Reducing Cliff Effects in Iowa Child Care Assistance

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By Peter S. Fisher and Lily French

One of the most significant roadblocks on the path to self-sufficiency for low-wage working parents in Iowa is the cost of child care. The statewide average cost of care in a licensed center for a 2- to 5-year-old was $148 per week in 2013. Yet weekly pay before taxes for someone making $9.00 per hour (well above the minimum wage) is just $360; 41 percent of that pay would go to child care. With a minimum wage job, or with more than one child (or an infant), the percentage is even higher.

Fortunately for those with very low wages Iowa does have a program that pays for all or part of child care for working parents. The bad news is that Iowa has one of the lowest income eligibility ceilings in the country: 145 percent of the federal poverty guideline. In 2013, only seven states had a ceiling lower than Iowa's; in 30 states (and in parts of three others) the threshold was 165 percent of poverty or higher, including 16 states with a threshold at or above 200 percent.[1] When parents trying to provide for their families get a better job, a pay raise or more hours that pushes family income above 145 percent of poverty, they find themselves worse off instead of better off. Their total family resources fall off a cliff as the child care assistance disappears and they are suddenly left footing the entire bill with only a minor increase in income.

A previous report by the Iowa Policy Project demonstrated how the current operation of Iowa's Child Care Assistance program creates barriers for low-income parents trying to further their education.[2] Several policy reforms were identified that would make it easier for low-wage workers with children needing child care to raise their earning ability and move closer to self-sufficiency. The authors also showed, in a 2009 report, *Strengthening Child Care Assistance in Iowa: The State's Return on Investment*, that expanding eligibility limits in the CCA program would raise earnings and future tax payments of recipients, returning a significant portion of the cost to the state through higher lifetime tax payments.[3] This brief focuses on eligibility ceilings, co-pays, and the cliff effects in Iowa's CCA program and how they might be reformed.

Basic Needs Budgets for Iowa Families

To illustrate this fundamental problem with the Child Care Assistance Program (CCA), we consider the basic-needs budgets for two families: a single mother with one child age 2 or 3, and a married couple (both working) with two children, one preschool age and one age 6 to 10 (needing care in the summer and before and after school). Table 1 shows the average expenses such a family would face in Iowa, based on the cost of basic needs such as food, rent, utilities, transportation, child care, health care, and clothing in 2013-14.[4] The single parent would need to earn almost $21 an hour to make ends meet without the help of any work support programs or tax credits. For the two-parent, two-earner family, each parent would need to make almost $17 an hour.[5]

Table 1. Basic Family Budgets for Two Families: Iowa Statewide Average

	Single Parent with One Child*	Married Couple with Two Children**
Monthly Expenses		
Child care	$566	$919
Clothing & household expenses	317	403
Food	382	765
Health care	469	985
Rent and utilities	681	924
Transportation	563	844
Monthly total	$2,979	$4,841
Annual Total Basic Expenses	**$35,749**	**$58,086**
Income and Taxes		
Before-tax earnings needed	**$41,731**	**$67,724**
Less: Income & payroll taxes	(6,261)	(9,696)
Plus: EITC & other credits	279	58
Net after-tax income	35,749	58,086
Family supporting hourly wage	**$20.87**	**$16.93**

One child age 2 or 3

***One child age 2 or 3, one child age 6-10; both parents work full time.*

Source: Iowa Policy Project, Cost of Living in Iowa, 2014 Edition

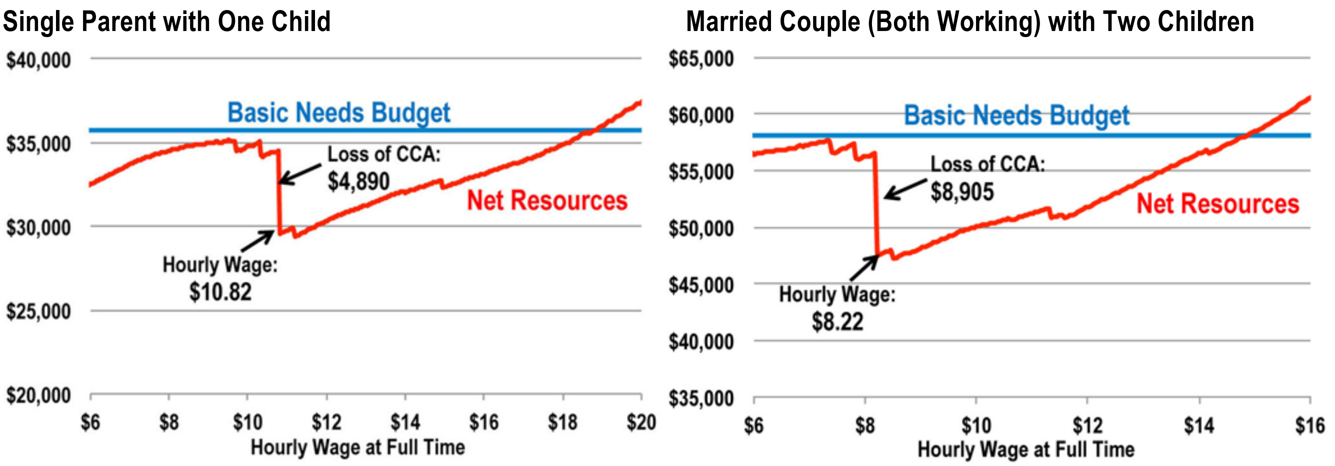
Basic Needs Budget

IPP's *Cost of Living in Iowa* builds basic-needs budgets for various family types. These budgets represent a frugal living standard for what is needed to "survive," not to "thrive." This allows for rent, utilities, food prepared at home, child care, health care, transportation, clothing and other household necessities. It does not include savings, loan payments, education expenses, vacation or any entertainment, or meals outside the home. Budgets show the before-tax income for a family to meet basic needs without public assistance or work supports, and the hourly full-time wage needed to produce that level of annual income.

The Cliff Effects

The charts below illustrate the various cliff effects that impact a family's net resources — after-tax wages plus public supports — as earnings increase. The charts assume that the family participates in every possible assistance program: TANF (Temporary Assistance to Needy Families), SNAP (Supplemental Nutrition Assistance Program, formerly Food Stamps), LIHEAP (Low Income Home Energy Assistance Program), Child Care Assistance (CCA) and the federal and state EITC (Earned Income Tax Credit), as well as other credits available.[6] (In fact, this is highly unlikely; for most of these programs only one-third to two-thirds of those eligible actually participate, the exception being the EITC.[7])

Figure 1. The Cliff Effect: How Net Resources Change as Earnings Increase, Statewide Average — Current Law



Source: The Cost of Living in Iowa, 2014 Edition.

As earnings increase above the minimum wage, the families lose SNAP benefits (at 130 percent of poverty, which is an hourly wage of $9.71 for the single parent), and then switch from Iowa's Medicaid expansion to premium subsidies under the Affordable Care Act (at 138 percent of poverty).[8] These benefit losses create small cliff effects — $500 to $800. But when the family loses child care assistance, the cliff is huge, because child care costs are huge: The single parent sees net resources fall by $4,890 as CCA disappears; for the married couple the cliff amounts to $8,905.

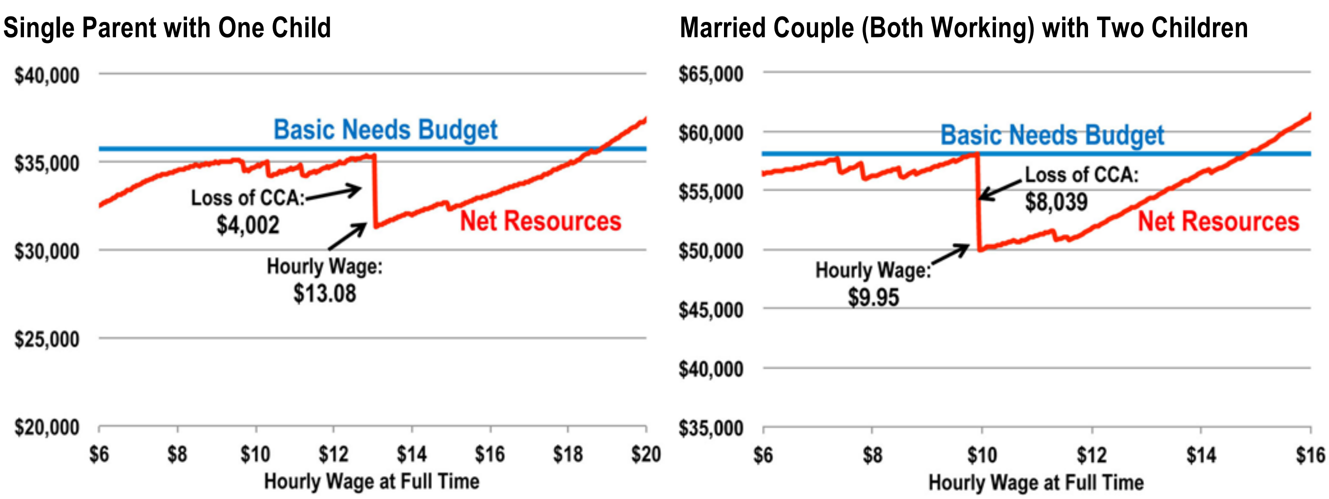
The single parent with one child will pay about 26 percent of the cost of child care if she earns 144 percent of poverty ($10.75 an hour full time), because the program requires a co-payment once income reaches the poverty level. But when her income rises to 145 percent of poverty, benefits disappear all at once, leaving her with the full cost instead of the previous 26 percent of child care costs.[9] The two-parent family will be responsible for about 17 percent of the cost of child care for their two children (one in all-day care, the other in a before- and-after-school program) if their income is just below the eligibility ceiling. When a small increase in wages or hours worked pushes them to 145 percent of poverty, they will suddenly be responsible for all $11,000 in annual child care costs out of their $34,200 annual income.[10]

The cliff effect and the low ceiling on eligibility for Iowa's Child Care Assistance Program create a serious disincentive for working families to increase their working hours, accept pay increases or advance to a better paying job. They also create a significant hardship for those who do earn more than the limit despite those disincentives. An increase in the income limit, along with a phase-in of the co-pays, could reduce the cliff effect substantially and push it off to a higher wage level where the family is closer to self-sufficiency and better able to pay for increased child care costs.

Reducing Cliff Effects and Raising the Eligibility Ceiling

Raising the income eligibility ceiling closer to the average across U.S. states could help many Iowa families who work full time but earn considerably less than what is needed to achieve a basic standard of living. Below we show the effects for our two representative families if the ceiling were raised to 175 percent of poverty, while using the existing co-pay schedule. Under Iowa's current CCA program, once a family's income reaches 100 percent of the poverty guideline, a co-pay schedule takes effect, with a "unit fee" that rises with income. The existing schedule continues up to income equal to 200 percent of poverty for parents of children with special needs. We

Figure 2. The Cliff Effect: How Net Resources Change as Earnings Increase, State Average — 175 Percent Option
Eligibility Ceiling Raised to 175 Percent of Poverty, with Existing Co-pay Schedule



assume that this schedule, with cost sharing that increases (quite gradually) as income rises from 145 to 200 percent of poverty, is used for everyone under the 175 percent eligibility ceiling.[11]

The effect of the increase in eligibility to 175 percent of poverty is to increase the wage at which CCA disappears and reduce the size of the cliff somewhat. The single parent can earn up to $13.00 an hour instead of $10.82, a 21 percent increase, and still retain child care assistance. At $13.08, CCA is lost and family resources decline by $4,002 (Figure 2). The cliff is $882 shorter, but still sizable. For the two-parent family, the parents can now each earn $9.90 per hour, a 20 percent increase, without losing eligibility. Just a nickel higher, at $9.95, their net resources suddenly drop by $8,039. Still a sizable cliff, it is $866 lower than under current law, but the family is now in a better position to overcome this loss of assistance because they are earning more.

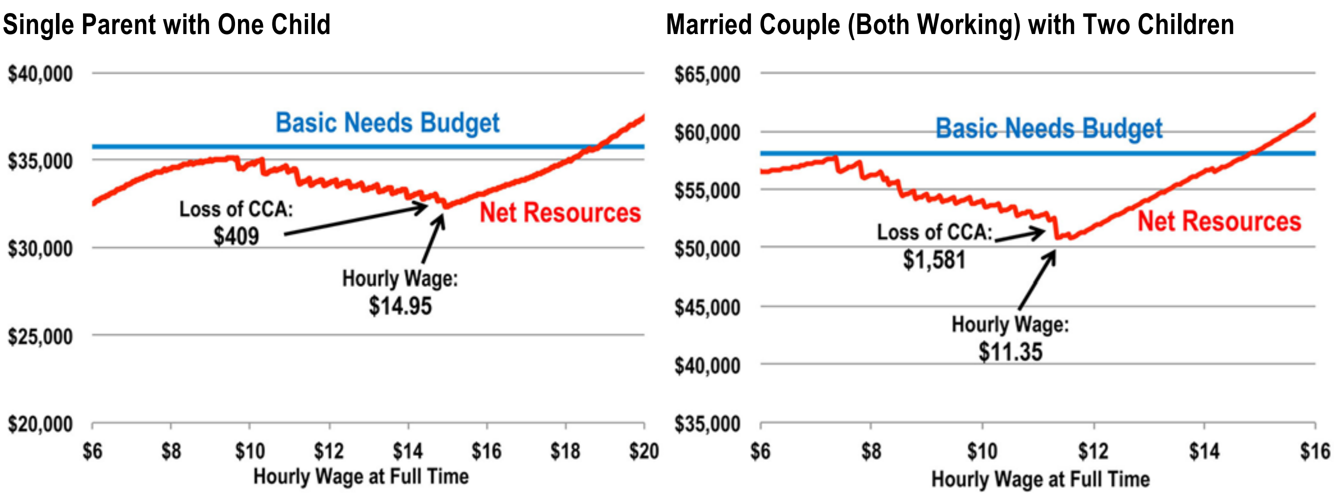
Making the Cliff Effect Disappear

Increasing the eligibility ceiling while using the existing co-pay system slightly decreases and postpones the cliff effect, but it is far from eliminated. The reasons are twofold: The increase in co-pays as income increases are quite modest and the unit fee applies only to hours of child care for the child in care for the most time. Families with more than one child in care will still face sizable cliffs as they would pay a smaller share of the total cost of care than a family with only one child.

Our final policy simulation, then, alters the unit fee structure for all families with income above 145 percent of poverty (but does not change the co-pay system for those currently eligible). There is only one unit fee based on income alone, not also on the number of children in care, but that fee is applied to the total units of child care for all children in subsidized care, instead of just the units of child care for the child who spent the most time in care. The income eligibility ceiling is raised to 200 percent of poverty to allow a longer and more gradual phaseout of benefits. (For a more detailed description of alternative ways to modify the co-pay schedule, see the appendix.)

The results are shown in Figure 3. The single parent with one child now faces a series of quite small cliffs and continues to receive some assistance up to an hourly wage of $14.95. When the eligibility ceiling is reached, the loss of net resources amounts to only $409. For the married couple with two children in care a cliff still occurs, but at an hourly wage of $11.35. The cliff amounts to just $1,581 compared to the $8,039 cliff in Figure 2.

Figure 3. The Cliff Effect: How Net Resources Change as Earnings Increase, State Average — 200 Percent Option
Eligibility Ceiling Raised to 200 Percent of Poverty, Modified Co-pay Schedule



Conclusions

These simulations illustrate policy choices. If the eligibility ceiling is raised and co-pays increase as income rises above the current ceiling, child care assistance can help families who are still well below the income level needed to support basic needs. Those families between 145 percent and the new ceiling will be better off, and the disincentive effect of the cliff will be reduced. The ideal trade-off between higher benefits for those who would qualify under the new eligibility ceiling, and the size of the cliff when they hit that ceiling, is a matter of judgment. The higher the unit fee increase, the lower the benefits and the smaller the cliff. The lower the increase in co-pays, the greater the benefits for those eligible, but the higher the cliff when they lose that eligibility.

The gradual phaseout of benefits combined with a higher eligibility ceiling would not just eliminate, or nearly eliminate, the cliff effect. It would also allow families to continue to receive some benefits from CCA as their income approaches what is needed to support a family at a reasonable but basic level. Furthermore, it would do so at a much lower cost to the state than simply raising eligibility while leaving in place the current co-pay schedule. Raising eligibility to 200 percent of poverty while adopting something like our modified co-pay schedule would be much less expensive than the same eligibility ceiling with no change in the co-pay schedule.[12]

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[1] Karen Schulman and Helen Blank.*Pivot Point: State Child Care Assistance Policies, 2013*. National Women's Law Center, Washington, D.C. http://www.nwlc.org/resource/pivot-point-state-child-care-assistance-policies-2013. In Colorado, Texas and Virginia, the threshold varies across the state, and in some areas exceeds 200 percent of poverty. These three states are not counted among the 16.

[2] Lily Frenchand Peter Fisher. *Child's Play: Creating a Path to the Middle Class. Improving Child Care Assistance Can Facilitate Parent Education.* The Iowa Policy Project, November, 2013. Executive summary at: http://www.iowafiscal.org/executive-summary-childs-play-creating-a-path-to-the-middle-class/ . Full report at: http://www.iowapolicyproject.org/2013docs/131126-IFP-CCA.pdf

[3] Lily French and Peter Fisher. *Strengthening Child Care Assistance in Iowa: The State's Return on Investment.* The Iowa Policy Project, March 2009. See executive summary at www.iowapolicyproject.org/2009docs/090909-CCROI-xs-rev.pdf

[4] These examples are drawn from *The Cost of Living in Iowa, 2014 Edition, Part One: Basic Needs Budgets*, published by the Iowa Policy Project in February, 2014, at http://www.iowapolicyproject.org/2014docs/140226-COL.pdf

[5] The table assumes that the parents have no health benefits from a job, and rely on Medicaid and Hawk-I, or on the premium and cost-share subsidies available under the Affordable Care Act, if eligible. While the availability of health insurance through the employer would lower the basic needs budget somewhat, it would not affect the size of the cliff effects, or the wage levels at which they occur, in the illustrations that follow. *The Cost of Living in Iowa, 2014 Edition,* has basic family budgets for families with employer-sponsored insurance.

[6] Rules for all programs are based on eligibility criteria and benefit levels in effect for Fiscal Year 2014 (including the recent cuts to SNAP), or calendar 2014 in the case of health programs. The availability of health insurance through the employer would lower the basic needs budget somewhat, but would not affect the size of the cliff effects, or the wage levels at which they occur, in the illustrations that follow.

[7]See the report *Bridging the Gaps in Iowa*, June 2007, at http://www.iowapolicyproject.org/2007docs/070626-BTG_Report.pdf

[8] Loss of TANF benefits occurs at a much lower level of earnings – about $10,800 annually, or 70 percent of poverty, for the single parent.

[9] The loss of $5,003 in child care assistance as income rises from $22,400 to $22,500 is offset by the $100 increase in earnings but only trivial increases in other benefits, leaving a loss of net resources of $4,890. The federal child and dependent care credit rises just $10, while the state credit is unchanged because the credit was already maxed out at an income level of $22,400.

[10] The $9,107 loss in child care assistance as income rises to 145 percent of poverty (from $34,000 to $34,200) is offset by the $200 in greater earnings but tax credits increase only trivially, leaving a net loss of disposable income of $8,905. The federal child and dependent care credit rises $20, but the Iowa credit is unchanged, while gross taxes increase slightly.

[11] Once a family's income reaches 100 percent of Federal Poverty Guidelines, a co-pay schedule takes effect where families begin to pay part of the cost of child care. The family contribution is based on the number of "units" of child care, with one unit equal to a half day. To determine the family's contribution to the cost of child care, the units are multiplied by a "unit fee." The unit fee, and hence the family contribution, increases as household income increases. For a married couple with two children and total income at 125 percent of poverty, for example, the unit fee would be $2.20 for one child in care. The unit fee increases by 25 cents for each additional child in care, up to three. If both children in our example were in child care, then, the family would pay a unit fee of $2.45. The number of units for the child receiving the most hours of care is multiplied by the unit fee to determine the total cost to the family.

[12] As family income rises from 145 to just under 200 percent of poverty, for a family with two children in care the state share of costs under the current unit fee schedule declines from 83 percent to 68 percent (average about 75 percent). Under the alternative schedule it declines from 83 percent to about 8 percent. For a family with one pre-schooler in care, the state share falls from 74 percent to 51 percent as income rises from 145 to 200 percent of poverty under the current schedule, but would fall from 74 percent to near zero in our alternative.