A New Safety Net for Low-Income Families

By Sheila Zedlewski, Ajay Chaudry, and Margaret Simms
The Urban Institute[1]

During the 1990s, the federal government promised low-income families that work would pay. Parents moved into jobs in droves in response to new welfare rules requiring work, tax credits, and other work supports that boosted take-home pay. These policy changes were enacted during one of the strongest labor markets on record. A decade later, the labor market is tepid, and policies have to be re-evaluated keeping in mind the circumstances of today's families.

With so many so vulnerable, the nation needs new policies that make work pay in today's economy.

Low-income working families face the greatest risks in today's unpredictable economy. The proverbial economic ladder has largely disappeared: the wages of less-skilled workers have on balance either stagnated or fallen over the past two decades, making it difficult for many families to make ends meet. The loss of a job, a cut in work hours, a serious health problem, or an increase in housing costs can quickly push these families into greater debt, bankruptcy, or even homelessness. Most do not receive group health insurance coverage from their employers or qualify for unemployment insurance if they lose their jobs. Neither the government nor employers give them much of a safety net.

With so many so vulnerable, the nation needs new policies that make work pay in today's economy. This essay synthesizes an integrated set of policy proposals designed to establish a new safety net for low-income families. The policies are based on four principles:

- Work should pay enough to cover the basic costs of everyday family living. When full-time work fails to cover these costs, basic needs should be subsidized in ways that also promote greater work effort.
- Young children in low-income working families require quality day care and their parents must be able to combine a job with parenting so their children develop fully.
- Workers need access to training to move up the career ladder. This should include access to specialized supports when their underdeveloped or outdated skills, their health problems, or other factors put even the first rung of the ladder out of reach.
- Workers should be able to bridge employment gaps through unemployment insurance and accumulated savings.

Policies built on these principles would enhance low-income families' financial stability, expand investment in children, and fulfill the promise that earnings coupled with government work supports would enable parents to pay for their families' basic needs. Below, we profile specific policy recommendations that would help to achieve these goals, each developed by authors of the "New Safety Net" paper series published by the Urban Institute.

Making Work Pay

For many workers, a living wage remains elusive. The disparity between minimum wage income and the ever increasing cost of basic needs places many families in financial jeopardy. To help make work pay, Gregory Acs and Margery Austin Turner recommend policies to enhance low-income families' purchasing power and reduce household expenses, in particular unusually high housing costs.[2]

Minimum wages and poverty

Box 1.1

The federal minimum wage increased to $6.55 per hour on July 24, 2008. At this rate, a person working a 40-hour week for all 52 weeks in a year would earn $13,624. According to the Department of Health and Human Services, the 2008 poverty line for a single parent with one child was $14,000, and for a single parent with two children, it was $17,600. A single parent trying to support a family on a full time minimum-wage job would qualify as poor.

The federal minimum wage was constant for a decade, from 1997 to 2007, at the rate of $5.15 per hour. Wages increased in 2007 to $5.85, then again to the current rate of $6.55 earlier this year. The minimum wage will increase to $7.25 per hour effective July 24, 2009.

The disparity between minimum wage income and the ever increasing cost of basic needs places many families in financial jeopardy.

Key among these policies is expanding the effectiveness of the earned income tax credit (EITC), a refundable federal income tax credit that supplements the wages of low-income workers. As a refundable credit, the EITC directly increases disposable income, thus creating a work incentive for low-income individuals. However, once earnings exceed about $1,000 per month, benefits begin to "phase out," meaning they are gradually reduced as earned income increases. Currently, families with two or more children phase out of the EITC more quickly than do families with one child. Extending the phase out threshold for larger families would encourage additional work and add a few hundred dollars to the annual disposable incomes of those just above the poverty threshold.

In addition, Acs and Turner propose making the child tax credit refundable, starting with the first dollar of earnings. The child tax credit is currently structured as a non-refundable credit that allows income-qualified parents to reduce their federal income tax liability by up to $1,000 for each qualifying child under the age of 17. By making the credit refundable, families who have earnings at about one-half the poverty level (about $10,000 for a family of three) would experience an increase in disposable income that would bring it more in line with the costs of necessities.

To make housing costs more affordable, Acs and Turner recommend a new refundable tax credit for both renters and owners. This credit would be available to families with earnings between $10,000 and $49,000 and would vary with the cost of decent housing in the community. Larger families and families living in high-cost housing markets would receive a larger credit, while those living in low-cost housing markets or paying less than fair market rent for their housing would receive a smaller credit. To encourage and reward work, the credit's value would be greatest for families with earnings at or above the full-time minimum wage level. The amount would then remain the same (regardless of earnings increases) until earned income topped $40,000, holding families' effective housing expenditures down as their incomes increased. In effect, this would reduce the housing cost burden for low-income working families–especially in high-cost markets–while at the same time encouraging work and earnings.

Expanding the current tax credit incentives for state and local jurisdictions to increase moderate-cost housing production in geographic areas with the greatest need would complement other changes designed to make housing more affordable. Acs and Turner recommend a 20 percent increase in the size of the Low Income Housing Tax Credit program, with revised targeting formulas that direct more tax credits to states where rental housing is in short supply (and fewer to states where the supply of rental housing is adequate). In addition, credits would be targeted to locations within these states where moderately priced rental housing is scarce.

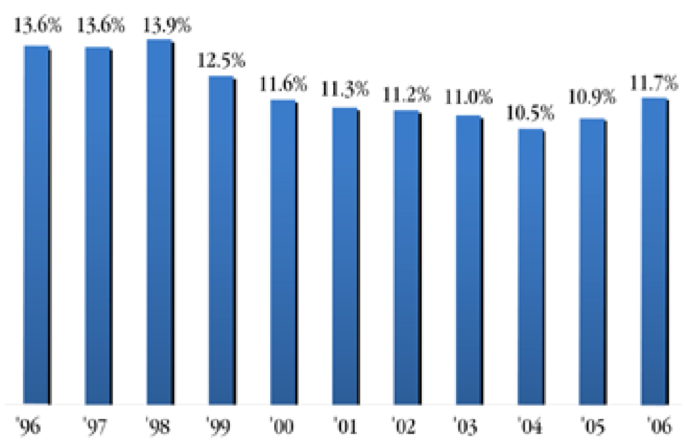
Guaranteeing Health Insurance

An estimated 45.7 million individuals, including 8.1 million children, do not have access to health insurance.[3] Cynthia Perry and Linda Blumberg call for comprehensive health insurance reform that extends coverage to everyone. They recommend moving to an "individual mandate" system, a legal requirement that everyone enrolls in health insurance coverage that meets the minimum standards set in the law. They argue that limiting coverage to low-income working families might create a significant incentive for these families to hold earnings below the maximum eligibility level and, thus, to limit work. Also, with universal coverage in force, uncompensated care payments currently going to health care providers could be redirected to help finance a new, more efficient system of coverage.

The authors suggest that a politically viable, practical first step would be phasing in comprehensive reform by initially targeting the low-income uninsured.[4]

Perry and Blumberg argue that the new system would require new state-designed purchasing pools to offer health insurance to all non-elderly persons, including those with public or state employee coverage. State participation would be voluntary, but strong federal financial incentives would make participation attractive to most states. Federal subsidies would cover 100 percent of costs for those with incomes

Figure 1.1 *Percentage of Children Under Age 18 Without Health Insurance, 1996 – 2006*



Source: Employee Benefit Research Institute estimates from the Current Population Survey below 150 percent of the poverty level and would gradually require families to pay a greater share of their incomes; families at 301 to 400 percent of the federal poverty level would pay up to a federal cap of 12 percent of their incomes. Families with incomes above four times the poverty level would not receive subsidies. Families that qualify for subsidies and have employer sponsored insurance would bring their employer's contribution to the pool to offset the government cost. Eventually the purchasing pools would be open to everyone (including employers on the same terms). Under this individual mandate, most workers would continue getting insurance through their employment (even though many employers might purchase insurance through the new pools), while those who may not have access to coverage through an employer would still be covered.

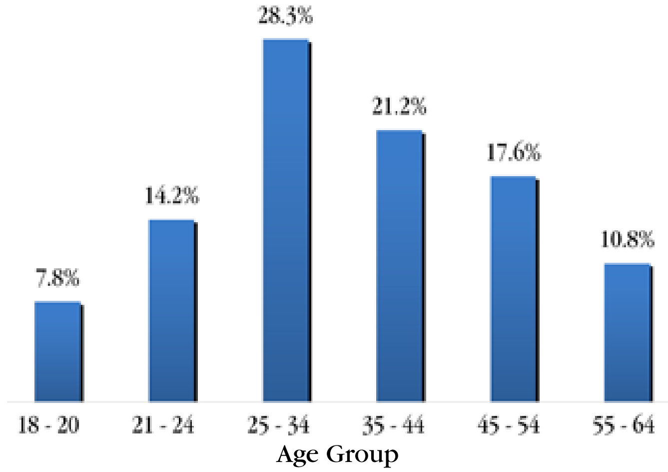
New policies are also needed to help parents advance to better-paying jobs and support parents finding it difficult to move into the labor market.

Supporting Children's Development in Working Families

Working families across the economic spectrum struggle to balance the demands of work and family, but the high cost of quality child care places an especially significant burden on low-income families. Shelly Waters Boots, Jennifer Macomber, and Anna Danziger suggest policies for enabling parents to improve prospects for their children and combine work with child rearing.[5] They argue that there should be universal access to childcare, with the costs subsidized for low-income families. The costs of guaranteed child care assistance for low-income families would be shared by states and federal government and by families, whose co-payment would vary with income level as determined annually. The researchers propose instituting a child care quality rating system to help parents identify the best child care choices. They also recommend making the Early Head Start program a hub that links parents of infants and toddlers to such services as child care, nutrition programs, and health care.

Augmenting direct help with child care, the national sick leave policy proposed by the researchers would require employers to provide at least seven days of paid sick leave for employees working at least half time. With a national policy, businesses would not be put at a competitive disadvantage because of the state in which they do business. Meanwhile, the federal government should support state efforts to provide employee-financed paid parental leave as well as encourage more employers to permit flexible schedules.

Figure 1.2 *Percentage Uninsured Among Nonelderly Adults, 2006*



Source: Employee Benefit Research Institute estimates from the Current Population Survey

Moving Ahead in the Labor Market

New policies are also needed to help workers advance to better-paying jobs and support those finding it difficult to move into the labor market. Harry Holzer and Karin Martinson suggest competitive federal matching block grants that reward states for developing new career advancement systems.[6] Initially, competitive grants would be awarded to selected states, providing matching funds for increases in public and private expenditures on the most promising approaches to training less-educated workers for good private-sector jobs and for other financial supports for low-income workers. To obtain the grants, states (or localities) must agree to spend more of their own funds than they now do on training for low-income workers and would-be workers. The authors would link new systems to current state workforce development structures and require partnerships with training providers (such as community colleges), employers, and support services that would allow parents to get training. These arrangements would make it easier for disadvantaged populations to participate in skill-building activities. The new systems would be selected competitively, with states required to evaluate their effectiveness annually.

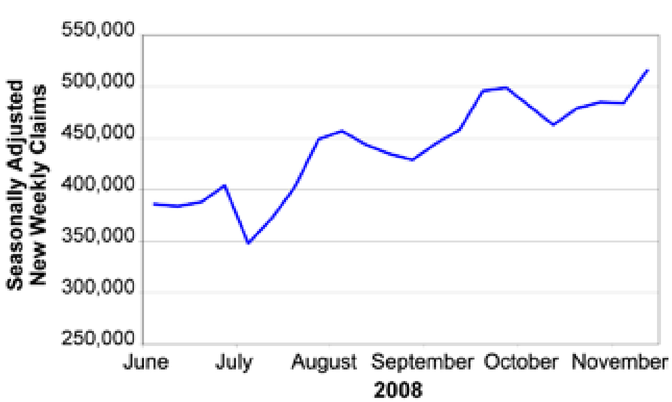
Pamela Loprest and Karin Martinson suggest a parallel initiative: offering states competitive matching grants to try to integrate programs that alleviate barriers to work (such as mental health and substance abuse services) with employment services and to evaluate these initiatives so policymakers can better understand what works.[7] Currently, individuals with significant barriers to work often drop out of the labor force entirely. A competitive matching grant program would encourage states to innovate in how to provide 'wrap around' services, ensuring that families get the help they need as well as promoting work. The researchers also recommend some short-run changes to current programs that would serve that same end—extending the amount of time that state welfare programs can allow recipients to spend in services designed to address barriers (such as mental health counseling or substance abuse treatment) and providing financial incentives to workforce development programs to serve more parents facing steep challenges.

Bridging Gaps in Employment

As family breadwinners, parents must be able to weather inevitable short-term gaps in employment. Margaret Simms recommends adopting the changes advanced in the Unemployment Modernization Act (UMA) along with some additional measures to address unemployed parents' needs.[8] The UMA, introduced as part of the Trade and Globalization Assistance Act of 2007 (passed in the House in 2007 and awaiting vote in the Senate) would give states federal financial incentives to extend unemployment benefits to more workers, such as those with shorter work histories, those seeking part-time work, and those leaving jobs due to domestic violence, illness, disability of a family member, or relocation to accompany a spouse. The UMA also would provide extended payments for workers enrolled in approved training programs. Many states have already adopted some of these initiatives and if more did, children in low-income working families would not have to suffer short-term deprivation and the workers would have time to seek jobs that might provide better long-term prospects for them and their families.

Figure 1.3 *New Weekly Claims for Unemployment Insurance*

Congress passed an emergency 13-week extension of unemployment benefits starting in July, 2008. Over 890,000 unemployed workers already have exhausted their 13-week extension, and another 1.2 million are projected to exhaust benefits by the end of 2008. Without these benefits, the Congressional Budget Office finds that about 50 percent of the long-term unemployed fall under the poverty line.



Source: Economic Policy Institute

Increasing the number of families on a solid economic footing will strengthen the nation's competitive advantage in the global economy.

To shore up big holes in the safety net for working families, Simms recommends increasing the share of wages that unemployment insurance replaces—currently about 35 percent of wages, on average—and providing benefits to more low-wage parents. All states should, she suggests, provide a uniform minimum of 26 weeks of benefits and add a small payment for dependents of low-wage workers. Another wise move would be switching from total wages earned to time worked in order to estimate workers' eligibility for unemployment insurance. Simms also recommends providing benefits to job-seeking women who have taken time out for childbearing/rearing or other family responsibilities, provided that these workers were eligible when they left the workplace.

Families also need savings to finance emergency needs and build their family's long-term economic security. Signe-Mary McKernan and Caroline Ratcliffe suggest a cluster of policies that would improve financial markets and savings opportunities for low-income families across the life cycle.[9] One is increasing competition and regulation in the small dollar loan market, as a few pioneering credit unions and banks have already done, so that consumers are not paying exorbitant interest rates for access to short-term financing. Another is initiating savings accounts for all children at birth (see Box 1.2) with an initial government deposit of \$500 (restricting the use of funds until the child reaches age 18). The accounts would be tax-free for low-income families. Unlike other approaches to children's savings accounts which recommend restricting the use of funds for certain asset building activities (such as a college education), McKernan and Ratcliffe argue that a more flexible, universal approach will reduce administrative burden and encourage greater participation by financial institutions.

McKernan and Ratcliffe also propose other methods for increasing savings among low-income families. These include a dollar-for-dollar federal match on savings from EITC refunds deposited into long-term savings accounts (e.g., Individual Retirement Accounts [IRAs] and Individual Development Accounts [IDAs]) or used to buy U.S. savings bonds. Automatic IRAs could be used to promote retirement savings by requiring employers that do not offer a pension plan to directly deposit a small percentage of individuals' earnings unless the employee opts out. McKernan and Ratcliffe also propose allowing IDA funds to be used for vehicle purchase, to avoid subprime auto loans that can carry annual interest rates of 25 to 30 percent. Under a complementary proposal, a national competitive grants program would be set up to fortify current state and local programs that help low-income families purchase and repair their vehicles.

Conclusion

The authors of these policy proposals argue that additional investments in low-income families are essential now. In the short run, achieving the goals behind the proposals would fulfill the promise of the new social contract introduced in the 1990s. In the longer run, the benefits of implementing these initiatives will reach far beyond helping low-income families. Increasing the number of families on a solid economic footing will strengthen the nation's competitive advantage in the global economy. Surely, parents with health care, with jobs that provide benefits, and with just enough government support to make them confident that they can meet their families' basic needs will be more productive workers and more successful. Their children–nurtured in supportive families and positive learning environments–will contribute more to our future economy. Investment in a new safety net for low-income families will generate these valuable returns. CI

Children's Savings Accounts

Box 1.2

Children's savings accounts (CSAs) are a broad set of proposals aimed at establishing financial security for children through the creation of a savings account for each child. The accounts may be established in the child's name, giving exclusive ownership and withdrawal privileges to the child in many cases. Depending on program design, funds accumulated in the account may be tax-exempt and protected until the child reaches maturity (most often age 18), at which point the money could be utilized for asset building or skill development, such as paying for college or vocational training.

Proponents suggest that CSAs provide economic stability for children's development, while also inducing positive changes in attitudes and behaviors. By establishing a savings platform at birth, parents and children can envision and work towards a future with expanded possibilities, increase their financial literacy skills, and develop a lifelong habit of saving. These benefits could be especially valuable for children from low- and moderate-income households who might otherwise lack access to even the most basic banking products.

There is no universal model for CSA program design. A variety of pilot programs and policy proposals are underway in the U.S. as well as internationally. Programs can vary significantly, with each mix of policies possessing a variety of strengths and weaknesses. Some key design features include:

- ***Initial deposit*** – Some programs provide initial seed money for accounts, typically in the range of $500 to $1,000. In some cases, children from low- or moderate-income households may receive an additional "boost."
- ***Milestone deposits*** – Programs may offer one-time deposits at milestone events, such as graduation from high school.
- ***Match rates*** – Deposits into CSAs could be matched at various rates, up to certain limits. For example, at a 2:1 match rate, a child's $10 deposit would be matched by $20, placing a total of $30 into the account.
- ***Use restrictions*** – While some models require that funds be used for specific approved purposes, such as education, other models suggest no use restrictions in order to reduce administrative oversight.
- ***Institutional model*** – Researchers are still debating the best institutional model for CSAs. Some favor a private sector model, while others believe programs should be administered publicly at the federal, state, or local level.

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3. Subtracting out the $6.5 billion currently provided to three- and four-year olds through Head Start yields the $18 billion figure for new costs. The long-term goal would be to bring the national Head Start program and the burgeoning state pre-kindergarten programs together into an expanded national pre-kindergarten initiative that provides comprehensive, high-quality services to three- and four-year-olds. Initially, however, the federal government might have to continue separate funding streams for Head Start and the new pre-kindergarten initiative.
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