



The Iowa Policy Project

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EXECUTIVE SUMMARY

Strengthening Pathways to the Middle Class: The Role of Work Supports

The Cost of Living in Iowa — 2014 Edition, Part 3

By Peter S. Fisher and Lily French

Working full time, year round is not enough to guarantee a middle-class standard of living. One in six working Iowa families, in fact, does not earn enough to meet basic needs. A number of public policy choices could help such families move into the middle class. Part 3 of *The Cost of Living in Iowa, 2014 Edition*, focuses on a set of policies called “work supports,” which help low-wage working families survive and keep their children out of poverty. This research illustrates:

- A basic-needs cost of living is between two and three times higher than the federal poverty guidelines on which public work supports are based.
- Work supports are critical to helping low-income families put together a household budget that brings them closer to a basic-needs level — but poorly targeted supports can miss families who then find it harder to seek education and better jobs to reach the middle class.
- “Cliff effects” emerge when a household has slightly more income, but loses a greater amount in work supports to create a net loss of resources — falling off a “cliff.” Child Care Assistance offers a clear example of this, with an abrupt loss of support with a small increase in income.
- Work supports can be structured to ease cliff effects and make work pay. Iowa’s Earned Income Tax Credit does this, gradually phasing out benefits at higher incomes. Iowa’s recent Medicaid expansion and the Affordable Care Act together have expanded access to health insurance for low-wage families and reduced cliff effects that previously existed.

Reforms could provide and strengthen pathways to the middle class:

- Improving access to Iowa’s Child Care Assistance program could eliminate a huge disincentive to seek better work, helping parents to improve their skills and raise their wage level.
- An expanded Earned Income Tax Credit would provide even stronger support to low-wage workers, encourage more work effort, and keep children out of poverty.
- A stronger Child and Dependent Care Credit could cushion the loss of Child Care Assistance and better reflect the cost to families of raising children.

These reforms should be combined with education policies that ensure future generations of Iowans receive a quality and affordable education, from preschool through post-secondary institutions. This will require expansion of the universal preschool program, support of K-12 education through adequate funding of state foundation aid, and continued efforts to make post-secondary education more affordable by restraining tuition growth.

What Does it Take, and How Well Do Iowans Get By?

Part 1 of this study established that an Iowa family with one wage earner and one or two children needs \$35,000 to \$48,000 a year just to pay for the basic costs of rent, utilities, food, transportation, child care and health care in a “basic needs” budget. In Part 2, we showed take-home pay for almost three-fifths of the single parents in Iowa cannot cover the basic needs budget. Overall, 16.7 percent of working families do not earn enough to get by. Iowa is a low-wage state, with over half of the jobs in the state paying less than \$16 per hour, even though most families need to earn more than that for a bare-bones budget.

Current Work Supports and Cliff Effects

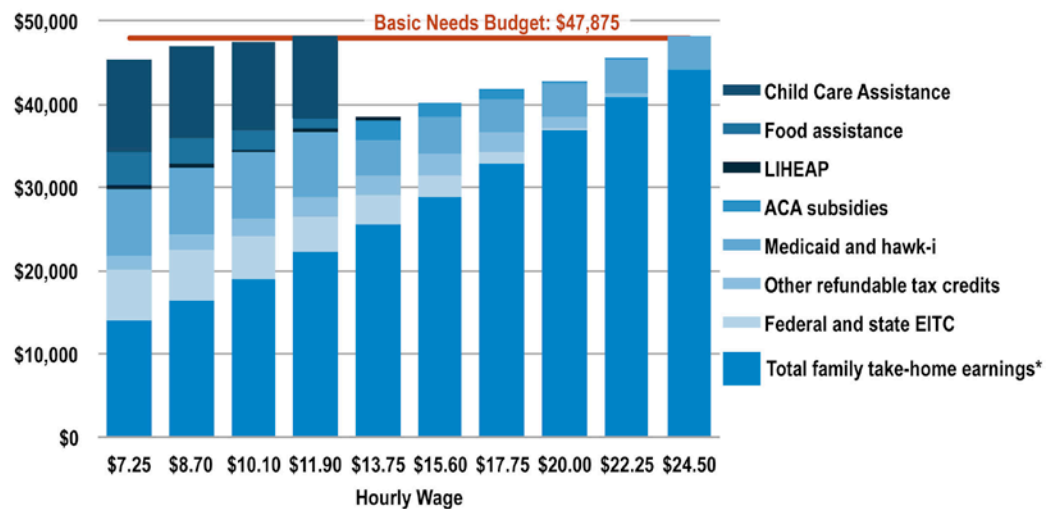
How do those families meet basic needs when they aren’t paid enough? Some do without health insurance, and then risk medical indigency or bankruptcy. Some rely on friends for child care. Some simply do without. But many families get help from one or more work support programs, for food, energy, child care and health insurance assistance, as well as targeted tax credits. These are part of a larger structure of public policy that offers opportunity for advancement — such as education — that can improve employment prospects and ultimately enhance family prosperity.

At times, however, the public policy offers two steps back — or off a “cliff” — for the step forward of a small increase in pay that comes with a slightly better job, a second job, or more work hours on that road to the middle class. This is what is known as the “cliff effect,” illustrated in the graph below, which shows the maximum possible benefits from the various work supports available.

Most work support programs taper off as income increases, so that a family is always better off as a result of earning more. But Iowa’s Child Care Assistance (CCA) benefits abruptly disappear with a slight increase in income. As a low-wage single parent of two progresses toward the state’s median wage, about \$15.60, resources plummet because CCA vanishes at 145 percent of the federal poverty level. While the family is no longer officially in poverty, they are thousands of dollars short of the resources necessary just for a basic-needs household budget, despite earning more than when Child Care Assistance was available. For this family, CCA disappears at a wage of \$13.65, at which point the family’s net resources — earnings plus program benefits — drop by a little over \$9,000. There is a disincentive to work more hours or seek a slightly higher-paying job.

How Work Supports Decline as the Hourly Wage Rises

Single parent working full time, two children



In an earlier report we detailed alternatives for reducing the cliff.¹ One reform option: raising Iowa's low eligibility ceiling from 145 percent to 200 percent of federal poverty guidelines, while instituting a co-pay schedule that takes effect once income rises above the current 145 percent ceiling. The co-pay would rise with income, allowing benefits to taper off and substantially reduce the state cost of extending the eligibility ceiling.² Raising eligibility and instituting a higher co-pay replaces the cliff with a gradually declining benefit and greatly reduces the disincentive effect.

Easing Cliffs in Health Care Access

Iowa's Medicaid expansion, which raised the eligibility ceiling for adults from 100 percent to 138 percent of poverty, along with subsidies for private insurance offered by the Affordable Care Act, have eased the previously substantial benefit cliffs in Medicaid. A single parent of two would lose Medicaid at an hourly wage of \$13.00. But instead of facing a benefit cliff in the form of a \$3,600 sudden loss of health benefits, the parent can now purchase insurance on the private market with subsidies and faces an additional expense of only about \$1,100, with ACA subsidies tapering off quite gradually. The ACA in effect reduces a significant program cliff by 70 percent. For married couples with children, the ACA subsidies help to cushion the loss of hawk-i child health insurance benefits because the premium subsidies continue beyond the eligibility ceiling for hawk-i.

While easing cliffs, the Medicaid expansion and ACA have provided health insurance for thousands of Iowans and almost certainly has driven down the percentage of Iowans without insurance.

Child and Dependent Care Credit

At an hourly wage of \$13.65, the single parent currently loses all child care assistance in Iowa. However, the federal and state child and dependent care tax credits make up for a small part of that loss, covering about 11 percent of child care costs. Despite a small improvement in Iowa's Child and Dependent Care Credit that passed in 2014, another bill that only passed the Senate would have done more. SF2337 would have raised the percentage of child care costs covered by credits to 19 percent at the point where child care assistance is lost (for that single parent) and would have extended benefits to those earning up to nearly \$36 per hour.

Earned Income Tax Credit

The average Iowa taxpayer pays state income taxes equal to about 29 percent of his or her federal income tax.³ For the state Earned Income Tax Credit (EITC) to be consistent with other features of the state tax code, the state EITC should be raised from 15 percent to 29 percent of the federal. This would help Iowa families with children who often start owing Iowa income tax well before they owe any federal tax.

¹ Peter S. Fisher and Lily French, "Reducing Cliff Effects in Iowa Child Care Assistance." The Iowa Policy Project, March, 2014. Report and appendix at www.iowapolicyproject.org/2014docs/140313-CCA-cliffs.pdf and <http://www.iowapolicyproject.org/2014docs/140313-CCA-cliffs-appendix.pdf>

² The policy simulation details are described in the appendix to the report noted above, with a modified formula for determining co-pays that is based on total hours of child care, and an 80 cent increment in the co-pay with each new income bracket.

³ For tax year 2012, Iowa income tax paid by residents (from Iowa Department of Revenue, *2012 Iowa Individual Income Tax Annual Statistical Report*, at <https://tax.iowa.gov/report/Individual-Income-Tax>) was 29 percent of federal income tax liability of Iowa residents (from IRS, Statistics of Income, at <http://www.irs.gov/uac/SOI-Tax-Stats-Historic-Table-2>).

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