>	
Indiana	1%	54%	-40%
Ohio	1%	78%	-41%
Wisconsin	1%	65%	-42%
Arizona	1%	64%	-42%
Texas	3%	62%	-40%
<b>U.S.</b>	<b>9%</b>	<b>31%</b>	<b>-28%</b>

Table 9  
 An Illustrative Example of a Child Support Incentive Plan  
 (Annual Dollar Amounts)

Gross Income of NCP	Child Support Order	Matching Rate	CSIP Subsidy	Order+ CSIP
\$5,000	\$218	1.50	\$328	\$546
\$6,000	\$310	1.50	\$465	\$776
\$7,000	\$527	1.50	\$790	\$1,317
\$8,000	\$708	1.50	\$1,061	\$1,769
\$9,000	\$908	1.50	\$1,362	\$2,270
\$10,000	\$1,070	1.40	\$1,500	\$2,570
\$11,000	\$1,250	1.20	\$1,500	\$2,750
\$12,000	\$1,431	1.05	\$1,500	\$2,931
\$13,000	\$1,657	0.88	\$1,462	\$3,119
\$14,000	\$1,910	0.73	\$1,386	\$3,296
\$15,000	\$2,163	0.61	\$1,310	\$3,473
\$16,000	\$2,416	0.51	\$1,234	\$3,651
\$17,000	\$2,670	0.43	\$1,158	\$3,828
\$18,000	\$2,923	0.37	\$1,082	\$4,005
\$19,000	\$3,176	0.32	\$1,006	\$4,182
\$20,000	\$3,429	0.27	\$930	\$4,360
\$21,000	\$3,683	.23	\$854	\$4,537
\$22,000	\$3,936	.20	\$778	\$4,714
\$23,000	\$4,189	.17	\$702	\$4,891
\$24,000	\$4,442	.14	\$626	\$5,069
\$25,000	\$4,696	.12	\$550	\$5,246
\$26,000	\$4,949	.10	\$474	\$5,423
\$27,000	\$5,202	.08	\$398	\$5,600
\$28,000	\$5,455	.06	\$323	\$5,778
\$29,000	\$5,708	.04	\$247	\$5,955
\$30,000	\$5,962	.03	\$171	\$6,132
\$31,000	\$6,215	.02	\$95	\$6,309
\$32,000	\$6,468	.00	\$0	\$6,487

Note: The table presents a simplified example. The actual table that should be used would be in \$50 or \$100 increments and the decline in the subsidy rate would be more finely calculated.

Table 10

Two Illustrative Comparisons of Disposable Income for A Custodial Family (Mother and 2 Children) and a Single Non-Custodial Parent Under Current Law and Proposal for the State of California: 1998

	Custodial Family with No Earnings and Noncustodial Parent with Earnings of \$10,000	Custodial Family with Earnings of \$10,000 and Noncustodial Parent with Earnings of \$10,000
<b>Annual Child Support Order</b>		
Current Law	\$3,216	\$3,828
Proposal	\$1,070	\$1,070
<b>Child Support Order as Percent of Noncustodial Parent's Earnings</b>		
Current Law	32.2%	38.3%
Proposal	10.7%	10.7%
<b>Custodial Family's Income with Taxes and Transfers (Annual Dollar Amounts)</b>		
Current Law (Order Ignored)	\$9,530	\$16,226
Current Law (Order Fully Paid)	\$9,950	\$16,646
Proposal <sup>2</sup>	\$11,329	\$17,651
<b>Effective Tax Rate on Child Support</b>		
Current Law	86.9%	89.0%
Proposal	(68.1)%	(33.1)%
<b>Income as a Percentage of Poverty</b>		
<b>Custodial Family<sup>1</sup></b>		
Current Law	76.0%	127.2%
Proposal	86.6%	134.9%
<b>Noncustodial Parent</b>		
Current Law	60.6%	53.3%
Proposal	86.3%	86%

<sup>1</sup> In addition to adding the CSIP payment as described in the paper, the proposal changes the way that child support programs affect the TANF benefit calculations. Child support payments are included in the TANF calculation as earnings and disregarded in the same manner as earnings. The CSIP subsidy is passed through directly to the family; the TANF benefit is unaffected by the amount of the CSIP subsidy.

Current law models TANF, food stamps, child support payments, child care (through TANF and food stamp disregards and tax policy),

federal tax policy (employee share of payroll, income, EITC), and work expenses (5 percent of earnings). Health care, state taxes, and housing are not included in this analysis. Child care expenses for the custodial family are 30 percent of earnings, not to exceed \$200 per month. The \$500 child tax credit is fully phased in, even though this was not the case until 1999. Custodial families take advantage of all benefits available to them. Child support is calculated using the state's published guidelines, assuming the mother has full custody of the children and the non-custodial parent has no other children or families to whom he has additional child support obligations.

**Table 11**

**Overall Indicators of the Effectiveness of the Child Support Program**  
(in millions of 1998 dollars)

	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>
Total Collections	\$10,861.7	\$11,613.9	\$12,541.4	\$13,583.4	\$14,347.7
TANF Collections	\$2,811.6	\$2,884.8	\$2,979.0	\$2,889.4	\$2,649.9
Administrative Expenses	\$2,829.9	\$3,231.3	\$3,187.4	\$3,488.2	\$3,589.3
Collections distributed to TANF families	\$504.0	\$508.9	\$501.2	\$159.6	\$151.7
Paternities Established and Acknowledged (in thousands)	676	932	1,058	1,294	1,459
Orders Established (in thousands)	1,025	1,051	1,092	1,260	1,140
Orders Enforced or Modified (in thousands)	5,805	6,546	7,913	9,934	11,908

Source: Office of Child Support Enforcement administrative data reported in Department of Health and Human Services, *Temporary Assistance to Needy Families (TANF) Program: Second Annual Report to Congress*, August, 1999.

**Table 12**

<b>EARNED INCOME TAX CREDIT PARAMETERS FOR TAX YEAR 1999</b>						
	Credit Rate	Beginning of Plateau	Plateau End Point	Maximum Credit	Phaseout Rate	Income Cut-off
Families with one Child	34.0%	\$6,800	\$12,460	\$2,312	15.98%	\$26,928
Families with two or more children	40.0%	\$9,540	\$12,460	\$3,816	21.06%	\$30,580

**Table 13**

**Effects of Three Illustrative Examples on the Disposable Income of a Single Parent with Two Children in Maryland, 1998**

Earnings	Family Receives Food Stamps and Child Care Assistance <sup>1</sup>	No Food Stamps or Child Care Assistance After Mother Becomes Employed <sup>2</sup>	Proposal <sup>3</sup>
\$0	\$8,508	\$8,508	\$8,628
\$10,000	\$14,797	\$8,429	\$15,061
\$15,000	\$16,107	\$12,276	\$17,358
\$20,000	\$16,501	\$15,697	\$19,267
As Earnings Increase:		Disposable Income Increases By:	
\$0-\$10,000	\$6,289	(\$79)	\$6,433
\$10,000-\$20,000	\$1,704	\$7,268	\$4,206
\$0-20,000	\$7,993	\$7,189	\$10,639

NOTE: One child in school, one child requires day care assistance. Disposable income reflects payment of work expenses and includes state and federal income and payroll taxes (including federal and state EITC). Family receives TANF and food stamp benefits when earnings are zero. When employed, family pays \$7.50 per week in transportation expenses.

<sup>1</sup> Family receives child care assistance according to child care schedule for Baltimore.

<sup>2</sup> Family pays child care expenses of \$90 per week for which it receives no assistance.

<sup>3</sup> Proposal includes modest increases in food stamp and EITC benefits and a more reasonable child care copayment schedule. It does not reflect any aspect of the child support or minimum wage increase proposal.

**Figure 1**

