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In fighting the 'job lock,' Democrats opened a poverty trap

By Michael Tanner
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When the Congressional Budget Office weighed in earlier this month on the work incentives of ObamaCare, much of the attention was focused on whether millions of Americans could cut back their work hours or even quit their jobs.

The law's supporters called this "ending job lock," and Nancy Pelosi pointed out that people could now leave unsatisfying jobs to, say, "write poetry."

Opponents pointed out that, while ending the job lock might be a good thing, the people quitting those jobs would now be subsidized by taxpayers, many of whom might be working in unsatisfying jobs themselves.

But the contretemps over "job lock" obscured another, perhaps even more important, issue raised by the CBO report — the way in which taxes and welfare benefits create a "poverty trap" for the poor that makes rising up to the middle class far less likely.

Because the subsidies under ObamaCare are phased out as incomes rise, it creates situations where, "the phase-out effectively raises people's marginal tax rates (the tax rates applying to their last dollar of income), thus discouraging work."

In fact, for those low-wage workers who fall into this phase-out range, CBO estimates that it will increase their marginal tax rate by an average of 12 percentage points. As CBO points out, "[f]or those workers, the loss of subsidies upon returning to a job with health insurance is an implicit tax on working."

Unfortunately, ObamaCare is not the only government program creating such a poverty trap. Most programs for the poor have similar phase-outs, leading to a similar conundrum.

Consider Mary, a single mother with two kids earning around 150% of the federal poverty level for a household of three.

If she works, she must pay a marginal federal income tax of 15% on each additional dollar she earns. In addition, she faces a marginal New York state income tax rate of roughly 5.9%, and in New York City, a marginal rate of 3.54% for the municipal income tax. Therefore, if she earns $1, Mary pays more than 24 cents in income taxes. In addition, she must pay 7.5 cents in payroll taxes. (Her employer matches that 7.5 cents, which ultimately comes out of Mary's pocket through lower wages, but let's ignore that for the moment). Thus, Mary only gets to keep 68 cents of that dollar.

And that is only one side of the equation. As Mary earns more income, she will start to lose some of the benefits that she currently receives from the government. As CBO points out, as her ObamaCare subsidies phase out, she will lose another 12 cents out of every dollar she earns. This continues as she loses eligibility for other benefits. It all adds up.

In many ways, in fact, the highest marginal tax rates in this country are not those faced by millionaires and billionaires, but those paid by a person leaving welfare for work.

In 1999, Dan Shaviro of NYU found that some poor people actually could face taxes and lost benefits that exceed the total amount of what they earn, a marginal tax rate higher than 100%. Things have improved since then, largely because of expansion of the Earned Income Tax Credit and Child Tax Credits.

Even so, a poor mother of two who takes a job in New York, and earns just 150% of the poverty level, roughly $29,685, still faces a marginal tax rate of nearly 52%. That means that for every additional dollar she earns, she would lose more than half of it in taxes and foregone benefits. In Connecticut, the marginal tax rate would be only marginally better, roughly 51%. And in New Jersey, a poor mother taking a job could face a marginal tax rate of 47.5%.

Welfare benefits in all three states are quite generous. A mother of two receiving benefits from seven of the 126 federal anti-poverty programs (Temporary Assistance to Needy Families, Medicaid, food stamps, WIC, utilities assistance, public housing, and free commodities), could receive more than $38,000 per year in benefits. If that person takes a job, they will suddenly face a host of new expenses, transportation, child care, and so on, not to mention the loss of family and leisure time. How likely is that person to take a job or increase their work hours if they then stand to lose half of everything they earn?

The same combination of tax hikes and benefits phase out can also discourage marriage among the poor. For example, if Mary, who works at a low-wage job, marries John, who also works at a low-wage job, their combined income will not only be potentially subject to higher tax rates, but will result in an even faster loss of benefits.

And this does not even consider how taxes and regulations may encourage employers to reduce what they pay workers. ObamaCare, for example, encourages employers to cut workers' hours from full- to part-time in order to avoid the mandate that they provide insurance to those workers.

We know that work and marriage are key tools in moving from poverty to the middle class. Just 2.8% of those working full time are poor, compared to 23.6% of those without a job. Single mothers are five times more likely to live in poverty than those in two-parent households. It seems amazingly self-defeating, therefore, to set up a system that discourages both work and marriage.

While there is no easy answer to the poverty trap, we should recognize that every time we raise taxes, and every time we set up a new welfare program, we help trap people deeper into poverty. We may make that poverty a bit more comfortable, but we make it harder for them to get out.

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