

PRELIMINARY DRAFT – Please contact authors before citing

A phase-out problem? How taxes and transfer policy designs interact with asset development
strategies for upwardly-mobile earners

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Paper to be presented September 20, 2006

at the CFED / Federal Reserve Conference on

“Closing the Wealth Gap: Building Assets among Low-Income Households”

Researchers and advocates are increasingly looking at the importance of asset-building strategies in addressing the needs of low-income households. Past efforts focused on income supports have not translated into greater household wealth and the long-term economic stability that assets can provide. As policy makers look for new options, it is important to examine the characteristics of income supports (through both the tax system and various transfer programs) that affect asset-building opportunities.

Asset building requires having resources in excess of current expenses. For low-income households, this is difficult, almost by definition. The monthly expenses of low-income working families are often greater than what they earn. The Earned Income Tax Credit (EITC) is seen as one solution to this quandary. Because the EITC can provide a lump-sum tax refund of as much as a few thousand dollars, it has been seen as a model for asset building (Dailey and Beverly 2002; Beverly, Tescher et al. 2005). This has proven less successful than many had hoped. Although the EITC may look like a windfall, the households eligible for the largest credits usually need the funds simply to make ends meet and have often made expenditures in anticipation of credit receipt.

More productive strategies focus on those households who are able to begin generating the surpluses that can be converted into assets. A lifecycle model recognizes that earnings – and thus the ability to build assets – tend to increase over time. The challenge is that a lower-income household's total resources are a combination of earnings and income supports¹. An assessment of lower-income households' asset-building capacity must include two aspects of the interaction of earnings and income support policies. The first is the

¹ Although the focus of this paper is on lower-income households, such households are in no way unique in that their asset-building options are shaped by tax and transfer policies. Transfers to higher income households in the form of tax expenditures, most notably the mortgage interest deduction, contribute significantly to asset building among the wealthier. Critics note that this creates a de facto "hidden welfare state" for the wealthy (Shapiro and Wolff 2001).

application of static program rules to changes in earnings. The structure of support programs can mean that an increase in earnings triggers reductions or other changes in support programs, meaning additional earnings have little effect on total resources (or even a negative effect). The second aspect involves changes in the rules themselves. Many programs have indexing features that can accommodate normal year-to-year increases in income without adversely affecting the level of support. Policy makers also regularly restructure income support programs. For instance, changes in the tax code can increase or reduce after-tax income or provide different types of incentives for savings. Finally, asset-building capacity is affected by changes in the prices households must pay for basic goods and services

This paper has three main parts. First, we show the combined effect of tax and transfer programs on families' take-home income. Second, we present budget simulations using actual program rules and market conditions for 2000 through 2005 for three types of households to assess the resources potentially available for asset development. Finally, we summarize challenges and lessons for the design and delivery of asset-building programs

Part 1. Net income lags as earnings rise

A number of policies or programs contribute to low-income household budgets. A household with no earnings or private source of income has a possible resource package composed of cash assistance, vouchers (such as Food Stamps), and the value of free or subsidized services such as Medicaid and public housing. A household with a low-wage worker may still receive some cash assistance and will generally also have access to vouchers and free or subsidized services (including child care). The household could also be eligible for the EITC.

When taken individually, programs such as Food Stamps or tax measures such as the EITC are seen as positive supports for families. These programs all have progressive designs such that families with lower incomes receive a greater subsidy. But as earnings rise, families' benefits are reduced, and that has the effect of being taxed. Some benefits phase-out gradually, but sometimes a one dollar increase in earnings is enough to impose a sizeable hike in cost-sharing or even total loss of eligibility. This can also occur in the asset context if there is a means test. These "cliffs" can completely negate the effect of a raise and even make a household worse off. In addition, higher earnings generate increasing positive tax liabilities. The combined effect can be high marginal tax rates that cause overall household resources to lag earnings growth. (Ellwood 2000; Holt 2002; Holt 2003).

This section describes the sources of marginal taxation and the complexities in determining a given family's situation. We use the blanket term 'implicit total taxation' to refer to the combination of tax-like reductions in benefits and actual taxation through income and payroll taxes.

Means-tested benefits

Implicit taxation results from the benefit schedule of means-tested programs including Food Stamps and subsidized services such as public housing, publicly-funded child care, and the Medicaid/State Child Health Insurance Programs (SCHIP) (Ellwood 2000; Holt 2002; Holt 2003). The progressive nature of these programs' schedules means families' benefits are reduced as income rises. When a benefit is reduced, the effect is that of being taxed.

The size of the implicit taxation depends on the benefit schedule in question. In the case of Food Stamps, benefit amounts are calculated according to a formula that includes family size and household income after deductions for earned income, certain medical and dependent care expenses, child support paid, and particularly high housing costs (U.S.

Department of Agriculture 2004). The basic benefit reduction for earnings alone is 24 cents for every additional dollar, an implicit marginal tax rate of 24% (author calculations using USDA 2004).

Other programs, such as housing vouchers, child care subsidies, and health care, vary both eligibility and cost-sharing based on income. For instance, children in a household below 100 percent of the Federal Poverty Guidelines (FPG) are generally covered by free Medicaid. With some variation by state, children and some parents in households who earn between 100 percent and 200 percent of the FPG qualify for SCHIP, but cost-sharing measures such as annual enrollment fees, monthly premiums or co-pays apply to some or all families in this range (Dubay, Hill et al. 2002).

Some benefits phase-out gradually, but sometimes a one dollar increase in earnings is enough to impose a sizeable hike in cost-sharing or even total loss of eligibility. Such incidents of sharp benefit decreases are referred to as “cliffs” or “notches” in the marginal tax rate literature, and they can completely negate the effect of a raise and even make a household worse off.

This discussion focuses only on key federally-funded supports commonly used by families who may be welfare-eligible. Other programs and benefits also operate on a means-tested or sliding-scale basis. As families earn more, they may lose eligibility for nutrition programs such as WIC or school lunches; Head Start or locally subsidized children’s after-school or summer programs; community resources such as Legal Aid; and reduced-fee health services.

The tax system

State and Federal income tax systems, anti-poverty credits delivered through the tax system and payroll taxes affect taxpayers at different earnings levels differently. Overall, the Federal income tax system is progressive, meaning that lower-income households face lower tax rates, but for some low-income workers, an increase in earnings may be partly undone through higher tax obligations or lower total credits. Please note that although state and local sales and property taxes represent a significant part of the overall tax obligations paid by low-wage workers (Seipel 2000), these taxes are not linked to specific earnings levels and are not discussed below.

At the Federal level, income and payroll taxes are paid on earnings. The Omnibus Budget Reconciliation Act of 1985 raised the earnings level at which federal income taxes are owed. As a result of the standard deduction and exemptions for household members, the lowest-income households owe no income taxes. For instance, in tax year 2005, an adult worker with two children pays no Federal income tax on the first \$17,000 of earnings. Above \$17,000 this household is in the 10 percent tax bracket (Internal Revenue Service 2005). Low-income workers also pay payroll taxes of 7.65 percent on each dollar earned to fund Social Security and Medicaid.

For low-wage workers, tax credits are a more important feature in determining the ultimate size of a tax return check. A series of expansions in the EITC over the late 1980s and early 1990s and recent expansions in the Child Tax Credit have increased the redistributive properties of the tax system as a whole. In particular, EITC is credited with increasing the number of single mothers in the workforce (Meyer and Rosenbaum 2001) and more generally boosting families' ability to save, pay off bills, and get ahead (Smeeding, Phillips et al. 2000; Beverly 2002). However, when a tax credit phases out, it acts like an additional tax. Low-income workers who increase their earnings level will find themselves getting lower tax

credits. Phase-out ranges and rates depend on filing status and number of children. In 2005, EITC phase-out points begin between \$6,530 for a worker without qualifying children and \$16,370 for a married worker with two or more children. For workers with two children, the phase-out rate is 21.06 percent, meaning that the total credit is reduced by just over 21 cents for each additional dollar earned. From the perspective of the tax filer, the effect is equivalent to a 21 percent tax.

At the state level, forty-one states plus the District of Columbia tax income, and fourteen states plus DC have some sort of state EITC. Some state income tax systems are less progressive than the Federal system. For instance, Illinois levies an income tax of 3 percent on all income above an exemption of \$2000 per filer or dependent. Other states are more progressive. Some localities also levy income taxes; for example, the City of Philadelphia taxes all residents' earnings at 4.33 percent.

Variations

Rates of implicit taxation can vary greatly from household to household. In addition to obvious considerations such as earnings and the number and age of children, program interactions introduce additional complexities. For example, income supports such as SSI can affect benefit levels depending on the program. Families who have high housing costs and do not receive any housing subsidy will receive higher Food Stamp allotments. Even federally-funded benefits can vary by state, and benefit calculation formulas change on varying schedules or because of state budgetary considerations.

Another source of variation is transitional provisions designed to ease the transition from welfare to work. SCHIP programs may allow families who qualify for coverage with incomes of less than 185% of the poverty guidelines to continue their coverage for a period of time even when income exceeds the standard income cap. Some residents of public housing

have a phased 24 month exemption for the earnings of household members who moved from long-term unemployment or TANF receipt into employment (U.S. Department of Housing and Urban Development (HUD) 2002).

Combined Effects

When taken individually, programs such as Food Stamps or progressive tax measures such as the EITC are seen as positive supports for families. However, the combination of reduced benefits and increasing net taxes may pose barriers to families. Figure 1 shows the changes in eligibility for means-tested assistance and net tax liability that affect households moving along an earnings trajectory. A household with earnings of \$10,000 per year (roughly full-time work at the Federal minimum wage of \$5.15) qualifies for Medicaid, housing subsidies and Food Stamps. This household would also be in the phase-in portion of the EITC, meaning that each additional dollar earned is supplemented by an additional 40 cents in the tax credit. However, if this worker were to move to a higher-paying job, the family would soon reach the “flat” or plateau point of the EITC schedule, in which additional earnings do not increase the total EITC. The family’s Food Stamps and rental assistance would be taxed away at 24 percent and 30 percent respectively. Above \$16,090, adults and children over age six would no longer be eligible for Medicaid, although they could switch to SCHIP.

[FIGURE 1 ATTACHED]

The total implicit tax rate for working poor households with children can easily exceed 50 percent, meaning that a family loses out on over half of every additional dollar earned. If higher earnings trigger a cliff effect, the household may actually have less money although earning more (an implicit tax rate over 100 percent). Figure 2 illustrates these results of high implicit taxation by showing the disposable income available to a sample family after paying taxes, receiving transfers and securing basic essentials (basic food, housing and health

insurance). As earnings double from \$15,000 to \$30,000 per year, household income after basic expenses is relatively flat, increasing only by about \$250 per month. The dip at the \$20,000 point corresponds to a cliff effect where the household starts to pay health insurance premiums.

[FIGURE 2 ATTACHED]

A household with earnings of \$10,000 per year (roughly full-time work at the Federal minimum wage of \$5.15) qualifies for Medicaid, housing subsidies and Food Stamps. This household would also be in the phase-in portion of the EITC, meaning that each additional dollar earned is supplemented by an additional 40 cents in the tax credit. However, if this worker were to move to a higher-paying job, the family would soon reach the “flat” or plateau point of the EITC schedule, in which additional earnings do not increase the total EITC. The family’s Food Stamps and rental assistance would be taxed away at 24 percent and 30 percent respectively. Above \$16,090, adults and children over age six would no longer be eligible for Medicaid, although they could switch to SCHIP. As earnings double from \$15,000 to \$30,000 per year, household income after basic expenses is relatively flat, increasing only by about \$250. The dip at the \$20,000 point corresponds to a cliff effect where the household starts to pay health insurance premiums.

Part 2. Longitudinal household budget simulations

A new set of budget simulations will show how these policy constraints facing upwardly-mobile workers interact with asset-building programs. Drawing on the above analysis and prior research on families’ experiences using administrative and ethnographic data (Holt 2003; Romich 2006; Holt and Romich under review), we present hypothetical six-year budgets using actual program rules for 2000 through 2005.

We track household resources (earnings, available cash and in-kind transfers; and tax credits) and expenditures (payroll, income and sales taxes; child care costs; household maintenance (housing, food and utilities); transportation and other work-related costs) to analyze the net resources potentially available for asset development. This section summarizes these budget simulations for two types of lower-income households: a single adult with one child and a married couple with two children. We also projected budgets for these two types of households at higher incomes and for a single non-custodial parent. All projections are included in the appendix and select lessons from these additional scenarios are summarized below.

Budget simulation for one-adult, one-child household

Our household budget model is built on a resource adequacy standard consistent with self-sufficiency and other minimum-level household budgets developed in recent years (Pearce and Brooks 2000; Boushey and Brocht 2001; Center on Public Policy Priorities 2001). The following table breaks out the annual adequacy budget for a single parent with one young child living in Milwaukee, Wisconsin in 2000:

Table 1. Adequacy budget for single adult with one child, Milwaukee 2000

Housing (2-bedroom rental, including utilities)	\$7,428
Food	\$3,608
Transportation	\$2,903
Miscellaneous (clothing, personal care, telephone, household supplies, etc.)	\$2,106
Child care (co-payments for state subsidy program)	\$1,150
Health insurance (SCHIP coverage, below premium threshold)	\$0
Other medical	\$1,102
TOTAL	\$18,297

By working full-time, year-round at \$6.75 an hour and taking advantage of available income supports (in addition to the subsidized child care and health insurance included in the adequacy budget), the household would have had the following resources:

Table 2. Earnings and transfer income for single adult with one child, Milwaukee 2000

Earnings	\$14,040
<i>Less: Social Security/Medicare taxes</i>	<i>(\$1,074)</i>
<i>Less: State income tax</i>	<i>(\$75)</i>
Food Stamps	\$1,223
Federal Earned Income Tax Credit	\$2,137
State Earned Income Tax Credit	\$85
State Homestead (property tax) Credit	\$469
TOTAL	\$16,805

Despite full-time work and full utilization of available supports, the single parent in this example falls \$1,492 short of the minimally-adequate budget. She may bridge this gap by living in cramped or substandard housing, by visits to a food pantry, by relying on a family

member for free child care, or by forgoing other basics. She may also accrue debt. In most any case, she will be living at a deficit that represents the opposite of building assets.

Would getting a raise help? The following table looks at the same household in 2001, comparing the impact of two possible earnings trajectories, a 3% or 10% increase:

Table 3. Expense and income budget under 3% or 10% earnings increases
Single adult, one child, Milwaukee, WI 2001

	3% raise	10% raise
EXPENSES		
Housing	\$7,596	\$7,596
Food	\$3,763	\$3,763
Transportation	\$3,082	\$3,082
Miscellaneous	\$2,183	\$2,183
Child care	\$1,200	\$1,400
Health insurance	\$0	\$0
Other medical	\$1,153	\$1,153
TOTAL EXPENSES	\$18,977	\$19,177
RESOURCES		
Earnings	\$14,456	\$15,454
<i>Less: Social Security/Medicare taxes</i>	<i>(\$1,106)</i>	<i>(\$1,182)</i>
<i>Less: State income tax</i>	<i>(\$62)</i>	<i>(\$119)</i>
Food Stamps	\$1,194	\$0
Federal Earned Income Tax Credit	\$2,209	\$2,050
State Earned Income Tax Credit	\$88	\$82
Federal Child Tax Credit ²	\$446	\$545
State Homestead (property tax) Credit	\$459	\$389
TOTAL RESOURCES	\$17,684	\$17,219
SURPLUS / (GAP)	(\$1,293)	(1,958)

² The federal Child Tax Credit was made partially refundable beginning in 2001, meaning that a portion could be received (like the entire Earned Income Tax Credit) regardless of whether the taxpayer had a positive federal income tax liability. Refundability increases as income increases above a minimum threshold. This was done in part to mitigate the phase-out of the Earned Income Tax Credit, and this effect may be seen in this example.

This household would have been worse off if the worker had received the much larger raise, mostly because of the complete loss of Food Stamps through the cliff effect. Moreover, the larger household resources gap in this example would have occurred despite keeping expenditures to the minimum adequacy level (with cost-of-living adjustments) and not making any repayments of debt. This scenario – especially forgoing any efforts at lifestyle improvements when receiving a 70-cent-an-hour raise – is probably unrealistic, so the “negative asset building” problem would likely have been even worse.

The table on the following page continues the scenario – same household configuration, expenses measured according to the annually-adjusted adequacy standard, and annual wage increases of 3% and 10% -- through 2005:

Table 4. Expense and income budget under 3% or 10% earnings increases, Single adult, one child, Milwaukee, WI 2002-2005

	2002		2003		2004		2005	
	3%	10%	3%	10%	3%	10%	3%	10%
EXPENSES								
Housing	\$7,896	\$7,896	\$8,040	\$8,040	\$8,256	\$8,256	\$8,328	\$8,328
Food	\$3,835	\$3,835	\$3,914	\$3,914	\$4,133	\$4,133	\$4,188	\$4,188
Transportation	\$3,261	\$3,261	\$3,216	\$3,216	\$3,350	\$3,350	\$3,856	\$3,856
Miscellaneous	\$2,268	\$2,268	\$2,299	\$2,299	\$2,387	\$2,387	\$2,483	\$2,483
Child care	\$1,250	\$1,700	\$1,450	\$2,000	\$1,500	\$2,300	\$1,500	\$2,500
Health insurance	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$971
Other medical	\$1,207	\$1,207	\$1,255	\$1,255	\$1,310	\$1,310	\$1,366	\$1,366
TOTAL EXPENSES	\$19,717	\$20,167	\$20,174	\$20,724	\$20,936	\$21,736	\$21,721	\$23,692
RESOURCES								
Earnings	\$14,893	\$16,994	\$15,350	\$18,678	\$15,808	\$20,550	\$16,286	\$22,610
<i>Less: Social Security/Medicare taxes</i>	(\$1,139)	(\$1,300)	(\$1,174)	(\$1,429)	(\$1,209)	(\$1,592)	(\$1,246)	(\$1,730)
<i>Less: State income tax</i>	(\$67)	(\$185)	(\$80)	(\$274)	(\$89)	(\$392)	(\$99)	(\$521)
Food Stamps	\$1,269	\$0	\$1,244	\$0	\$0	\$0	\$0	\$0
Federal Earned Income Tax Credit	\$2,291	\$1,956	\$2,277	\$1,745	\$2,322	\$1,564	\$2,356	\$1,346
State Earned Income Tax Credit	\$92	\$78	\$91	\$70	\$93	\$63	\$94	\$54
Federal Child Tax Credit	\$454	\$600	\$485	\$818	\$506	\$980	\$793	\$884
State Homestead (property tax) Credit	\$464	\$316	\$449	\$215	\$444	\$110	\$419	\$0
TOTAL RESOURCES	\$18,257	\$18,459	\$18,642	\$19,823	\$17,875	\$21,283	\$18,603	\$22,643
SURPLUS / (GAP)	(\$1,460)	(\$1,708)	(\$1,528)	(\$901)	(\$3,061)	(\$453)	(\$3,118)	(\$1,049)

In both versions of the scenario, household resources never meet the adequacy standard. In fact, in each case the household's progress toward filling that gap falters as they receive reduced benefits and pay higher taxes. At 3% annual wage growth, the key event is the cliff effect loss of Food Stamps in 2004. This leaves the household with twice the annual financial deficit as experienced in 2000. At 10% annual wage growth (where Food Stamps were lost in 2001), the harshest implicit tax impact is in 2005. At that point, income is high enough to trigger the imposition of a premium for SCHIP coverage. Also, increasing federal income tax liabilities have begun to erode the value of the refundable Child Tax Credit, and other phase-outs have a significant cumulative effect. Although this worker is making over 60% more in 2005 than she did in 2000, she has erased only one-third of her financial deficit. She is likely unable to devote any of her wage gains to asset building and is instead probably further in debt.

Budget simulation for two-adult, two child household

The significance of tax and benefits policy to asset accumulation opportunities among lower-income households may be seen in a different way by looking at the effect of recent tax legislation providing benefits based marital status and the number of children in a household.

This simulation is for a married couple with two children. One parent works full-time, year-round at \$7.75 an hour (in 2000), and the other parent works half-time at \$6.75 an hour during the school year (obviating the need for paid child care). The table below looks at the household's annual adequacy budget and resources each year through 2005, assuming a 5% annual earning increase for the full-time worker.³ This household also would have faced significant implicit tax rates, but it would have benefited from generous tax code restructuring as well:

³ The 5% wage growth rate is used to illustrate a household with real-dollar earnings increases. The average annual increase in the Consumer Price Index-Urban during these years was 2.7%, so 5% growth would provide real opportunity for asset accumulation absent other factors. By comparison, the average

Table 5. Expense and income budget, 5% earning increases
Married couple, two children, Milwaukee, WI 2000-2005

	2000	2001	2002	2003	2004	2005
EXPENSES						
Housing	\$7,428	\$7,596	\$7,896	\$8,040	\$8,256	\$8,328
Food	\$6,561	\$6,841	\$6,972	\$7,116	\$7,515	\$7,614
Transportation	\$4,081	\$4,333	\$4,584	\$4,521	\$4,709	\$5,421
Miscellaneous	\$2,684	\$2,789	\$2,892	\$2,930	\$3,051	\$3,182
Child care	\$0	\$0	\$0	\$0	\$0	\$0
Health insurance	\$0	\$0	\$0	\$0	\$0	\$0
Other medical	\$1,102	\$1,153	\$1,207	\$1,255	\$1,310	\$1,366
TOTAL EXPENSES	\$21,856	\$22,712	\$23,552	\$23,862	\$24,841	\$25,911
RESOURCES						
Earnings	\$21,190	\$21,996	\$22,842	\$23,731	\$24,664	\$25,644
<i>Less: Social Security/Medicare taxes</i>	(\$1,621)	(\$1,683)	(\$1,747)	(\$1,815)	(\$1,887)	(\$1,962)
<i>Less: State income tax</i>	(\$66)	(\$43)	(\$64)	(\$96)	(\$126)	(\$157)
Food Stamps	\$509	\$411	\$424	\$0	\$0	\$0
Federal Earned Income Tax Credit	\$2,098	\$2,132	\$2,394	\$2,309	\$2,273	\$2,447
State Earned Income Tax Credit	\$294	\$299	\$335	\$323	\$318	\$343
Federal Child Tax Credit	\$0	\$920	\$901	\$1,323	\$1,391	\$1,716
State Homestead (property tax) Credit	\$0	\$0	\$0	\$0	\$0	\$0
TOTAL RESOURCES	\$22,404	\$24,032	\$25,085	\$25,775	\$26,633	\$28,031
SURPLUS / (GAP)	\$548	\$1,320	\$1,533	\$1,913	\$1,792	\$2,120

The beneficial tax policy effect may be seen most clearly in 2003, when the household would have experienced the cliff effect loss of Food Stamps in 2003 but would have received an offsetting increase in the Child Tax Credit.

annual increase in the wage and salary component of the Employment Cost Index for this period was 3.1% (Bureau of Labor Statistics, 2006).

The key tax law changes reflected in this scenario (in addition to the creation of the lower 10% initial tax bracket in 2001) were partial refundability of the Child Tax Credit beginning in 2001, an increase in the maximum Child Tax Credit in 2003, higher beginning phase-out points for the Earned Income Tax Credit for married filers in 2002 and 2005, and an increase in the refundability rate for the Child Tax Credit in 2005. Some of these changes would have been beneficial to the household presented in Tables 3 and 4; however, because that household is a single filer with only one child, the tax law changes would have been overwhelmed by the other implicit tax effects.

Other budget simulations

Because asset-building capacity is presumably greater at higher-income levels, we simulated both of the households described above with a baseline wage in 2000 of \$10.75 an hour and increasing it by 5% each year. For the single adult with one child, earnings in 2000 of \$22,360 would have generated a small surplus for the year (\$166) above the minimally-adequate budget. Loss of eligibility for subsidized child care in 2001 would have created a deficit of over \$1,000, and there would have been both surpluses and deficits in the remaining years as the market price for child care fluctuated, the Child Tax Credit expanded, and the premium rate for SCHIP coverage increased.

The married couple with two children and no child care costs would have been much better off. The combined earnings of \$27,430 in 2000 would have provided them \$3,501 more than the basic budget. Once again, the tax law changes that became effective in 2001 through 2005 would have cushioned the implicit tax effects, including the initial imposition of and later increase in the premium for SCHIP coverage, and they would have had an additional \$1,293 in surplus funds available in 2005.

We also calculated changes for a single worker with no dependent children. This worker cannot qualify for the Child Tax Credit or SCHIP. At baseline earnings of \$8 per hour or \$16,640 per year,

this worker would also not have qualified for Medicaid, Food Stamps, or the Earned Income Tax Credit. For this worker, changes in the cost of living are most important. In 2000, the surplus potentially available for asset development would have been \$355. We again assumed a healthy earnings growth of 5% per year, but jumps in the costs of private health insurance, rent, and gasoline would have reduced the impact of this earnings trajectory; with a net surplus in 2005 of only \$448.

Part 3. Lessons for asset-building program design and delivery

It should not be surprising that many lower-income households have limited capacity for asset building. Their earnings, even when supplemented with free or subsidized benefits and tax-based transfers, often do not finance a minimally-adequate budget. Lump-sum benefits such as the Earned Income Tax Credit and Child Tax Credit are frequently spoken for well before they are received.

Lower-earning households able to garner significant earnings growth can encounter cumulative benefits losses and higher taxes that limit their ability to amass funds for asset development. The implicit tax effects can be especially large when there is a cliff effect that eliminates eligibility for an income support. Those with higher earnings (as well as those without children) frequently do not have access to these programs at all and must finance both basic household needs and any asset aspirations from income alone.

If we are going to create greater asset building opportunities, tax and benefit policies need to recognize the limited options available to lower-income households. The simulations presented here – showing the effect of recent tax law changes – demonstrate the potential for these strategies.

In general, household budget simulations can be useful tools in the design and implementation of asset-building programs. Most importantly, they underscore the need for individualized approaches that recognize a household's particular circumstances and take advantage of available opportunities. By placing the receipt of lump-sum benefits (notably the EITC) in the broader household economic environment, budget simulation tools can isolate those situations when an asset development opportunity truly exists. Budget simulation tools also provide a more realistic picture of asset development potential among those working their way up the earnings ladder. The generation of surpluses available to asset building can fluctuate considerably over time and is unlikely to follow a straight-line model

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Appendix 1. Single adult, one child, Milwaukee, WI 2000-2005

Earnings start at \$6.75/hour, full-time, year-round; increase 3% annually

Subsidized child care (infant/toddler in 2000 & 2001)

	2000	2001	2002	2003	2004	2005
EXPENSES						
Housing	\$7,428	\$7,596	\$7,896	\$8,040	\$8,256	\$8,328
Food	\$3,608	\$3,763	\$3,835	\$3,914	\$4,133	\$4,188
Transportation	\$2,903	\$3,082	\$3,261	\$3,216	\$3,350	\$3,856
Miscellaneous	\$2,106	\$2,183	\$2,268	\$2,299	\$2,387	\$2,483
Child care	\$1,150	\$1,200	\$1,250	\$1,450	\$1,500	\$1,500
Health insurance	\$0	\$0	\$0	\$0	\$0	\$0
Other medical	\$1,102	\$1,153	\$1,207	\$1,255	\$1,310	\$1,366
TOTAL EXPENSES	\$18,297	\$18,977	\$19,717	\$20,174	\$20,936	\$21,721
RESOURCES						
Earnings	\$14,040	\$14,456	\$14,893	\$15,350	\$15,808	\$16,286
<i>Less: Social Security/Medicare taxes</i>	(\$1,074)	(\$1,106)	(\$1,139)	(\$1,174)	(\$1,209)	(\$1,246)
<i>Less: Federal income tax</i>	(\$0)	(\$0)	(\$0)	(\$0)	(\$0)	(\$0)
<i>Less: State income tax</i>	(\$75)	(\$62)	(\$67)	(\$80)	(\$89)	(\$99)
Food Stamps	\$1,223	\$1,194	\$1,269	\$1,244	\$0	\$0
Federal Earned Income Tax Credit	\$2,137	\$2,209	\$2,291	\$2,277	\$2,322	\$2,356
State Earned Income Tax Credit	\$85	\$88	\$92	\$91	\$93	\$94
Federal Child Tax Credit	\$0	\$446	\$454	\$485	\$506	\$793
State Homestead (property tax) Credit	\$469	\$459	\$464	\$449	\$444	\$419
TOTAL RESOURCES	\$16,805	\$17,684	\$18,257	\$18,642	\$17,875	\$18,603
SURPLUS / (GAP)	(\$1,492)	(\$1,293)	(\$1,460)	(\$1,528)	(\$3,061)	(\$3,118)

Appendix 2. Single adult, one child, Milwaukee, WI 2000-2005

Earnings start at \$6.75/hour, full-time, year-round; increase 10% annually

Subsidized child care (infant/toddler in 2000 & 2001)

	2000	2001	2002	2003	2004	2005
EXPENSES						
Housing	\$7,428	\$7,596	\$7,896	\$8,040	\$8,256	\$8,328
Food	\$3,608	\$3,763	\$3,835	\$3,914	\$4,133	\$4,188
Transportation	\$2,903	\$3,082	\$3,261	\$3,216	\$3,350	\$3,856
Miscellaneous	\$2,106	\$2,183	\$2,268	\$2,299	\$2,387	\$2,483
Child care	\$1,150	\$1,400	\$1,700	\$2,000	\$2,300	\$2,500
Health insurance	\$0	\$0	\$0	\$0	\$0	\$971
Other medical	\$1,102	\$1,153	\$1,207	\$1,255	\$1,310	\$1,366
TOTAL EXPENSES	\$18,297	\$19,177	\$20,167	\$20,724	\$21,736	\$23,692
RESOURCES						
Earnings	\$14,040	\$15,454	\$16,994	\$18,678	\$20,550	\$22,610
<i>Less: Social Security/Medicare taxes</i>	(\$1,074)	(\$1,182)	(\$1,300)	(\$1,429)	(\$1,592)	(\$1,730)
<i>Less: Federal income tax</i>	(\$0)	(\$0)	(\$0)	(\$0)	(\$0)	(\$0)
<i>Less: State income tax</i>	(\$75)	(\$119)	(\$185)	(\$274)	(\$392)	(\$521)
Food Stamps	\$1,223	\$0	\$0	\$0	\$0	\$0
Federal Earned Income Tax Credit	\$2,137	\$2,050	\$1,956	\$1,745	\$1,564	\$1,346
State Earned Income Tax Credit	\$85	\$82	\$78	\$70	\$63	\$54
Federal Child Tax Credit	\$0	\$545	\$600	\$818	\$980	\$884
State Homestead (property tax) Credit	\$469	\$389	\$316	\$215	\$110	\$0
TOTAL RESOURCES	\$16,805	\$17,219	\$18,459	\$19,823	\$21,283	\$22,643
SURPLUS / (GAP)	(\$1,492)	(\$1,958)	(\$1,708)	(\$901)	(\$453)	(\$1,049)

Appendix 3. Married couple, two children, Milwaukee, WI 2000-2005

Primary wage earner starts at \$7.75/hour, full-time, year-round; increase 5% annually

Second wage earner earns \$6.75/hour, half-time, 39 weeks/year, no annual increases

No paid child care

	2000	2001	2002	2003	2004	2005
EXPENSES						
Housing	\$7,428	\$7,596	\$7,896	\$8,040	\$8,256	\$8,328
Food	\$6,561	\$6,841	\$6,972	\$7,116	\$7,515	\$7,614
Transportation	\$4,081	\$4,333	\$4,585	\$4,521	\$4,709	\$5,421
Miscellaneous	\$2,684	\$2,789	\$2,892	\$2,930	\$3,051	\$3,182
Child care	\$0	\$0	\$0	\$0	\$0	\$0
Health insurance	\$0	\$0	\$0	\$0	\$0	\$0
Other medical	\$1,102	\$1,153	\$1,207	\$1,255	\$1,310	\$1,366
TOTAL EXPENSES	\$21,856	\$22,712	\$23,552	\$23,862	\$24,841	\$25,911
RESOURCES						
Earnings	\$21,190	\$21,996	\$22,842	\$23,731	\$24,664	\$25,644
<i>Less: Social Security/Medicare taxes</i>	(\$1,621)	(\$1,683)	(\$1,747)	(\$1,815)	(\$1,887)	(\$1,962)
<i>Less: Federal income tax</i>	(\$0)	(\$0)	(\$0)	(\$0)	(\$0)	(\$0)
<i>Less: State income tax</i>	(\$66)	(\$43)	(\$64)	(\$96)	(\$126)	(\$157)
Food Stamps	\$509	\$411	\$424	\$0	\$0	\$0
Federal Earned Income Tax Credit	\$2,098	\$2,132	\$2,394	\$2,309	\$2,273	\$2,447
State Earned Income Tax Credit	\$294	\$299	\$335	\$323	\$318	\$343
Federal Child Tax Credit	\$0	\$920	\$901	\$1,323	\$1,391	\$1,716
State Homestead (property tax) Credit	\$0	\$0	\$0	\$0	\$0	\$0
TOTAL RESOURCES	\$22,404	\$24,032	\$25,085	\$25,775	\$26,633	\$28,031
SURPLUS / (GAP)	\$548	\$1,320	\$1,533	\$1,913	\$1,792	\$2,120

Appendix 4. Single adult, one child, Milwaukee, WI 2000-2005

Earnings start at \$10.75/hour, full-time, year-round; increase 5% annually

Subsidized child care (infant/toddler in 2000 & 2001)

	2000	2001	2002	2003	2004	2005
EXPENSES						
Housing	\$7,428	\$7,596	\$7,896	\$8,040	\$8,256	\$8,328
Food	\$3,608	\$3,763	\$3,835	\$3,914	\$4,133	\$4,188
Transportation	\$2,903	\$3,082	\$3,261	\$3,216	\$3,350	\$3,856
Miscellaneous	\$2,106	\$2,183	\$2,268	\$2,299	\$2,387	\$2,483
Child care	\$2,450	\$4,500	\$4,375	\$3,833	\$4,003	\$4,172
Health insurance	\$566	\$600	\$644	\$681	\$1,184	\$1,251
Other medical	\$1,102	\$1,153	\$1,207	\$1,255	\$1,310	\$1,366
TOTAL EXPENSES	\$20,163	\$22,877	\$23,486	\$23,238	\$24,623	\$25,644
RESOURCES						
Earnings	\$22,360	\$23,478	\$24,652	\$25,885	\$26,864	\$28,207
<i>Less: Social Security/Medicare taxes</i>	(\$1,711)	(\$1,796)	(\$1,886)	(\$1,980)	(\$2,055)	(\$2,158)
<i>Less: Federal income tax</i>	(\$495)	(\$2)	(\$135)	\$0	\$0	\$0
<i>Less: State income tax</i>	(\$665)	(\$683)	(\$743)	(\$820)	(\$873)	(\$951)
Food Stamps	\$0	\$0	\$0	\$0	\$0	\$0
Federal Earned Income Tax Credit	\$808	\$768	\$732	\$594	\$555	\$451
State Earned Income Tax Credit	\$32	\$31	\$29	\$24	\$22	\$18
Federal Child Tax Credit	\$0	\$0	\$0	\$452	\$0	\$186
State Homestead (property tax) Credit	\$0	\$0	\$0	\$0	\$0	\$0
TOTAL RESOURCES	\$20,329	\$21,796	\$22,649	\$24,155	\$24,513	\$25,753
SURPLUS / (GAP)	\$166	(\$1,081)	(\$837)	\$917	(\$110)	\$109

Appendix 5. Married couple, two children, Milwaukee, WI 2000-2005

Primary wage earner starts at \$10.75/hour, full-time, year-round; increase 5% annually

Second wage earner earns \$6.75/hour, half-time, 39 weeks/year, no annual increases

No paid child care

	2000	2001	2002	2003	2004	2005
EXPENSES						
Housing	\$7,428	\$7,596	\$7,896	\$8,040	\$8,256	\$8,328
Food	\$6,561	\$6,841	\$6,972	\$7,116	\$7,515	\$7,614
Transportation	\$4,081	\$4,333	\$4,585	\$4,521	\$4,709	\$5,421
Miscellaneous	\$2,684	\$2,789	\$2,892	\$2,930	\$3,051	\$3,182
Child care	\$0	\$0	\$0	\$0	\$0	\$0
Health insurance	\$0	\$800	\$836	\$873	\$1,521	\$1,590
Other medical	\$1,102	\$1,153	\$1,207	\$1,255	\$1,310	\$1,366
TOTAL EXPENSES	\$21,856	\$23,512	\$24,388	\$24,735	\$26,362	\$27,501
RESOURCES						
Earnings	\$27,430	\$28,832	\$30,020	\$31,268	\$32,578	\$33,953
<i>Less: Social Security/Medicare taxes</i>	(\$2,098)	(\$2,206)	(\$2,297)	(\$2,392)	(\$2,492)	(\$2,597)
<i>Less: Federal income tax</i>	(\$332)	\$0	\$0	\$0	\$0	\$0
<i>Less: State income tax</i>	(\$487)	(\$491)	(\$541)	(\$608)	(\$674)	(\$741)
Food Stamps	\$0	\$0	\$0	\$0	\$0	\$0
Federal Earned Income Tax Credit	\$784	\$693	\$882	\$721	\$606	\$697
State Earned Income Tax Credit	\$110	\$97	\$123	\$101	\$85	\$98
Federal Child Tax Credit	\$0	\$237	\$183	\$1,043	\$952	\$885
State Homestead (property tax) Credit	\$0	\$0	\$0	\$0	\$0	\$0
TOTAL RESOURCES	\$25,357	\$27,162	\$28,370	\$30,133	\$31,055	\$32,295
SURPLUS / (GAP)	\$3,501	\$3,650	\$3,982	\$5,398	\$4,693	\$4,794

Appendix 6. Single adult, no children, Milwaukee, WI 2000-2005

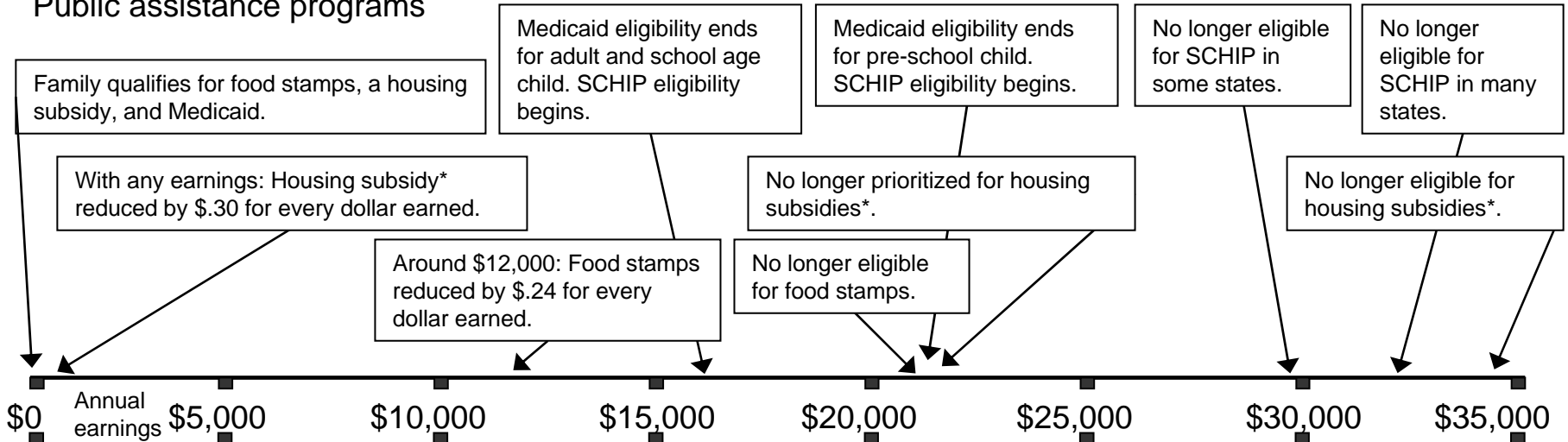
Earnings start at \$8.00/hour, full-time, year-round; increase 5% annually

	2000	2001	2002	2003	2004	2005
EXPENSES						
Housing	\$4,524	\$4,632	\$4,812	\$4,896	\$5,028	\$5,772
Food	\$2,159	\$2,249	\$2,296	\$2,346	\$2,465	\$2,508
Transportation	\$2,903	\$3,082	\$3,261	\$3,216	\$3,350	\$3,856
Miscellaneous	\$1,496	\$1,556	\$1,621	\$1,640	\$1,701	\$1,890
Child care	\$0	\$0	\$0	\$0	\$0	\$0
Health insurance	\$1,010	\$1,082	\$1,312	\$1,590	\$1,518	\$1,590
Other medical	\$1,102	\$1,153	\$1,207	\$1,255	\$1,310	\$1,366
TOTAL EXPENSES	\$13,194	\$13,754	\$14,509	\$14,943	\$15,372	\$16,982
RESOURCES						
Earnings	\$16,640	\$17,472	\$18,346	\$19,263	\$20,226	\$21,237
<i>Less: Social Security/Medicare taxes</i>	(\$1,273)	(\$1,337)	(\$1,403)	(\$1,474)	(\$1,547)	(\$1,625)
<i>Less: Federal income tax</i>	(\$1,416)	(\$1,203)	(\$1,297)	(\$1,369)	(\$1,484)	(\$1,591)
<i>Less: State income tax</i>	(\$402)	(\$417)	(\$455)	(\$505)	(\$554)	(\$591)
Food Stamps	\$0	\$0	\$0	\$0	\$0	\$0
Federal Earned Income Tax Credit	\$0	\$0	\$0	\$0	\$0	\$0
State Earned Income Tax Credit	\$0	\$0	\$0	\$0	\$0	\$0
Federal Child Tax Credit	\$0	\$0	\$0	\$0	\$0	\$0
State Homestead (property tax) Credit	\$0	\$0	\$0	\$0	\$0	\$0
TOTAL RESOURCES	\$13,549	\$14,515	\$15,191	\$15,915	\$16,641	\$17,430
SURPLUS / (GAP)	\$355	\$761	\$682	\$972	\$1,269	\$448

Figure 1. Means-tested public assistance, tax credits and tax liability at different income levels.

Based on 2005 figures for a one-adult worker with one pre-school and one school-aged child.

Public assistance programs



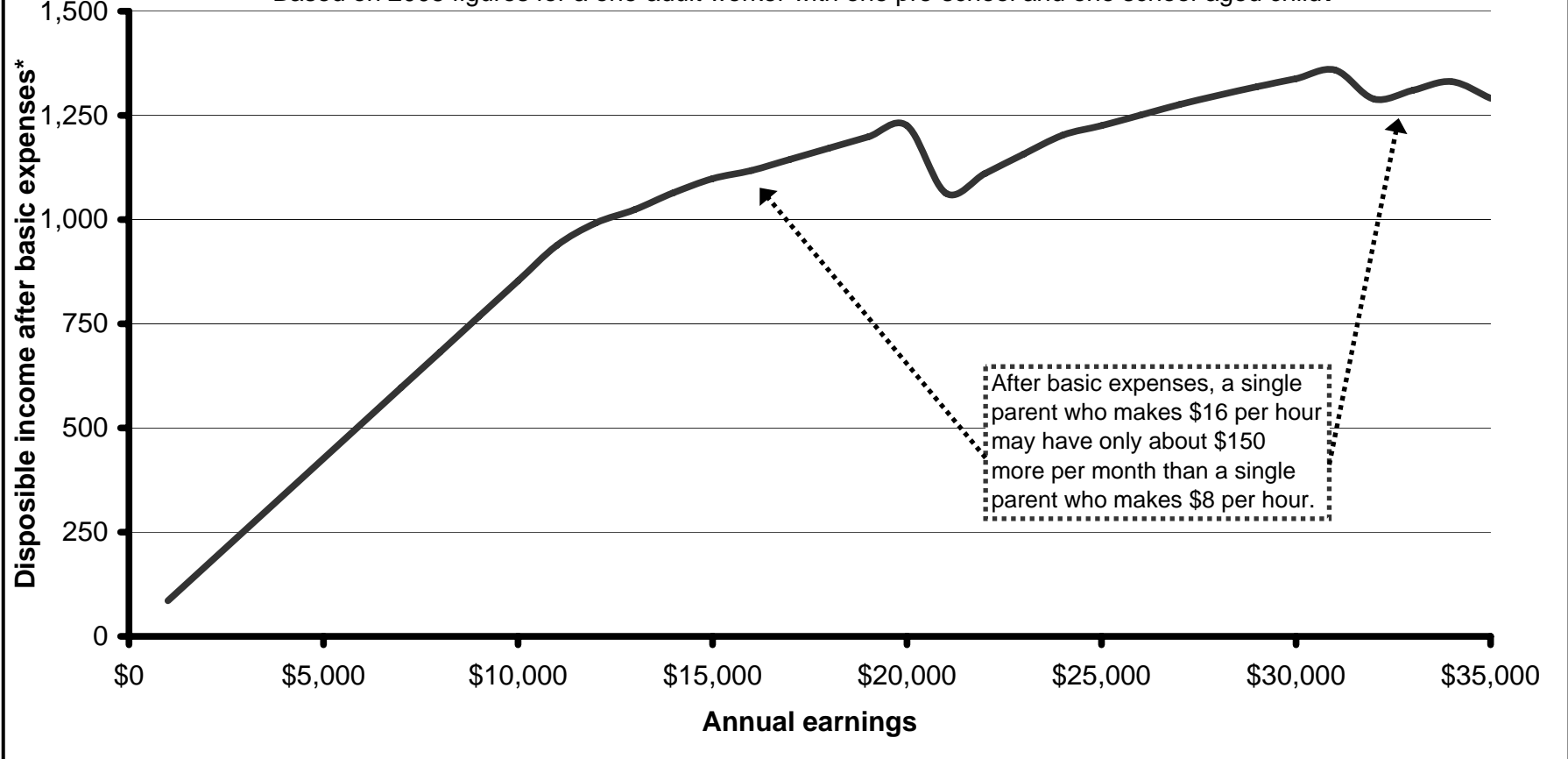
Taxes on wages and tax credits

Sources: Food stamp formula from U.S. Department of Agriculture (2005). Medicaid/SCHIP information from Dubai, Hill and Kenney (2002). Housing subsidy information from U.S. Department of Housing and Urban Development (2002). Tax and tax credit information from author calculations using TAXSIM (Feenberg and Coutts 1993; NBER 2001) assuming wages are only income source and child care costs of \$200 per month.

*Housing subsidy rates based on national median income and rental rates. Specific cut-off points vary by location and housing assistance is subject to limited availability. Reductions in subsidy are delayed for 12 months and then phased in at a 50 percent rate for an additional 12 months for housing subsidy recipients who move from unemployment into the labor force.

Figure 2: Annual earnings and disposable income after basic expenses

Based on 2005 figures for a one-adult worker with one pre-school and one school-aged child.



"Disposable income after basic expenditures" refers to household funds left over after buying basic common essentials (basic food, shelter, and health insurance coverage). Figure assumes the household uses food stamps, housing assistance, and Medicaid/SCHIP (with cost sharing set by averaging premiums by income level for the three most populous states). Federal taxes (including FICA) and eligible tax credits are included as monthly averages. Other common expenditures not included as basic expenditures may include: utilities and phone service; cleaning and personal hygiene products; child care costs (costs of \$200 per month assumed for purposes of tax calculations); over-the-counter medications and medical co-payments; clothing, including school clothes and work uniforms; school supplies, books and fees; transportation such as bus, train or ferry fare and/or car ownership and gas expenses; union dues; political, charitable or religious contributions; personal life or property insurance; expensive food such as fresh meats and produce or food for special diets; entertainment or travel; gifts; etc. For sources see Figure 1. Additional documentation available by request from first author.