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The Height of the Net - How can an anti-poverty program encourage people to work?

By: Oren Cass – October 14, 2013

America long ago committed to providing for the basic needs of all its citizens, constructing a so-called safety net of government programs to catch those unable to support themselves. But an effective safety net must be positioned at the right height-safely above the rock-hard floor yet still well below the tightrope. The value of the baseline government benefits provided to someone not working must be significantly lower than the income that person could earn in an entry-level job. That "income gap" creates the economic incentive to work in the first place, ensuring that all who are able will strive to climb back up and into the labor force.

Unfortunately, a combination of macroeconomic trends and counterproductive policy choices has significantly eroded the incentive to work. Wages for low-skilled and entry-level positions have stagnated, while many of the positions that would have afforded a middle-class lifestyle have vanished entirely. At the same time, the safety net has grown to encompass an ever wider panoply of benefits that have become ever more expensive as health-care and education costs have exploded. This system of benefits, obviously requiring careful design and management, has neither. Countless programs are delivered through an alphabet soup of agencies, leaving no holistic anti-poverty approach and no one accountable for measuring or maintaining a meaningful income gap.

The results are as predictable as they are depressing. Labor-force participation is at a 35-year low overall, and an all-time low for men. (If participation were as high as it was before the recession, today's unemployment rate would be above 11 percent.) There are 2 million fewer Americans working than there were before the recession but 2 million more Americans receiving disability payments. The number of food-stamp recipients has climbed by more than 25 percent since the recession ended, and more than 100 million Americans now receive some form of food assistance each year. The War on Poverty is in its 50th year, and yet the poverty rate today is as high as any previously recorded-and 30 percent higher than it was in the 1970s.

Conservatives, whether genuinely awakened to the severity of America's poverty crisis or merely chastened by the disastrous aftermath of Mitt Romney's "47 percent" remarks, are at least taking notice. Representative Paul Ryan held House Budget Committee hearings on the issue. Proposals to reform existing programs, create new ones, increase spending, or decrease spending are flying from all sides. None of these ideas are likely to succeed unless they are built atop a new framework, one that establishes a benefit-delivery system capable of clearly separating those who work from those who do not, and one that maintains a substantial income gap between the two.

By some measures, the War on Poverty has already succeeded. If the goal is simply to guarantee that every American has access to food, providing an average of more than $3,000 of food stamps each year

to households in need is a nearly unqualified victory. If the goal is access to medical care, a Medicaid program spending an average of $7,000 each year for a family of three represents extraordinary progress. Indeed, counting the full range of federal benefits as "income" to low-income households leads to a substantial reduction in the poverty rate.

But simply transferring enough resources to someone so that he is no longer "poor" treats only the symptom; it does not move him toward self-sufficiency or a foothold at the bottom of an economic ladder that could lead to better opportunities. To the contrary, it hinders that process. Therein lies the paradox at the heart of anti-poverty policy. Every dollar spent to reduce the suffering of an impoverished person reduces the incentive for that person to improve his own condition by earning an income-not only because the need has become less pressing, but also because the system will in fact punish him for any success by taking the dollar away once he earns one of his own. The "handout" is locked in perpetual battle with the "hand up."

One could say, "So what?" Why not just spend the money to ensure everyone's needs are met, and let work be its own reward? For one, fiscal constraints preclude the possibility of further expanding benefits for the further-expanded pool of beneficiaries that this approach would attract. But even if one were prepared to undertake the taxation and redistribution necessary to implement such a policy, the result would undermine societal values of individual responsibility and self-reliance and impede the upward economic mobility that is possible only for those who enter the work force in the first place. Thus the conservative emphasis on work requirements and other incentives to move people into jobs. And thus the effectiveness of welfare reform in the 1990s, one of the great conservative policy successes of recent decades.

But welfare reform was actually quite limited, replacing the traditional Aid to Families with Dependent Children (AFDC) with the new, work-focused Temporary Assistance for Needy Families (TANF). TANF is not even among the top five federal anti-poverty programs in either expenditures or enrollees. Medicaid, the Supplemental Nutrition Assistance Program (SNAP, commonly referred to as "food stamps"), the Earned Income Tax Credit (EITC), Supplemental Security Income (SSI, commonly referred to as "disability"), and even Pell Grants for higher education are larger. And when all the spending is added up, the results are stunning.

The Cato Institute added up the annual expenditures for all federal, state, and local anti-poverty programs (defined as programs whose eligibility is dependent on income level) and arrived at a total of $1 trillion. (That total excludes Medicare and Social Security, which amount to more than $1 trillion in additional spending each year. It also excludes the onset of the Affordable Care Act, which will expand Medicaid and provide more than $100 billion in annual insurance subsidies.) To understand the magnitude of that $1 trillion in spending, consider that it could provide each of the nearly 50 million Americans living in poverty with an annual cash payment of more than $20,000. A single mother with two children could receive more than $60,000. Median household income in this country is only $52,000.

Of course, not every dollar of the $1 trillion is spent on Americans living below the poverty line. A significant share of Medicaid spending also goes to support long-term care for the elderly. So Cato went one step further and looked at the full package of benefits a welfare-eligible single mother with two children could receive in each state. In most states the value of a package of welfare benefits exceeded earnings from a minimum-wage job. In half of all states, the benefit package brought the family up to at least 80 percent of the state's median salary.

The issue here is not whether taxpayers are spending "too much" on support for lower-income families. The issue is not even whether welfare benefits are "better" than entry-level jobs. The problem is that with such high baseline benefit levels-benefits that fall away as the recipient begins to earn income-the income gap is too low. The lowest-income households end up facing what in effect are extraordinarily high marginal tax rates, meaning they receive far too little additional take-home income for each dollar they earn and thus face relatively little incentive to earn any income at all.

The Congressional Budget Office reviewed the impact of key federal programs and found that a hypothetical single mother with one child would have $20,000 of disposable income if she earned $0 in wages, but less than $30,000 of disposable income if she earned $30,000 in wages. From her perspective, she receives less than $10,000 in reward for her $30,000 of work-the equivalent of a 70 percent tax rate. Gary Alexander, Pennsylvania's secretary of public welfare, found that taking into account his state's benefits as well resulted in an even starker picture: There a hypothetical single mother with no earnings might receive $45,000 in benefits, a total amount of take-home income comparable to what she could expect with a $50,000 salary.

Recent trends only compound the problem. Society's definition of a minimum standard of living is expanding to include higher education, health coverage for everything from birth control to the most advanced therapies, and even cell phones and broadband Internet access. Ensuring that every American has access to these things is an admirable goal, but if every American is entitled to them, then those who work hard to earn a middle-class living will find themselves doing little better than those who do not work at all.

At the same time as expectations rise, the standard of living offered by low-skilled work continues to decline. In 1970, the average income for a male with a high-school degree amounted to more than double the poverty line for a family of four. In 1990, it exceeded the poverty line by only 60 percent. Today it clears the threshold by only 30 percent. For entry-level positions specifically, those numbers drop even lower. Entry-level jobs are often just steppingstones to better opportunities for workers who develop skills and a track record of performance. But that upward mobility requires that the initial leap into the work force be made. Without a sufficient income gap, it may never be.

As the range of potential benefits expands and the attractiveness of entry-level work declines, maintaining an income gap that favors work and encourages labor-force participation becomes more challenging and more important. Unfortunately, the current anti-poverty infrastructure makes it nearly impossible.

The system through which $1 trillion flows each year from taxpayers to beneficiaries appears designed to stifle reform, increase spending, expand bureaucracy, and avoid accountability.

The core assistance programs were created through different pieces of legislation and are administered by different agencies, with different eligibility requirements, incentives, and procedures. Medicaid is an entitlement program within the Department of Health and Human Services (HHS). Disability operates within the Social Security Administration. The Department of Agriculture (USDA) controls food stamps through legislation incorporated into the farm bill; the Department of Housing and Urban Development controls housing assistance; and the Department of Education controls education programs. Unemployment insurance relies on a hybrid state- and federally financed trust fund, administered by the states, with oversight from the Department of Labor, backstopped by additional federal funds. The IRS administers the Earned Income and Child Tax credits through the tax code. And so on and so forth for dozens of smaller programs, from the School Breakfast Program to the Weatherization Assistance Program.

Implementation is sometimes but not always assigned to the states, sometimes but not always with matching state funds, sometimes but not always with state-established income thresholds. From the states' perspective, little can be done but to replicate the structure of an array of federal programs and play by the perverse rules set from above. The tangle of strings attached to each program prevents any harmonization or consolidation among programs. Matching funds reward higher spending in some instances, while block grants attempt to curtail spending in others. State-level programs get layered on top of federal programs rather than integrated with them efficiently. Individuals end up facing wildly different incentives depending on their specific circumstances, sometimes encountering so-called income cliffs where small increases in their earnings will disqualify them from benefits and leave them worse off than before.

For policymakers, the system defies analysis, let alone substantive reform. The USDA is an illustrative microcosm: Last year the agency spent $114 billion on 15 different nutritional programs, each with a separate legislative authorization. In June, its inspector general's office expressed concern that the agency "may be duplicating its efforts by providing total benefits that exceed 100 percent of daily nutritional needs," explaining that the agency "has not fully assessed its food safety net as a whole to determine the impact of providing potentially overlapping nutritional benefits through multiple programs." Now multiply the absurdity across more than 100 different programs spanning numerous agencies and objectives.

No one even considers how best to allocate funds across types of assistance or types of beneficiaries. Rising health-care costs drive Medicaid spending higher, crowding out funding for other types of programs regardless of whether a marginal dollar is best spent on health care. Thirty-five billion dollars goes annually to Pell Grants subsidizing higher education-a worthy and politically unassailable effort, but one that prioritizes those with the brightest futures (and with access to already-subsidized public universities and already-subsidized loans) over those with fewer skills and opportunities.

Year after year the entrenched bureaucracies of separate agencies shovel their separate funds down separate chutes, each striving to secure the largest possible shovel for next year by establishing just how acute is the need for its program. None are required to show the reduction in demand for their services that actual success would entail. Here comes another year, there goes another trillion dollars, and the poverty rate is unchanged.

A better social safety net is only one piece of the anti-poverty puzzle. Economic policies need to create greater demand for workers. Immigration policies need to control the supply. Better investments in areas from education to infrastructure to policing need to offer greater opportunity for economic mobility. But if labor-force participation is crucial to easing poverty, structuring the $1 trillion of annual spending on the safety net to advance rather than interfere with that goal seems a sensible place to start.

An effective anti-poverty program requires reform in two ways: first, restructuring the funding system to give state-level policymakers the incentives and authorities they will need if substantive reforms are to succeed; second, sharply dividing programs designed to provide a safety net for those not working from programs designed to increase the incomes of those who are working, coupled with reestablishing an income gap by increasing the relative generosity of the latter.

The restructuring process should begin with an acknowledgment that the federal government is well situated for only one of its present tasks: collecting and distributing funds. Rather than have numerous federal agencies each administer numerous programs, the federal government would ideally have a single agency apply a formula, establish the year's lump-sum payment for each state, and transfer the funds. Call it the Flex Fund. States happy with the existing funding allocations and program structures could continue to apply the funding as they do today. But states with better ideas-even radically different ones-would be free to pursue them.

The Flex Fund sounds like a block grant, but it is not the type of program-by-program block grant typically proposed as a pretext for capping the growth of costs. To the contrary, the funding formula would be pegged to the size of the population in need and would grow at the same rate as the poverty threshold itself-a figure that already factors in growth in cost of living for the relevant household. But with the dividing lines between programs erased, states would have genuine and complete flexibility over resource allocation as opposed to the faux flexibility of applying for waiver after waiver or delivering the federal Section 8 housing-voucher program "however you want."

Why should the states have control? First, because states are already largely responsible for implementing individual programs and delivering benefits. For all the reasons that, as the federal government realizes, states can best perform those tasks, so too can they best structure the programs and allocate funds across them. States have different populations, different economic circumstances, and different political preferences, making the state a unit better suited to establish these types of policies. State policymakers and administrators are also attuned to the real-life challenges of implementing policy in a way that their Washington counterparts never will be.

Second, and relatedly, good policymaking requires a decision-maker to have control. As a practical matter, substantive reforms cannot occur today because no one has the power to implement them. Combining funding streams creates an initial point of control, while devolving that control to the state level consolidates the full range of spending and implementation authorities. As a matter of institutional design, that consolidation also increases the likelihood of constructive reform by increasing accountability and eliminating unfunded mandates from above or efforts to game the system from below.

Third, where the federal government has floundered for decades, state-level experimentation is the more promising path forward. Not every state will pursue innovative reforms-indeed many will not-but innovation will occur. Welfare reform, like it or not, was inspired by state-level innovation enabled by waivers from federal welfare requirements. President Obama's health-care reform, like it or not, was inspired by state-level innovation enabled by waivers from federal Medicaid requirements. There will be successes and failures, and policymakers might not always learn the right lessons from them. But over time-decades, even-the testing ground in the states will yield an evolution of approaches far superior to the stagnant federal landscape of today.

The Flex Fund itself is an important reform, with the potential to improve the performance of today's programs and to produce further innovation. But just as important are the subsequent reforms it could launch in the direction of reestablishing an income gap.

There are several paths one might take to increase the value of an entry-level job relative to the value of welfare benefits. One could simply refuse to give benefits to those who do not work, but that approach ignores both the political realities of what American society is committed to providing and the everyday realities of millions of Americans who struggle to find or keep a job. Proposals to impose work requirements on food stamps sound like easy fixes but imply that America could or should strip a significant number of people of their access to food. One might also question the wisdom of striving for a system in which people with jobs not only need food stamps but are indeed the program's only constituency.

At the other extreme, one could focus on expanding support for workers, either by allowing them to retain the benefits that they currently lose as their income increases or else by adding new and more generous supplements to their income. The expense of such an approach would be enormous, especially as it would kick the problem farther up the income scale: If welfare benefits alone can provide income approaching the level of today's median income, then low-skilled workers would have to be supported at or above today's median income, which would mean that today's median earners would suddenly need support as well. In the current and foreseeable budget environment, such an approach is as unrealistic as cutting off support to those not working.

Striking a feasible balance requires a finely calibrated set of benefits that would make some progress on both sides of the ledger. The goal should be to create two separate sets of low-income programs-a state-administered safety net for those who are not working and a direct federal wage subsidy for those

who are. Benefit types and levels should be adjusted between the two in an effort to reestablish an income gap.

An adjustment in benefit types offers the best opportunity to incentivize work without slashing benefits or increasing spending. Two families-one whose head of household works, one whose head of household does not-may both need $3,000 worth of nutritional support. But if the non-working household receives the $3,000 in food stamps while the working household receives it as cash via a wage subsidy, the latter might feel substantially better off. While the Affordable Care Act draws an arbitrary line, providing Medicaid to those below 138 percent of the poverty line and a subsidy for private insurance to those above 138 percent of the poverty line, the benefit could instead be provided as Medicaid for those who do not work and, for those who do work, as additional cash provided via wage subsidy.

These types of reforms would only produce further complexity given today's policy structure, but substitute a Flex Fund and they become more straightforward. For example, more than 40 percent of food-stamp recipients live in households with earned income. If $50 billion, equivalent to 40 percent of what is spent today on USDA nutrition programs, were shifted out of the Flex Fund and into a doubling of a still-federal EITC, there would be no change in anti-poverty spending, but for working households a greater share would come in the form of a subsidized wage instead of an in-kind benefit.

Taking a similar approach in other benefit categories could continue to expand the EITC dramatically. Reforming the credit itself to make it a direct-to-the-worker wage subsidy would further clarify its incentives and amplify its impact. The infrastructure for such a subsidy already exists, of course-it is called the payroll tax, which reduces the take-home pay of every worker, on every dollar earned in every paycheck, up to a specified income level. The wage subsidy would function as a reverse payroll tax, increasing the effective wage associated with a given job in a predictable and transparent way. The effect in many ways would mirror a substantial increase in the minimum wage. But whereas a price control would tend to decrease the size of the labor force, a subsidy would tend to increase it. And whereas higher wages paid by employers tend to increase prices for consumers-affecting most the lower-income population the policy is intended to help-a subsidy-supported higher wage is funded disproportionately by the higher-income tax base.

States, via their federal Flex Fund dollars, their own programs, and their public-private partnerships, would be responsible for crafting a safety net to provide basic support for those outside the labor force. The federal government, via direct wage subsidies held apart from the Flex Fund, would ensure that anyone entering the labor force found significant advantages in doing so. The income gap would be easily quantifiable, and if necessary it could be expanded by shifting additional resources out of the Flex Fund and into the wage subsidy-not a reduction in support for the poor, only a shift in who receives what share. On this foundation, efforts to attack the causes of poverty and to improve the effectiveness of anti-poverty programs might actually succeed.