HOW WELFARE AND TAX BENEFITS CAN DISCOURAGE WORK

JOINT HEARING

BEFORE THE

SUBCOMMITTEE ON HUMAN RESOURCES

AND

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

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HOW WELFARE AND TAX BENEFITS CAN DISCOURAGE WORK

WEDNESDAY, JUNE 27, 2012

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON HUMAN RESOURCES,
SUBCOMMITTEE ON SELECT REVENUE MEASURES,
Washington, DC.

The subcommittees met, pursuant to call, at 12:15 p.m., in Room 1100, Longworth House Office Building, the Honorable Geoff Davis [Chairman of the Subcommittee on Human Resources] presiding.

[The advisory of the hearing follows:]

HEARING ADVISORY

Davis and Tiberi Announce Hearing on How Welfare and Tax Benefits Can Discourage Work

UPDATE: NEW TIME
Wednesday, June 27, 2012

UPDATE: NEW TIME

Congressman Geoff Davis (R–KY), Chairman of the Subcommittee on Human Resources of the Committee on Ways and Means, and Congressman Pat Tiberi (R–OH), Chairman of the Subcommittee on Select Revenue Measures of the Committee on Ways and Means, today announced that the Subcommittees will hold a joint hearing on how certain welfare and tax programs can discourage work as a result of the high effective marginal tax rates they impose on certain populations. **The hearing will take place on Wednesday, June 27, 2012, in 1100 Longworth House Office Building immediately following the full committee markup that begins at 10:00 AM.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Witnesses will include experts who have studied how increased earnings may not yield additional income for families due to the complex interaction between earnings and federal tax and transfer programs. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

Low-income families often receive benefits from multiple welfare and tax programs, such as assistance with food, housing, and day care costs, help with medical costs, or cash payments to supplement earnings from work. While these programs often support and encourage employment, program "phase-out rules"—especially when combined across multiple programs—mean certain households may not be significantly better off if they earn more from work.

Economists have studied the interaction between earnings and benefits under various programs by focusing on what are called "implicit marginal tax rates," which refers to the portion of an additional dollar of earnings effectively lost due to rising taxes and benefit reductions. Due to implicit marginal tax rates that can approach or even exceed 100 percent when individuals receive benefits from multiple programs, it is possible that some individuals will be little better off financially—and in some cases even worse off—if their earnings increase.

This problem has been exacerbated by the addition of new programs and the expansion of existing programs over time. For example, the expansion of the Earned Income Tax Credit over time has allowed more households to claim this credit and has increased the benefit received by many households. However, these expansions also mean that more families face a higher implicit marginal tax rate as their earnings increase and the credit phases out. In addition, the Patient Protection and Affordable Care Act created a new subsidy to purchase health insurance that phases out as household income increases. As the phase-out of these healthcare subsidies interacts with other welfare and tax programs for families, the return from working will be even lower than before and individuals who increase their earnings may keep even less of their hard-earned money in the future.

In announcing the hearing, Chairman Davis said, **"Americans should believe with confidence that hard work pays off. However, because of today's many welfare and tax programs for low-income families, it is not clear that work pays—and in fact additional work may not actually result in additional income. Federal programs must send a clear message that work is always better than welfare. This hearing will allow us to explore problems with the current system and determine how we can ensure these programs can**

be improved to encourage families to increase their work and self-reliance."

Chairman Tiberi said, **"In recent years, Congress has increasingly used the Tax Code to provide means-tested benefits to low- and moderate-income Americans. These programs, however, are often flawed, imposing high marginal tax rates on those in the phase-out ranges as well as steep marriage penalties—thus discouraging both work and marriage. As part of comprehensive tax reform, this hearing will help the Ways and Means Committee reform these tax programs to make sure they reward work and honor marriage."**

FOCUS OF THE HEARING:

This hearing will focus on the interaction of various welfare and tax credit programs and how concurrent receipt of benefits from those programs can create perverse incentives that discourage work and higher earnings.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "Hearings." Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the online instructions, submit all requested information. ATTACH your submission as a Word document, in compliance with the formatting requirements listed below, **by the close of business on Wednesday, July 11, 2012.** Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721 or (202) 225–3625.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit materials not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone, and fax numbers of each witness.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above. Note: All Committee advisories and news releases are available on the World Wide Web at *http://www.waysandmeans.house.gov/*.

Chairman DAVIS. Good morning, everybody. Welcome to today's joint review of how welfare and tax benefits can discourage work. Before we begin our regular session today with opening statements, I would like to recognize a very special guest who is in Washington, D.C., the Right Honourable Iain Duncan Smith, Member of Parliament, the Secretary of State for Work and Pensions for the United Kingdom. We are truly appreciative that he has been able to adjust his schedule to join us today for a few minutes. The United Kingdom is currently undertaking significant reforms to its welfare and tax benefit programs to streamline their administration and reduce marginal tax rates so that work always pays.

This is an issue that I have cared about for many years. We have been watching many of the developments in Great Britain closely, as these reforms have been undertaken in what appears to be a very bipartisan manner, and he has graciously agreed to share with us information about these recent reforms in the U.K., which will be useful as we consider the effectiveness of our own programs.

Mr. Secretary, we did a little digging through our archives, and even with the help of the experts at the Congressional Research Service we are not able to find another example of a sitting Foreign Secretary appearing before the Ways and Means Committee on nontrade matters, so this is actually a historic occasion. We are honored to have you join us today. And please proceed with your statement.

STATEMENT OF THE RIGHT HONOURABLE IAIN DUNCAN SMITH, SECRETARY OF STATE FOR WORK AND PENSIONS, UNITED KINGDOM

Mr. SMITH. Mr. Chairman, thank you very much indeed. I must say it is a pleasure to be here. It is also rather satisfying in this surrounding. I am used to doing my answering across the dispatch box in the House of Commons, being screamed and shouted at by most of the others at the other side within almost arm's reach. So I am anticipating that not to happen here necessarily, but if it does I hope I will be able to handle it.

Can I just say that what we are trying to do in the U.K. is much the same as anywhere else, is trying to figure out what has been going on with a system that was set out to actually try and help people to become independent but actually traps them now in a form of dependency.

We saw spending on welfare increasingly rise by 39 or 40 percent under the last government at a time prior to the recession. So, during a period of growth, the economy was growing but we were also seeing welfare grow, which does seem to be rather peculiar. And what we saw here was a growing level of people who apparently just didn't work, a very large number who regardless of whether the economy was growing or not were out of the environment of work. That, to my mind, causes wider problems we must recognize.

It is not enough just to take people off benefits. Anybody can do that. The question you have is where do those costs then go, because they don't disappear. By that I mean, for example, even if you don't pay people benefits, you end up with a kind of creative underclass, and that underclass then becomes very expensive in other ways, in policing. We saw our policing bill rise by over 50 percent during the course of the last government.

Your health, this is where most of your serious health concerns exist amongst the same underclass. They are the biggest drawer on health care and they are also the biggest, the most likely group to be almost recording every kind of sickness you can possibly imagine. So health care bills are highest. And last of all, education is deeply disrupted by people from that underclass who themselves have no expectation or anticipation of proceeding. So their knock on, notwithstanding the cost in taxation, therefore is huge to all of us. And so handling and changing this is not just about reducing the welfare bill, which of course is critical, it is also about reducing those other costs that come as a result of having a group like this.

And so what we have chosen to do is to look at, first of all, one, the entrapment principle. That is to say the welfare system that you set up: does it free people or does it trap them? And what we believe is the system that we have inherited is so complex with so many different benefits, all being withdrawn from people as they go into work at different rates, some are 100 percent, some are 60 percent, some are 70 percent, as they go up the hours towards full time work, and some are gross, some are net, it is almost impossible for the benefit recipients to understand or calculate exactly how much they would have in their pocket after the withdrawal. And in some cases they are losing, in the case of some lone parents, up to 95–96 pence in every pound. So that basically means they get about 4 or 5 pence out of every pound they work for every extra hour, not much of an incentive and often very difficult for them to understand that they are better off or worse off. And they assume hugely that they are worse off, it is not worth the effort, and so they don't make the effort.

So the system itself doesn't incentivize people to do the right thing, it actually does the opposite. And we will see most of the money under the last government was transferred not to people in work, although it was not intended, but mostly to people out of work, particularly large families living in larger houses, often not two couple families. So a lot of the shift of money made it worse because if you receive more money, you are less likely to go to work. So we created a thing called the universal credit, which starts next year. That merges all the back-to-work benefits into one benefit, and it takes them away at one single rate every hour. So every hour you work, you will come off, in our case it is 65 percent. Now, that is a line that can be adjusted according to the government. They make that decision. It is about investing money or withdrawing money; it is as simple as that, rather like taxation. So that simplifies your understanding of benefits.

The universal credit is critical in two regards. One, the marginal reduction rates are dealt with by that single, flat taper. The other bit, which is the participation tax rate, is the moment you enter work, to my mind that is the critical bit. So people who have been out of work generationally, you need to get them across that threshold, number one. After that, keeping them in work, and I will come back to that, is critical as well, but get them across. Keep that cliff edge very low indeed so going across is very easy. So that decision economically makes sense. The universal credit is basically about that, simplification and making work. Always pays to be in work, not on benefits. So you are better off in work always than on benefits.

Secondly, we have a work program, which is de-risking government, but actually making sure that it does what we need it to do. So we hand to the private and the voluntary sector those who are being difficult to get into work. I don't care what they do, it is not my problem. I simply pay them only after they have got somebody into work. So it is a payment by result system. And there we actually pay them 6 months after somebody has been in work and come off the benefit register. They don't receive their money for 6 months so they need to keep them in work, which is really critical. It is easy to get somebody into work; it is very difficult to hold them in work. You need to hold them in work because only then do they get what I call the "work habit." Once they got the work habit they will then satisfy that thereafter. They will make sure they understand work. So 6 months, 9 months, a year, even up to 18 months in the case of the most disabled. So in other words, the rewards lie further down the chain for them, which means they need to work with people even after they have got them into work. And the lack of risk is because basically they only get paid after they do the job, not before. And we calculate that by how much money we save on benefits and therefore how much money we can pay them. It is a straight crossover in money.

The third area of our reforms, which is important, is looking at sickness benefits and disability. We had a massive problem that a huge number of people were trapped really on two benefits, particularly one, a sickness benefit, called incapacity benefit. If you are on it, you are ineligible for work. We had some people on these not seen by anybody for up to 10 years. And of course if you are on a benefit like that you are not working. It doesn't take the brains of an incredibly intelligent individual to understand that if you had a problem you certainly have a big problem 10 years later, so you get worse not better. So what we have now done is we are reviewing all of those and moving them onto a new benefit or moving them back to work. And the assessment is around about 10,000 or 11,000 cases a week. We are doing the stock right now, and we are finding something on the order of over a third of those who are assessing that were are not fit for work are now going straight back to work and they will go to a work program. Just a bit more than that are going to the middle bit of this new benefit, which is you will be able to get to work but you have some transitory problems. You might be in cancer treatment or something like that. But the expectation is you will be available for work.

And the third group of roughly about the same, about a third, is a group that actually there is no expectation of work because you really are genuinely too sick.

And then of course we will keep assessing people once they are on that other benefit every year to make sure that if they are getting better now so we can move them back to work, whereas before we never had a constant check on them. And the other one is a disability benefit, which is about your mobility and your care. We are reforming that because it got too wide, mostly through judicial review, of course where the judges have sat on the appeals and widened the case law. So we are now tightening that back up now to make sure the benefit goes to those who really need the money. And that is not work related. So in other words you can receive that in or out of work. So now we can work with people to make sure that they get back to work and the most disabled are able to work, which is after all what they really want. They don't want to be trapped out of work.

That is it in principle. There are a lot of other things, but those are the main things that we are doing.

[The prepared statement of Mr. Smith follows:]

Statement of Rt Hon Iain Duncan Smith, Work and Pensions Secretary
27th June 2012

Thank you, Chairmen Davis and Tiberi, Ranking Members Doggett and Neal, and Members of the Subcommittees. It is a pleasure to appear before you today, to share my views on the case for welfare reform in the UK and to offer an overview of the changes I am implementing.

The Government's inheritance

When the Conservative-led Coalition Government entered office in 2010, it faced an enormous problem. A country with a debt burden of 75% of GDP which was set to grow by 16% of GDP over the years to 2013, fuelled by one of the largest current account deficits amongst advanced economies.

Our budget deficit was larger than every economy in Europe with the single exception of Ireland and compared to US gross debt in 2010 of 99% of GDP, expected to grow by 12% of GDP over the same period. The last Labour government had in effect run a debt-based set of public finances, as spending on the public sector rose by 68.3% between 1997 and 2010.

This runaway government spending was a symptom of a wider problem, of a society built on debt and consumption rather than saving and investment. Partially fuelled by some government policies which encouraged spending over saving and hugely assisted by the incredibly easy access to cheap credit, the public borrowed more than ever before. Over the years, we seemed to become addicted to debt.

In the lead-up to the recession, the UK accumulated one of the highest rates of personal debt in the whole of Western Europe: around £1.4 trillion – some 98% of GDP – even before the recession started. That compares to £9.1 trillion in the United States, equivalent to 120% of GDP. Interestingly, in Spain, personal debt stood at around only 83% of GDP.

We embraced a culture of 'live now, pay later' and looked to future generations to pick up the bill. The fact is that debt-fuelled booms feel good while they last, but like all addictions the detox is long and painful.

There were two main reasons why the last Labour Government found themselves in this situation.

The first reason for this economic crisis was that we had become too reliant on financial services. This once great manufacturing nation had given up on the idea of being a world leader in production.

Over the last decade, manufacturing as a share of total output in the UK declined from 14% to 10%. 10 years ago, 1 in 4 jobs in the UK was in manufacturing, today it's less than 1 in 5 – a decline of 6 percentage points as a proportion of the workforce. The UK too easily believed a modern western economy couldn't compete in manufacturing.

However look at Germany. Their record shows that after their labour market reforms in the first decade of the millennium, their productivity rose again. Over the same period, Germany's manufacturing has grown such that it has managed to maintain a much higher 22% share of its economic output. Equally, although the USA experienced a decline in terms of manufacturing as a proportion of the national output, in the last decade the sector grew by some 23% from around $1,500 billion to $1,800 billion.

The second important reason was that the last Government lost control of welfare spending. They sought to micromanage the system and the result was a benefit system of such fiendish complexity that too many chose a life on benefits over work. This was compounded by a lack of conditionality so far too many were able to sit on benefits unchallenged, and was made worse by the pursuit of a poverty target which cost more and more just to stand still. The safety net had become a cage.

The welfare challenge

Take some of the figures we were confronted with when we came into office: 5 million people – some 12% of the working age population – on out of work benefits, 1 million of them stuck there for a decade or more. 1 in every 5 UK households had no one working, and almost 2 million children were growing up in workless families. This was the cultural challenge we faced – entrenched and intergenerational worklessness and welfare dependency.

This problem was not just a product of the recession, as some might have us believe. In the UK, we had over 4 million people – 11% of the working age population – on out of work benefits throughout the years of growth.

Under the previous Government employment rose by some 2.5 million, yet more than half of that was accounted for by foreign nationals. To be clear, this is not a point about immigration, rather the facts serve to remind us that we had a huge challenge with our workforce at home.

Put simply, it was a question of supply and demand. Large numbers were on out of work benefits, yet many were unwilling or unable to take advantage of the job opportunities being created. This is an issue that I understand may have some relevance in the USA too, where according to the OECD, the inactivity rate actually increased by 2 percentage points from 22.6% to 24.6% in the decade between 1998 and 2008.

So what we need to achieve in the coming years is not political and technocratic welfare reform, but internal and external cultural change.

To explain what I mean let me start by taking you back to the early 1940s, when William Beveridge was laying out his vision for the modern welfare state.

A great economist and social reformer, appointed as Under-Secretary in the Ministry of Labour during the war years, Beveridge was driven by a desire to slay the 'five giants' that he identified in society at the time: want, disease, ignorance, squalor and idleness.

But he was also clear about the risks that were attached to this laudable cause. He warned that:

> *"The danger of providing benefits, which are both adequate in amount and indefinite in duration, is that men as creatures who adapt themselves to circumstances, may settle down to them."*

And he was clear that the system should not be allowed to *"stifle incentive, opportunity, or responsibility"*.

In other words, Beveridge was focussed on the kind of culture that the welfare system could underpin. Would it be one that fostered a society where people took responsibility for themselves and their families, and treated welfare as a temporary safety net in times of need, or one that conditioned people to grow dependent on state support, and in turn treat it as a long-term crutch? His fear was that if the balance was wrong it would lead to the creation of a semi-permanent underclass.

Beveridge's warning went unheeded and our welfare system received little more than a patch-up job, under an incredibly reactive process. A new challenge would emerge in the system and Government would respond by tweaking things, adding new rules, new supplements, even new benefits. But it was all built on a creaking edifice, and the result was a system of monstrous complexity. More than 30 different benefits, complicated by additions within each benefit.

This was then compounded by the fact that when an individual started work part time, they found it impossible to calculate if they would be better off or not. Some of their benefits were withdrawn at 40% as they moved into work, some at 65%, some at 100%; some net, some gross; some only available at 16 hours, some at 24, some at 30.

Feed all of that into a complicated computer system – because no normal person can calculate what it all means for their income – and something extremely damaging happens. People on low wages lose up to 96 pence in every pound they earn as they increase their hours in work. In other words for every extra pound they earn, 4 pence goes in their pocket and the rest goes back to the Government in tax and benefit withdrawals.

So suddenly you have a system that is incomprehensible to those that use it, except for one thing that seems clear – it's not worth the risk of working.

Debt and consumption

As a result under the last Government, the amount spent on welfare was remarkable, increasing by 40% in real terms even in a decade of unprecedented growth and rising employment. In 2009/10 alone, around £90 billion was paid out in benefit payments to working age people and their families – about the same as the entire education budget. Yet even as money was poured in, scant attention was paid to the results the other end.

Take the example of child poverty, where in the years from 2003/04 to 2010, there was an almost £30 billion increase in welfare spending and £171 billion paid out in tax credits – that's to say benefits for those in work but on a low income. Yet over the same period, there was no actual reduction in child poverty. Labour spent all this just to keep the poverty rate flat.

So too in healthcare, in crime, in education, where Government paid out to manage and maintain social problems, rather than tackling them at their root.

This is a culture marked by an obsession with inputs – with pouring money into social programmes – so that governments are seen to be doing something. Of course big spending is attractive because it brings big media headlines. But my concern is that no one asks what will come out at the other end, in terms of what impact the spending will have on people's lives.

So we are now faced with a fundamental challenge. Levels of social breakdown high and rising; millions of people stuck out of work on benefits; millions not saving nearly enough for their retirement; and politicians – of all hues – addicted to spending levels as a measurement of success, rather than life change as a measurement of success.

These are areas ripe for reform, but how do you reform when there is no money? The answer – you change the way you reform. Not just cheese-slicing, but recalibrating whole systems so that you change behaviours, and change the culture that allowed spending to get out of control in the first place.

This is absolutely critical. When welfare spending balloons, as it has done, the temptation for successive governments has been to squeeze it back down again. But rather like a balloon, when you squeeze it at one end it will tend to grow at the other.

So whilst savings must be made, they must also be sustainable. Otherwise, once the public finances are back in order, and the economy grows again, so the bidding war starts once more. Lobby groups put pressure on government to spend more. Government in turn dip its hands into taxpayer pockets to buy media headlines, and the vicious cycle continues.

Welfare reform

Structural change, leading to cultural change, is the key to this dilemma. In other words you have to tackle the demand itself, changing the effects of welfare by changing the incentives in the system.

My belief is that everyone in the welfare system should be on a journey – it should be taking them somewhere, helping them move from dependence to independence.

So if you are looking for work, the system should make work worthwhile and it should both support and encourage you. If you are a lone parent the system should support you with your caring responsibilities while your child is young, but it should also keep you in touch with the world of work and ensure at the earliest opportunity that you move back to the world of work. What we will not do is put anyone on benefits and then forget about them, as was so frequently the case for those on sickness benefits in the UK.

But if a journey for people is our purpose, we have to recognise that our current welfare system is not fit to provide it. That's why we are reforming it in a way that brings welfare spending back under control, whilst changing lives at the same time.

Universal Credit and the Work Programme

But as we reform, we also have to recognise a simple fact. Not everyone is starting from the same place. There is no point assuming, for example, that everyone understands the intrinsic benefits of work, the feelings of self-worth, or the opportunity to build self-esteem. If you are dealing with someone from a family where no one has ever held work, or no one in their circle of peers has ever held work, there is no point in simply lecturing them about the moral purpose of work.

What you must tackle is the biggest demotivating factor that many people face – the fact that the complexity of the system and the way it is set up creates the clear perception that work simply does not pay.

Thus, after generations in key communities, worklessness has become ingrained into everyday life. The cultural pressure to conform to this lifestyle is enormous, underscored by the easy perception that taking a job is a mug's game. It is this factor which can stop someone's journey back to work in its tracks.

Changing this is what the Universal Credit and the Work Programme are all about.

Universal Credit is a new system we are introducing from next year, which will replace all work-related benefits and tax credits with a single, simple, payment. It will be withdrawn at a single, constant rate, so that people know exactly how much better off they will be for each extra hour they work. This rate will be significantly lower than the current average, meaning that work will pay for everyone, and at each and every hour.

This requires investment up front and we are spending some £2 billion to get it right. But if we do so, and start reaping the effects of cultural change, it will save government huge amounts down the line, as workless households become working households.

But Universal Credit alone is not enough. When you are dealing with people who are a long way from the workplace, who do not have many skills, and do not have the work habit, you need to provide a system that supports them and helps them to get work-ready.

That's what we are doing with the Work Programme, and we have asked some of the best organisations in the private and voluntary sectors to deliver it for us.

They are tasked with getting people back to work, and then helping to keep them there. They are given complete freedom to deliver support, without Government dictating what they must do, through what we call the 'black box'. That means trusting that these organisations are best placed to know what works.

Universal Credit and the Work Programme are two sides of the same coin. Either without the other would not have the same impact, but together they will become formidable tools for taking people on this journey.

Through the two, we are creating a contract with clear obligations. Each unemployed person will understand that we support them to find work and ensure they are better off in work than they are on benefits. In return, they are required to be permanently work ready, attend interviews and try to get work and take work when it is offered. Failure to comply and we take their benefit away – for 3 months the first time, 6 months the second time and 3 years the third time.

The wider reform agenda

More than that, we are capping the total amount an individual can earn whilst on benefits so that even if different benefits add up to more than the cap, they don't get it. Yet this isn't about punishing people, rather it is about removing a major stumbling block as people try to move back to work.

Under the system we inherited, some people with large families on Housing Benefit were living in areas with incredibly high rents. It was actually possible for families to claim over £100,000 a year for help with housing costs in certain cases, and on top of that they received other benefits. Well from next year this will no longer be the case. No matter how the different benefits add up, claimants will not receive more than average earnings.

We are also reforming the culture that allowed people to avoid work by languishing on a sickness benefit for years – almost 1 million for a decade or more.

Large numbers are being checked – of some 130,000 initial outcomes, 37% were found fit for work and some 34% were placed in what we call the 'work-related activity group', ready to move back to work when their condition improves. So more than 70% who once would have languished unseen on a sickness benefit, will now be engaged on a journey to independence through work.

We are plotting out a journey in our pensions system as well, except here we are looking to set people on a journey to a decent and sustainable retirement whilst also reducing the pressure on the public purse.

We are pushing ahead with plans to automatically enrol all of those without pension coverage into pension schemes to make saving the norm, and we are making progress with plans to radically simplify the State Pension system – creating a 'single tier' pension which is set above the level of the means-test, so that people know that it makes sense to save.

Together with raising the retirement age alongside rising life expectancy which alone will save around £90 billion, these measures are set to deliver enormous savings to the exchequer in due course.

Cultural change

This is not just welfare reform, rather cultural change. The end of the something for nothing entrapment and the renewal of a welfare system that should be seen as a means of temporary support, the beginning of a journey back from dependence to independence.

We are already seeing positive signs that this cultural change is beginning to happen. Though the overall economic outlook is still poor, the jobs figures for the last 3 consecutive months in the UK showed some encouraging signs of stability, particularly stronger than expected growth in jobs from the private sector.

Latest statistics show that even with a big fall in public sector employment, private sector employment was up 205,000 on this quarter. There are now 419,000 more people in work than in there were when this Government came into power in 2010.

What's more, the total number on out-of-work benefits is down by 80,000 in the same period because of the changes we have introduced to get more people looking for work and into the jobs market. We are reassessing claimants on old incapacity benefits at a rate of 10,000 people a week, and with a further reduction in the age limit for single parents with young children claiming what we call 'income support', almost 100,000 lone parents have moved off inactive benefits since 2010.

In this year, we have reduced the economic inactivity level to its lowest since 1992, and we will get welfare inactivity down even further, as our other reforms start to bite.

Just take the changes we are making to cap Housing Benefit. Research published this month shows that of those Housing Benefit claimants affected, a third said they would be looking for a job in future.

This is what I mean by dynamic reform – creating a welfare culture that incentivises work and promotes independence over dependency. In other words, reform that is not just about the benefits system, but about social renewal, part of a wider vision for stable families, with educated children, growing up in areas of low crime.

Government spending

Yet there is one final piece to the puzzle. I have covered what I call external cultural change, change in society at large. But we must also achieve an internal cultural shift, changing the culture of government spending.

It is here that I think we still have much work left to do. We have to reject the old focus on inputs – the old mantra which says that 'more spending equals good, less spending equals cuts…which equals bad' – and open up a whole new dimension, one focussed solely on the impact that spending has on people's lives. That means changing not just how much we spend, but how we spend it.

So let me return to the example of the Government's Work Programme, where we have been pioneering the use of payment by results. While supporting someone into work obviously has a cost attached, you find that cost is quickly outweighed by the reductions you can make to the welfare bill when you get someone back into work and paying tax. The key point is that we use these future savings to pay for the Work Programme now.

We do that by putting the onus on the 18 Prime Providers who compete to deliver the Work Programme in different parts of the country. They raise the money to deliver the programme alongside their subcontractors; we then pay them when they deliver the results. That means first, getting people back into work. But from day one we've been clear that getting people into work on its own isn't enough. If people do not have 'the work habit' – in other words they are not used to the workplace, or convinced that working is right for them – the risk is that they will soon fall out of employment again. So the providers get the biggest payouts when they keep someone in work for 6 months, one year, 18 months, or up to two years in some cases.

Because we are paying for results we will only pay for what works, therefore hugely reducing the risk on the taxpayer, and we make sure that every pound is only being paid out because it has a positive impact on people's lives.

A payment by results system works best when the timescales for success are short and the metrics relatively straightforward. But in addition to Payment by Results there are other areas as well. In particular, we are really trying to open up the social investment market.

I see this as a huge opportunity to get much more private money working in pursuit of the social good. Historically it has been assumed that people could either be 'good citizens' and put their money into charitable works, whilst not expecting anything in return, or they could be 'profit maximisers', who invest their money in commercial ventures and have to forget about the social consequences. Social investment is a way of uniting the two – it is about saying to investors: 'You can use your money to have a positive impact on society, AND you can make a return.'

But to get this investment you need to have programmes that are tested and accredited. That then allows you to create a social bond that people can invest money in.

That is why we have we have agreed to establish an independent foundation that will accredit programmes of work and provide a rigorous assessment of their likely social returns. It's why we're testing a variety of cutting edge programmes through our Innovation Fund, which will help build the evidence base around social investment models, and it's why we have launched Big Society Capital, capitalised with £600 million, and tasked it with the sole mission of growing the social investment market.

This market may still be in its infancy, but I believe it has huge potential. First, it has the potential to greatly increase the amount of funding available for social programmes by bringing in private investment money.

Second, it brings a whole new level of discipline and rigour. Too often in the past good, proven programmes have been introduced by Government but haven't worked.

This isn't necessarily due to a problem with the programme itself, rather it is because as the programme has trickled through the system bits have been added or subtracted, modified and changed, so that in many cases the programme has been neutered.

Why? Because when Government care more about inputs than outcomes it doesn't have much interest in whether the programme actually works. Once it is underway the nature of the programme itself becomes largely irrelevant.

But if the money follows the outcome – as it does with payment by results, or with social investment – we can bring a whole new level of fidelity to the way that civil servants, local authorities, and government at large do social programmes.

It is my personal that if we can truly grow the social investment market it will mark the single biggest change to the culture of spending in Government.

Social renewal

So the prize could be enormous if we get all of this right: cultural reform of society, and of government, in a way that restores effectiveness in public spending, and restores the idea of mobility in our welfare system. In other words restoring the idea that no matter how hard things get for you we will be there with you to help you on an upward path.

But we've got to lock this process in, and as with the process of making savings that I spoke about earlier, it has to be done in a sustainable way or the problems will pop back up again just a few years down the line.

That means we need to change the incentives in the system. In welfare that means understanding that work has to be seen to pay, and people have to know that there is support available for them. In Government, it means making the money follow the outcome.

Through this process, and through the tool of social investment, I believe we can achieve something else as well. We can start to lock those at the top of society back into to our most disadvantaged families and communities at the bottom. We can get our biggest and best business people bringing their time and their skills to some of society's most intractable social problems.

Ironically, perhaps, it has taken difficult times to create a driver for change. When the economy was growing it was just too easy to say 'not now, but later'. For after all, this does involve very tough choices.

But as we try to reshape our economy, and revitalise and refloat the entrepreneurial spirit that has historically characterised the citizens of this global trading nation, we must accept that we will fail unless we can lock all in society to the benefits of this change.

I believe the economies are beginning to show that more manufacturing will return to modern western societies if they have the skills to make it work. Technologies and the best of transport offer a new opportunity to revitalise our countries as manufacturing hubs of sophisticated goods.

None of this will happen unless we reform our societies, so that those now left behind are enabled to play a full part in this future.

Chairman DAVIS. Thank you very much. I appreciate you sharing some of the challenges you are dealing with and we certainly are going to be dealing with in the very near future with addressing processes, and quite a bit of it is unknown.

I mean, for me it is ironic having you here. I went to the British parachute school at RAF Brize Norton 30 years ago as a U.S. army paratrooper on an exchange. And one of the more interesting aspects was having to jump out of an old barrage balloon to find out if the parachute worked. It was the longest opening time I ever had. We are glad to watch you take the first jump so that we can learn from some of these reforms.

But as we face these challenges, unemployment rates in both our countries are elevated, fewer people are working or looking for work, there is increasing family breakdown that leads to some of the social problems and financial costs that you alluded to that you are dealing with in your own jurisdiction. And given these factors it is critical that we develop approaches to integrate our processes to more effectively serve people, an issue I have cared about having grown up in a single parent home and I was on a form of assistance as a child as well, not meeting my father until I had been in the Army for 7 years. I am very interested in how you bring people over or avoid this cliff of falling off when they want to go back to work and they find disincentives.

I was wondering if you could elaborate for us on how your reforms are meant to address each of several issues; unemployment and work, family breakdown, and the need for budgetary discipline from a governmental perspective in terms of handling this, and I also understand that wage data is playing a key role in these reforms and I was wondering if you could comment briefly on how the wage and other data are being used to design and operate this new system.

Mr. SMITH. Again, the reason was family breakdown. Family breakdown was the main reason why people found themselves in what we describe as poverty. I have this big debate about how it is not relative income so much that looks at that income, it is not relative income about poverty that is the key. It is what leads you to the position of being unable to earn money for yourself as a household. And those are the things like family breakdown, failed education, debt, drug and alcohol abuse and then your dependency on the state.

So those areas need to be wound into any kind of assessment, because your lifestyle usually has a bearing on what is likely to happen to you. And here is the point about family breakdown. We therefore need to do a lot more in advance about the dysfunctional family life which exists in many of these areas. So early intervention has got to be the key to this to put particularly young dysfunctional mums and their families right so the kids are right early on. And secondly, really to look at families on the edge of breakdown, so we are now investing money into help and support from most the voluntary sector, etc. to help stabilize families before they break down rather than spend the huge sums we do picking up the pieces afterwards. It is estimated over 20 plus billion pounds a year we spend on the after effects of breakdown, whereas it is known if you put a bit of money into this you can restabilize families who are often on the edge but don't then break down and the children will benefit.

So that is a huge shift to where you put your money to focus on solving breakdown rather than dealing with the after effects of it.

On the issue about how the system works in terms of employment, the reality that we have here is that right now we know what the static levels are for benefits. So what we are simply saying is that as people go in from benefits into work, the levels they achieve in work for each hour should mean that their income is higher throughout that work process and demonstrably higher than it is when they are on benefits. So the universal credit is interesting because by and large it shifts some of the money down to the bottom end, that is to say, the early hours, because we think that going into work is the biggest issue. And then moving up the hours is the secondary issue of importance, you know, your marginal deduction rates. So the participation tax rate, that bit going in, you need to get that cliff edge right down so that they are always on an upward curve in income. And that starts literally at hour number one.

Now, that will hugely benefit, for example, lone parents who we want to go to work because we think it is good for them and their children after a certain point, quite rightly, that their children realize work is a part of life and a part of your future and they see somebody from that household working. So a lone parent household it has to be them, if it is a two couple household somebody else. So the early hours are really important because they may match that with some of their caring, but that needs to pay. And to keep them in work is important.

So that is really how the economics of this works, which is as they get paid, the withdrawals are lower, particularly in the early sector. And you do that by what I call disregards. So as they enter work, each category of persons, a lone parent, will have an amount of their income disregarded before the taper, so they can earn so much. A very disabled person will have a bigger disregard than the taper. Someone who is able bodied and young will have a very small disregard for the taper. And the lone parent will have a disregard slightly bigger than that and then the taper. The taper is the same for everybody, but the disregard evaluates what your particular level of need is for you to actually make that income work for you. And that is where most of the money is therefore concentrated on the investment but then takes them up the chain. And this will allow us later on to look at in work conditionality.

Chairman DAVIS. Thank you very much, Mr. Secretary. I would like to recognize my friend and the ranking member of the Human Resources Subcommittee, Mr. Doggett of Texas.

Mr. DOGGETT. Thank you for your insightful testimony. As I understand it, this universal credit is a new approach that you are just beginning to pilot or implement?

Mr. SMITH. That is true, that is correct. It goes live in October next year. We are building a new software system and everything else. And we are doing some early advance work on it starting at around about April next year in some key areas. Not trialing it, but running it out early in some key areas to see what the glitches are.

Mr. DOGGETT. Is the goal that once you resolve any of those glitches to have uniformity across the country, so you wouldn't have a different policy in Wales from Greater London or in Greater London from Northern Ireland?

Mr. SMITH. Not in terms of the basic structure of this, no, but how it is delivered later on it could be a very localized delivery. Right now, we will be doing it as a national delivery until it is bedded in and then we are open for discussion about whether that could actually be localized.

The key to this benefit, by the way, is that we also have to change the way we report on taxation. So alongside this is a big change to create what is called a real-time information system on our tax base. Because as someone goes to work under the present system, the tax authorities predict that they earn a certain amount of money. We know in part-time work that hours change, so it is not the same as the prediction. So you are expected as an individual to report your hours changes back to the authority so they can readjust your support through the tax credit as it exists at the moment.

The problem is you are coming from a group that really doesn't like authority very much, doesn't really understand it and gets confused. You forget to do this. Some might deliberately not do it, others forget. So they go on to pay you too much money over the year. The end of the year they turn around and say, oh, we have overpaid you, now we need to reclaim that money and take it back. But of course you are dealing with a group that spends every penny that you give them immediately. What the real-time information system will do with universal credit means every month we reconcile. So if your hours change, we don't even need you to tell us because the business reports that in their immediate report and then it just adjusts automatically. So now we say, hold on, his hours were down last month, we will adjust the payments this month.

Mr. DOGGETT. Are your projections that overall this will cost more to your national treasury to have this universal credit or less?

Mr. SMITH. We are investing money to get it in, but once it is in, you will more than save that money back because of two key features. The first is the point I was making, huge levels of fraud and huge levels of error that are costing billions in the system; they will be eradicated.

Mr. DOGGETT. How much more are you investing over the short term?

Mr. SMITH. Over the 3- or 4-year period we are averaging about $2 billion a year of investment. And then, as I say, once that is bedded in, after that that is where you start. Or you will be making your returns immediately, because we think we will more than offset that even as we are bringing it in through the savings we make through the error and fraud alone that exists in the present system.

Mr. DOGGETT. One of the obstacles that we found in this country to people moving freely from one job to another or moving from a job to setting up a small business is the lack of access to health insurance. Is it your feeling that access to health insurance in the U.K. is helpful to promoting employment?

Mr. SMITH. Well, our system of course is fundamentally different from what you have over here.

Mr. DOGGETT. Yes, it is.

Mr. SMITH. We have the National Health Service and therefore everybody gets access free at the point of delivery.

Mr. DOGGETT. You don't have any barrier to employment from people being locked into an insurance policy at one job and fear of losing it if they move to another setting up a small business.

Mr. SMITH. People do have private insurance, but I don't think it plays anything like the part it would play here because of that level of basic health care that they get. I am not, by the way, entering the argument about whether you should have anything similar here.

Mr. DOGGETT. What we have and what has been adopted here is very dissimilar, but it does reduce that job lock. And of course when we were considering it, one of your European parliamentarians was on Fox News telling us what a horrible system there was over there. He was repudiated by Prime Minister Cameron who referred to your health service as a great national institution. Is it still a great national institution in the U.K.?

Mr. SMITH. Yes. That is being reformed at the moment. There is a big, big change taking place. We have just put some reforms through to make it much more responsive to what people actually need and to make sure the money that you spend is focused, although overall we spend less money on health care than you do over here.

Mr. DOGGETT. Well, I agree with the concept of reform but not with repeal so that we have access to health insurance for our workers here. And thank you for your testimony.

Chairman DAVIS. I thank the gentleman. And the chair now recognizes Mr. Boustany from Louisiana, the chairman of the Oversight Subcommittee.

Mr. BOUSTANY. Thank you, Chairman Davis. Welcome. It is great to see you here today, and we appreciate the tremendous work you all are doing to reform this complex system in the U.K. to really align the incentives, to make sure that work actually pays and that those who are receiving the benefits will understand that moving, crossing that threshold to get to work is where they need to go, and of course how do you keep them in employment.

I want to focus on a slightly different part of what you were doing with reforms. I think it is called the work program. And it is a system of delivering employment services to these individuals. And as you restructured the benefits, the structure of the welfare benefits and tax benefits, you are also looking at your delivery system for these benefits. And my understanding is you have ways to leverage nonprofit organizations, certain private organizations, not only to help these individuals get into the workforce but stay in the workforce. Could you elaborate on this program?

Mr. SMITH. We describe the work program, which I think is unusual for two reasons. The first is that it is a payment by result system. So the risk is not taken by the taxpayer, the risk is taken by the private and the voluntary sector who actually run the program. So we don't pay them until they have got somebody in work and kept them there for a minimum of 6 months. And then after that they get further payments the longer they are in work.

The second point about this is that we also call it a black box system. By that I mean simply it is not my job to tell them what they should do, it is their job to figure that out and do it. This is where the voluntary sector comes in. The prime contractor, there are 18 of them in different areas, and they will have underneath them different subcontractors, some private, some voluntary. There is a lot of voluntary sector. And they tend to be the organizer, they will use to deal with systemic problems that an individual has. For example, somebody who, and we know this by knowing what prisoners are. They have no ability to read or write, a reading age of

10, even age of 11. If you get somebody in front of you like that, no good trying to put them straight into work because they simply won't stay in work because they will fall out at some point because they are incapable of doing half of the jobs. They can't read the signs. So what they will have to do is back load them very quickly to some organization, probably a voluntary sector organization that does remedial education work, enough to get them to the point where they can actually hold a job down, and then they take them through to work. So they have to invest a bit before they start to get them into work and get them paid. And that is how the process works. For the easy ones that just need to be attached and sorted, well, they will go through quickly. But it is these more difficult, and by the way, they get rewarded at a high level for those more difficult ones, and that is how it works. So the risk is taken by the private company who is the prime. They don't flow the risk on down to the voluntary sector, so the voluntary sector gets paid at a slightly lower level, but nonetheless it all works for them in terms of their total reward.

Mr. BOUSTANY. This was a big departure from past practice.

Mr. SMITH. Huge. It is a complete departure. In fact, I think it is the biggest anywhere in the world that I can be aware of where we are doing a payment by results program. It is now national, and we are not quite into the first year. And it is a 2-year program, and we have targets for them. And if one of the primes fails and doesn't achieve the results then simply we will get rid of them and somebody else will come in. So we keep the risk away from the taxpayer, very much on the provider, and in turn it is in their interest not just to get them to work, and I think I also mentioned this, holding them in work. And that is the bit that is being missed by endless government agencies, which is you churn massively after about 7 or 8 weeks, because if they are not right for work then they will not stay in work. And therefore what happens is they churn out. It is very expensive then because you are chasing them after that. Then they are less likely to go back to work later again because they got scarred. So when you get them once, you got to make it tell once. And so that means that the provider has to check on the individual who is at work constantly to see if they have any problems and deal with them and then hold them and talk to the employer if necessary to hold them in that job.

Mr. BOUSTANY. Well, I thank you very much. That is excellent work. And hopefully we will continue to learn from the experience that you have there in the U.K.

I yield back, Mr. Chairman.

Chairman DAVIS. Thank you. The chair now recognizes Mr. Neal from Massachusetts.

Mr. NEAL. Thank you, Mr. Chairman. Mr. Secretary, just to follow up a bit on what Mr. Doggett had to say. One of the reasons that data suggests that the Welfare Reform Act of 1996 here worked was in some measure because we added a number of mitigating issues to the overall package, including job training, childcare, and not to miss the point people were able to keep their health insurance. That had a profound impact on that flexibility that Mr. Doggett noted.

Now, I am not going to trespass into domestic politics in the U.K., but I think that just having observed from 3,000 miles away the Prime Minister during his election cycle, he actually suggested a much more radical transformation of the health care system in the U.K. than he was actually able to deliver on. And I understand that because that is just the reality of what happens. But I think as a follow up to what Mr. Doggett pointed out, I think the Prime Minister probably discovered that the health care system in the U.K. was pretty popular.

Is that a fair statement?

Mr. SMITH. Yes. You've got to understand, seeing it from the standpoint of the U.K., which it is quite different from where you are here. There is no question the health service because of its basic principle, which is that no matter what your means you will always be able to get treatment at the point you need it without any request or requirement for money. So that is and was a big change. It is now ingrained in people's psyche. And it is a very emotional point to lots of people. So they are very wary if you play with that because they don't want to see that shifted so they would have to start having to fork out for treatment. So that is the big balance.

But on your point . . . you know, we are a coalition. I am in a coalition that is not wholly conservative, so we sometimes have to cut our cloth according to what we can do in parliamentary terms. But the reforms that we have gotten through will make a big difference to recentering where that decision making should lie much more with those who are responsible for the treatment, and also knowing how much that treatment costs and bearing down and understanding how that money is spent better.

Mr. NEAL. Good point. And let me flip that argument. One of the problems that we ran into in 1996 was the suggestion I think that was fairly accurate that for many people who were receiving public benefits, they stayed with health care through the Medicaid system. The problem in some measure was that two people conceivably living next door to each other, one, who went to work every day and did not have health care benefits, came to resent the person who was receiving a public benefit and keeping the health care benefit. So those mitigating circumstances that I referenced earlier about a level of maintenance for health care in your instance seems to give you a little bit more room or flexibility in terms of experimenting.

Mr. SMITH. It possibly does. The only comment I would make on that is we all as politicians make this argument that I don't know where I am going but I know I wouldn't start from here is always our biggest point. So dealing with our position as to where we are, we obviously don't have that issue about health treatment in the two houses living next door to us. But we do have issues around welfare. And that resentment in welfare is a big issue right now in the U.K. where someone going to work on low and marginal income looks at the house next door with the curtains closed and realizes they are earning pretty much what they are already earning but they are not working because they have got a larger family or because they are living in a larger house. So that resentment does exist. It tends to exist for us in the welfare system. And a lot of people in work are now deeply resentful of those who are not in work. And so this is where our cultural shift is rather than on health care.

Mr. NEAL. And lastly this morning in Belfast Martin McGuinnis, who is an old friend of mine, and the Queen shook hands. And it is a lot of people like me to participate over 35 years in all these it will never happen moments to witness these huge changes. But as you noted in an earlier conversation that we had, there are still very stubborn elements, smaller in number year after year, who still are rejectionists. But as one who is very knowledgeable about the Shankill and the Falls Road in Belfast, the link between poverty and high rates of unemployment and violence. It was the best, I shouldn't say the best, but one of the best recruiting tools for the hardest men and women in those neighborhoods to organizations who sought destiny as never finding a common moment.

Mr. SMITH. Yes. My comment would be this really. First of all, I was a soldier. I was in the Scots Guards many years ago. I served in Northern Ireland so I have firsthand memories of some of the violence. I lost friends who have been killed in subsequent service in Northern Ireland. No one is happier than I am to see the possibility of peace in Northern Ireland. It has been a dreadful running sore in the United Kingdom for far too long.

But you are right about the cocktail. There is a very peculiar cocktail in parts of Northern Ireland where you overlay deep deprivation also alongside peculiar religious division and a lot of residual violence. And some of those are still in place today when I visit some of those communities, and breaking those down is a very big job, but we are making strides towards that. But, yes, hugely obviously deprivation has a part to play in it.

Mr. NEAL. Thank you.

Chairman DAVIS. I thank the gentleman. Mr. Secretary, again we thank you for taking time out of your busy schedule to come and share some of your experiences in the United Kingdom. We are going to continue to monitor your progress closely and we look forward to learning from what you are doing and to continuing this dialogue. Thank you again.

Mr. SMITH. Thank you, Mr. Chairman, for the opportunity.

Chairman DAVIS. As the Secretary departs, I would like to thank all of my colleagues for their unanimous consent in altering our normal agenda with opening statements until afterwards to accommodate the Secretary's time. I would like to proceed with opening statements. And now I will begin.

Today's joint hearing is on disincentives to work built into current welfare and tax credit programs in the United States. As we have already heard from Iain Duncan Smith, the Secretary of State for Work and Pensions in the United Kingdom, other countries are wrestling with these same issues. Secretary Duncan Smith's presentation, as well as the testimony of our witnesses today, will help us as we consider making changes on this side of the Atlantic as well.

Two weeks ago, when President Obama spoke in Cleveland, Ohio on the state of the economy, he talked about his vision for how we need to provide ladders of opportunities for folks who aren't yet in the middle class. Today we will consider whether the multitude of current welfare programs and tax credit programs create effective ladders of opportunity or are missing important rungs by effectively discouraging work and higher earnings for millions of families.

To explain this complicated topic one of our witnesses, Mr. Clifford Thies, describes an income dead zone in which a family earning $40,000 per year is barely better off financially than a family not working at all once all welfare benefits and tax credits are taken into account. Other experts like Harvard economist Greg Mankiw call this phenomenon a poverty trap. He says the bottom line is if you are poor, the government is inadvertently ensuring that you have little incentive to try to improve your condition.

What it really boils down to is this. When government benefits for low-income families and as their work and earnings increase, that discourages more work and earnings. The more benefits the government provides, the stronger the disincentive to work harder and earn more. Ironically many of the programs in question like TANF and childcare, in our human resources jurisdiction, are designed to alleviate poverty while promoting work. However, especially when combined with refundable tax credits that have grown rapidly in recent years, the collective weight of these programs can have an unintended side effect of discouraging harder work and higher earnings. This is not a new problem, but it is about to get a lot worse. The massive new health insurance subsidies under the Democrat's health care reform will expand this problem and extend its reach well into the middle class affecting families earning up to $90,000 for a family of four. According to the National Center for Policy Analysis, the exchange subsidies under ObamaCare will yield marginal tax rates over a broad range of low or middle incomes that are always above 55 percent, usually above 60 percent, and sometimes above 70 percent. Those are some staggering numbers. But as we will learn, for some people, the implicit marginal tax rate can actually exceed 100 percent. That means the family is actually worse off when their work and their earnings increase.

Here is how another Harvard economist, Jeff Liebman, advisor to President Obama, describes the story of one woman who went from earning $25,000 a year to $35,000 and could not make ends meet anymore as a result. "She lost free health insurance and instead had to pay $230 a month for her employer provided health insurance. Her rent associated with her Section 8 voucher went up by 30 percent because of the income gain, which is the rule. She lost the $280 a month in a subsidized childcare voucher she had for after school care for her child. She lost around $1,600 a year of the EITC. She paid payroll tax on the additional income. Finally, the new job was in Boston and she lived in a suburb so now she has $300 a month of additional gas and parking charges. She asked me if she could go back to earning $25,000." He estimated that the government imposed a 130 percent implicit marginal tax rate on her.

We look forward to all of the witnesses' testimonies today, including possible solutions, so Americans have more, not less incentive to work and support their families. This is an issue I have personally wrestled with for many years, first as a volunteer before coming to Congress and trying to find a way to build a bridge that would smooth this transition to work without creating a cliff, particularly for single parent families that are trying to make a go of it and improve the quality of their lives.

With that, I would like to now turn it over to the ranking member of the Human Resources Subcommittee, Representative Lloyd Doggett. Would you care to make an opening statement?

Mr. DOGGETT. Yes, Mr. Chairman. Thank you very much for your courtesy. Certainly if we can perfect our tax system so that it does more to reward work we should do it. And if we can ferret out any abuse of existing preferences or tax credits that are not being properly used in accordance with the law, we should do that and should take corrective steps. But I must say respectfully that it is my belief that the focus of this hearing and the focus of the overall work this year and last year of the Ways and Means Committee in this area is misdirected.

Let's look at the facts. The richest one-fifth of Americans are reported to own 84 percent of the wealth of this country, while the bottom 40 percent are estimated to own about 3 or 4 percent of the wealth of this country. The Congressional Budget Office reports that over the last 3 decades after tax income for the top 1 percent soared by 277 percent, while two-thirds of the income gains from 2002 to 2007 flowed to the top 1 percent of households.

The focus of this hearing is not on the 1,500 millionaires who paid zero income tax in a recent year, it is not on those corporations who not only paid zero, such as in some years General Electric, Boeing, Wells Fargo, but in some cases actually received money back in credits from the government. It is not on the area where revenues are not flowing to our government, it is not on those at the top, it is all focused on whether those who have an ownership interest in 3 percent or less of our Nation's wealth, whether they are getting too much.

The overall concept of this hearing seems to follow closely the report last year of the House Republican Study Committee concerning the disincentivizes of our current system. This is the same group and same set of reports that condemned as welfare and seemed to call for reductions in Pell grants, Title I grants to disadvantaged schools, Head Start, the school lunch program and the school breakfast program. I believe that is a mischaracterization of those important initiatives that help those who are struggling to become part of the middle class and to share in the American dream to help them advance, and that it is wrong to continue to deny those opportunities.

When a mother with a couple of children who lives in Austin or San Marcos or San Antonio leaves the welfare program for a full time minimum wage job, the earned income tax credit and the child tax credit are available to help her and other working families. That increases the value of her work in a significant way and is an incentive to advance.

At the same period of time through the recent recession there were reports by the Pew Research Center that Hispanics particularly represented the hardest hit by the recession, a 66 percent drop in wealth from 2005 to 2009, a widening of the gap in our country that has not been seen in the last quarter of a century during the time that data was collected.

These are serious problems that need to be addressed to encourage and help people move into the middle class and to see that our Nation has the revenues that it needs in order to sustain those programs. We need more focus on those real problems rather than on the small issue that is raised by today's hearing. And I yield back.

Chairman DAVIS. I thank the gentleman. I now turn to the Chairman of the Ways and Means Subcommittee on Select Revenue Measures, Mr. Pat Tiberi.

Chairman TIBERI. Thank you, Chairman Davis. Thank you for your leadership on this issue, and it is a real pleasure to have an opportunity to have a joint hearing with our subcommittees today.

Providing an adequate safety net for Americans who have fallen on hard times I believe is a nonpartisan issue in this Congress. It is something that all of us believe in. As is making sure government does not stand in the way of Americans who want to work to achieve their life and fulfill their American dream, I know firsthand for the need for a safety net. When I was in high school my father who immigrated to America with my mother with nothing lost his job of 25 years, lost his pension and our family lost our health care. At that time I was thrown into the free and reduced lunch program in high school. The good news is my dad found a job, he was rewarded and we went on being a family again.

Today what is dangerous with our Tax Code is that it appears that people or the Tax Code is saying to people, to Americans who are down on their luck, who had a job loss, that they will be penalized if they turn their luck around and are fortunate to find an opportunity of work.

Comprehensive tax reform is a chance to solve this problem. In tax reform we should ensure that low-income Americans are not punished through extraordinarily high implicit marginal rates. We should reduce complexity as well. There is no reason that my father should have to see a tax accountant for his tax returns. Our current code is a nuisance where taxpayers, for instance, claiming the earned income tax credit in many times and many places have to use a paid tax preparer, costing them money from their own pockets.

I look forward, Mr. Chairman, to discussing how we can fix this issue to empower Americans to live the American dream. I yield back.

Chairman DAVIS. Thank you very much. The chair now recognizes Mr. Neal, ranking member of the Select Revenue Subcommittee.

Mr. NEAL. Thank you, Mr. Chairman. Thanks to you and Mr. Tiberi for holding the hearing. I want to quote Ronald Reagan: The earned income tax credit is the best anti-poverty program, the best pro-family, the best job creation measure to come out of Congress. The earned income tax credit is a bipartisan idea and it was signed into law by President Ford with a Democratic Congress and expanded by every President since Ford, both Democrat and Republican.

Here is an opportunity where we might change the rhetoric in Congress when we frequently hear that 47 percent of the American people don't pay taxes. Of course they do. They pay the most onerous taxes, payroll taxes. There would be an easy way to soften some of the harsh rhetoric here by that simple acknowledgement.

President Reagan was absolutely right, the earned income tax credit is extremely successful at increasing work and lowering welfare receipt, making our tax rules more fair for low and moderate income tax families and, most importantly, reducing poverty. In 2010 the earned income tax credit lifted about 6.3 million Americans out of poverty, almost 3.3 million children. Without the earned income tax credit the number of children living in poverty would have been one-quarter higher. Is it perfect? Of course it is not. There is no provision in our Tax Code that is perfect. And I am open to working with my Republican friends and colleagues to strengthen the credit.

I do get a bit antsy, however, with recent comments that I have heard from some who would suggest or imply that we should increase taxes on low and moderate income families. Majority Leader Cantor recently stated, quote, we also know that over 45 percent of the people in this country don't pay income taxes at all and we have to question whether that is fair.

Mr. NEAL. Again, an opportunity to reshape language. Majority leader Cantor and I clearly have different definitions of the word "fair." Some are calling for increasing taxes on the poor and moderate-income Americans at the same time they are calling for lowering taxes on the wealthy. That is hardly fair.

Republicans tell us that we can't increase taxes on the wealthy because of the negative impact on jobs. But ironically, they link increasing taxes on poor people, because they say it will encourage them to work. We have come a long way since those days when President Reagan proudly proclaimed at the signing of the Tax Reform Act of 1986, quote, "Millions of the working poor will be dropped from the tax rolls altogether and the wealthy will pay their fair share." That is Ronald Reagan's quote.

But as I conclude, let me highlight that I am open to working on this legislation. I hope that the 1-year enhancements that we are attempting to offer EITC and the child tax credit would make their way to the end of the year and I hope that members of this subcommittee and the full committee can find a common path forward on these issues.

Yield back.

Chairman DAVIS. I thank the gentleman.

I will now turn to our member panel on which Representative Gwen Moore will be testifying. Representative Moore and I have worked on legislation in the Financial Services Committee affecting affordable housing, dealing with child homelessness and domestic abuse.

I would like to remind Representative Moore to limit her oral statement to 5 minutes, however. Without objection, all of your written statement testimony will be made part of the permanent record. Please proceed with your testimony.

STATEMENT OF THE HONORABLE GWEN MOORE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

Ms. MOORE. Thank you so much, Chairman Davis and Chairman Tiberi and Ranking Members Neal and Doggett. It is certainly a privilege to be here as an expert witness on being poor.

I am indeed an expert. As many of you may know, I had my first child at age 18. She is now 42 years old and talks back very regularly. But let me say that times were not always so easy. The very first welfare benefit that I received, sir, was Medicaid, because I gave birth to my daughter on Medicaid.

The subject of this, and I can tell you that if in fact welfare reform would live up to its promises and its rhetoric of making work pay, of helping to lift people out of poverty, to give people a hand up instead of a hand out, I can guarantee you that the 4 million people who are now receiving TANF would storm the Capitol and demand welfare reform. But of course that is more rhetoric than it is reality.

I was able to listen to some of the testimony of our distinguished guests, the Honorable Duncan Smith, catch a bit of his testimony before I walked over here today. And I must say that as a Britainer, he must appreciate the fact that Britain is the country with probably the least social mobility among the OECD states, which means that you can predict people's social mobility more by what their father's station, whether they were a duke or an earl or what their income was, than you can with anything that welfare would have done.

And I say that with all due respect, Mr. Chairman, and I mean it with all due respect, that the title of this hearing, "How Welfare and Tax Benefits Can Discourage Work," is at best a misnomer, and at worst is just fallacious non-sequitur because it assumes—I heard the testimony—it assumes a lot about the lack of character on the part of welfare recipients, and it doesn't talk at all about the structural intent of these welfare programs.

I just want to—I want to quote, since I see my time is expiring against my will here, I would like to just quote from Charles Dickens—I think that is appropriate, given our first panel—SparkNotes quote on Dickens. The theme of David Copperfield focuses on orphans, women, and the mentally disabled to show that exploitation, not pity or compassion, is the rule of an industrial society. So that when we look at the tax benefits, the marginal tax rates that people experience, it is because our benefits are not high enough to make work pay.

I would submit and I look forward to the question-and-answer period, I would submit that people don't work just for their self-esteem or for their dignity. They need to make enough money to be able to pay the rent and put a Barbie doll under the Christmas tree at Christmas.

In my case—and I am happy to share details of that with you—my daughter had her first asthma attack at age 4 days old. I could not afford to have a job that would have separated me from the Medicaid benefit that we had. And I once had a job and begged my supervisor not to give me a 50 cents an hour raise lest I lose Title 20 day care. I worked 80 miles away from my children. And as a person who survived childhood rape, I know how important it was to have reliable daycare.

And so I would say that if we really want to encourage work, things like the Earned Income Tax Credit, things like providing child care, things like providing food supplements, encourage work, not to simply take the position that we are going to take the Keynesian approach and just say, Well, the thing to do is to snatch food stamps, snatch housing benefits, snatch Medicare so that we can literally deliver this poor group of people, primarily women, to the workforce so they will be forced to work because, in fact, they will not have any other choice.

And with that I would be happy to answer questions Mr. Chairman.

[The prepared statement of Ms. Moore follows:]

Congresswoman Gwen Moore
Testimony
Ways and Means Committee Hearing June 27

I am here today to try to help debunk some of the myths about low-income people that some of the Majority witnesses are so committed to perpetuating. These thinly-veiled attacks on the poor have been occurring regularly in the House over the past few months—for example, in the Budget Committee, where Chairman Ryan and his colleagues are trying to hold up TANF as a "successful model" for reforming other safety net programs.

The premise of this hearing suggests that recipients of welfare and tax benefits have no incentive to work and that the benefits they receive from the government are actually "harmful" to them. Today's witnesses would have you believe that there are millions of people out there who are "prevented" from working because of the government programs that "keep them down."

This hearing is predicated on a series of false assumptions about our social safety net. I want everyone to know that contrary to what you might hear today, many of our government programs—SNAP, for example—work very well, and contribute to massive reductions in poverty by increasing family income. We also have programs, such as child care subsidies, that are effective because they provide supports that get people into the workplace. It's true that some of our programs, like TANF, need a serious structural update, because they have been designed to fail the very populations that they intended to serve. But make no mistake: the people of this country still need a safety net. Eliminating the safety net will not eliminate poverty.

I have personal experience living in poverty, and raising young children as a single mother while working, going to school, and sometimes relying on welfare to get by. I can tell you that I didn't sit down after a long day of work to calculate the "marginal tax rate" of government benefits to determine my choices. I think that the panelists here today—who make it sound like low-income women get home every night and pore over a spreadsheet to figure out how much they'll be taxed on the next dollar they earn, or their next dollar in benefits—need a bit of a reality check. They're showing very little understanding of the day-to-day factors that affect people's decisions about work, child care, education, and much more.

Congresswoman Gwen Moore
Testimony
Ways and Means Committee Hearing June 27

I don't have enough time to respond to each and every one of the false claims you will hear today. But I will point to one extremely noteworthy recent example that invalidates many of the Majority witnesses' claims: the TANF Emergency Fund. If low-income welfare recipients simply didn't want to work, then why was the TANF Emergency Fund so successful? In just two years it created over 250,000 jobs. Republican Governors and state and local policymakers across the country came out in strong support of this program, because it was undeniably successful. Many economists and researchers agree that the number one reason why some low-income people are not in the labor market is because we simply don't have enough jobs. When the TANF Emergency Fund was in effect, citizens came out in droves in search of jobs that were finally available to them. Their government had finally helped provide the work opportunities they need. And yet, here in Congress, conservatives refused to extend this program. And now they're arguing that poor people are looking for a free ride. Rather than continuing to help families find the jobs they need and supporting businesses struggling in tough economic times, Congress pulled the plug on a successful program.

If the argument is that we want to have a productive society, cutting off benefits to those who need them is not the way to do so. Researchers at Harvard have found that giving families very modest tax credits leads to higher standardized test scores for their children. These students then have lower teenage birth rates, are more likely to attend college, and eventually have higher earnings than had they not received the tax credit. In the end, as productive members of society, they are able to offset the cost of the initial tax credit.

Our welfare system under AFDC was not perfect. But at least it allowed people to receive a basic level of income while pursuing education and training. TANF, which we hear described as a "model" program, is simply not effective at getting people into decent jobs. The system is fundamentally and fatally flawed. Many states use the work participation rate of welfare recipients as their primary performance measure. Under this indicator, states are more likely to indicate better performance if they assist families that already have some education, skills, and/or work experience and therefore have the best chance of securing employment. As a result, the families who should be prime candidates for assistance are those that are often least likely to receive benefits.

With the Deficit Reduction Act, conservatives made it even more difficult for welfare recipients to get the education and training necessary to obtain better jobs. Limits on what constitutes work activities and a 12-month limit on education make it extremely difficult for a welfare recipient to receive post-secondary education.

Welfare recipients thus face multiple barriers. These barriers are the real factors that affect workforce participation—not the preposterous factors that are being discussed in this hearing today. Not only are there few jobs available to low-income people, but the few jobs that are available aren't ones that are going to help them earn enough—or learn enough—to truly change their financial situation, let alone alter the course of their lives.

Close to half of all TANF recipients lack even a high school diploma, making it extremely difficult for them to find employment. Various studies have estimated that about 45% of welfare recipients have cognitive impairments including learning disabilities, which can impede success in education and the workplace. Any barrier to education is a direct barrier to sustainable employment. Many jobs require specialized training and experience and most employers prefer workers who have completed a certified trade school program. The current limit of one year of full-time education is not enough to complete most programs of study, especially for students who need to complete remedial coursework in order to brush up on their skills and be college ready.

Unlike TANF, SNAP benefits automatically ebb and flow on the basis of economic need. SNAP benefits have thus been successful at increasing families' income, while rising evenly along with the unemployment rate. This is an important point—because the goal of these programs is to alleviate poverty, and SNAP does just that. And yet, the House Majority wants to change SNAP, and look at TANF as a model program. Republicans (admittedly aided by Democrats in the late 1990s) have decimated the TANF program, leading the caseload to decline by 68% from 1995 to 2010. Yet, interestingly enough, families with children in poverty increased by 17% over the same period. In what way is this program a model? It is simply not doing what it is designed to do.

There are a vast number of ways in which TANF could and should be fixed. We need to first acknowledge that welfare benefits are necessary and that the program we have is inept. TANF has effectively been capped as a block grant which is completely unrealistic in these difficult economic times. There's a reason more and more people are in poverty and it isn't because of their unwillingness to work. TANF doesn't account for inflation and isn't designed to be effective during a recession.

The Earned Income Tax Credit (EITC) was designed to reduce the tax burden and supplement the earnings of low and moderate income working adults, many of whom are raising children. Numerous studies have found that the EITC encourages work and helps reduce poverty; findings suggest it is more successful than TANF at increasing work rates. Despite what others may have you believe, most EITC recipients only use the credit temporarily when an event, such as a job disturbance, affects their income. Over an 18-year-period, 61% of EITC recipients received the credit for just one or two years at a time.

I find it unconscionable that we have somehow found a way to distance ourselves from the real-life human consequences of our actions on Capitol Hill. Millions of people are barely surviving. We hear stories of people watering down infant formula because they don't have enough to make it through the month. We hear of people giving babies juice or water because they don't have any benefits left. We hear of families running out of food, and adults starving themselves so their children can eat. This is the reality of living in poverty. People have to make terrible choices. They are working two or three jobs, earning low wages and never getting ahead. They are worried about who they're leaving their kids with during the day because they can't afford adequate childcare. We have to ask ourselves: do we think it is acceptable to allow people to have to live this way in the United States?

In 2010 the poverty rate reached its second-highest point since 1965. Not only that, but the deep poverty rate (as in, those living below half of the poverty level) reached 6.7% which is the highest rate ever since 1975 when we first began collecting this data. To put things in perspective, half the poverty line is about $11,000. Nearly 1-in-10 children is living in a household with this low income, barely able to get by. A study by researchers at the University of Michigan and Harvard found that the number of households with children living on less than $2 per person per day has almost doubled since 1996, now reaching 4%. Even if food stamps are counted as cash assistance, there remains one in every 50 children living in such a household.

After we pause to reflect on the way poor people in this country are living, I can't help but question the values and morals of those who would try to eliminate credit tax credits, like the EITC, for low-income people, while at the same time fighting tooth-and-nail for tax cuts for people at the top. The Ryan budget would have given each high-income family a $400,000 tax cut. And yet we're here listening to people complain about the expense of the EITC—which clearly incentivizes work, and is yet another example of a program that flies in the face of the premise of this hearing.

I'd like to close by reminding us of a recent New York Times article by Jason DeParle, featuring interviews with some of the people who have fallen through the cracks in our social safety net. They told stories of the desperate steps they have taken to stay alive, and feed their children. One woman told the all-too-common tale of returning to a violent boyfriend because she had nowhere else to turn. Others told stories of selling their food stamps at a reduced rate, or selling blood, or digging through trash cans.

DeParle's article tells the story of Tamika Shelby. Tamika first sought cash assistance at age 29 after working fast-food jobs, and as a waitress in a strip club. The state gives her $176 per month for her and her three-year-old son, and she works part-time for effectively $2 an hour job at a food bank. Her supervisor said she was "just wonderful" and indicated she would often even show up on her days off from work. But because Arizona reduced its time limit from five years down to just two, Tamika no longer has welfare assistance or her job at the food pantry. While she and her son can qualify for $250 a month in food stamps, she reports there are often days when she doesn't eat.

The witnesses on this panel would have you believe that welfare recipients are "taking advantage of the system." Does a mother who has to choose between eating herself and having enough food for her children sound like someone who is taking advantage of the system? The reality is that TANF is a failed program, and now here they are criticizing the poor who should be cared for by this so-called safety net. It must be nice to be at the top.

Chairman DAVIS. Do any members have a question?

Mr. DOGGETT. Thank you very much for your expert testimony Ms. Moore.

Do you think that Americans that are out there looking for work are more focused on the issues of child care, job training, job availability than they are on calculating their potential marginal tax rate if they work a certain number of hours?

Ms. MOORE. No, sir, I can tell you that they are not. But I want to stipulate, Mr. Doggett, that welfare recipients are not stupid. They have common sense, even though they may not have the ability to calculate implicit tax marginal rates. I can tell you that it is just common sense. Like what I learned as a parent of a 4-day-old child is that I had to have health care so that I think I would have been very successful as a waitress, you know, because I love people, I love engaging them, but I would not have been able to afford to, as a 4-day-old parent, go work in a restaurant that didn't provide health care, and risk at that time losing Medicaid. I couldn't afford to lose Medicaid. My daughter is 42 now and still has asthma. And I couldn't afford to lose Medicaid. It is a benefit, and if the government wants to help people, they should. I would want to work if in fact I didn't risk losing Medicaid.

Same thing with daycare. Just like I begged my employer, it is not something that I calculated. My daycare provider told me if that I was—that earning $17,000 a year with three kids—I was still poor—that I had, in fact, hit that marginal tax rate; and that if I earned any more—I was still poor—so that when January came around and the automatic increases in Title 20 occurred, the inflationary increases, then I could take, I could take the 50 cents an hour raise.

So I want to stipulate to the fact that there are implicit marginal tax rates that people hit. But the conclusion that poor people are then gaming the system or you should just take the benefit away is fallacious. What it means is that the cost of daycare in 2012 terms, $1,000 a month, $1,500 a month, depending on the age of your child, is so great that work does not pay. Women cannot afford to work without governmental assistance.

Mr. DOGGETT. Thank you.

Chairman DAVIS. And one thing I would like to point out to the gentlewoman, the purpose of the hearing in fact is in fact to address these questions. You said yourself that you begged not to get a raise, and I called this hearing——

Ms. MOORE. Yes, sir. And I want to stipulate that——

Chairman DAVIS. Reclaiming my time. I would just like to make the point that what we are trying to address are broken processes that we have worked on, a bipartisan process over the course of this Congress, to address this very cliff.

And I think what I am hearing from your commentary is actually agreeing with the premise of our hearing, to look at best practices, ways to better integrate information, and avoid people getting into the very situation that you yourself were in as a young mother.

With that I would like to recognize Mr. Neal.

Ms. MOORE. Mr. Chairman, can I respond to that because that was not your time. I think that was someone else's time, and so you reclaimed someone else's time. There is still 2 minutes remaining on the clock.

Chairman DAVIS. Actually that was my time, Ms. Moore. We will go ahead to Mr. Neal and then we can come back.

Mr. NEAL. Thank you. I think you hit some very important points, job training——

Ms. MOORE. Yes.

Mr. NEAL. Health care.

Ms. MOORE. Yes.

Mr. NEAL. Transportation.

Ms. MOORE. Yes.

Mr. NEAL. Daycare.

Ms. MOORE. Yes.

Mr. NEAL. The other agreement that we had in 1996 that was really far reaching and all encompassing—and maybe you could speak to it because you invited a question when you said you wanted to be as candid as possible—what about the role of child support? We do a pretty good job with trying to enforce child support here. Maybe you could give us a practical assessment of that?

Ms. MOORE. Well, thank you for asking that, because I am a huge fan of child support. And as a matter of fact, for several years the only bipartisan amendment that has passed out of the Budget Committee has been me and Mr. Ryan's amendment to try to do 100 percent passthrough of child support to a custodial parents. I am a huge fan of child support, particularly since all of the other source of supports are wanting. TANF is not a very reliable source of income, it is no longer a mandatory expenditure. So I think child support is very important.

I want to respond to something that Chairman Davis said with my tacit agreement about hitting these marginal tax rates. I come to a different conclusion about it. You know, instead of saying, Let's take away the work supports, I am saying that perhaps you ought to expand it. Because right now for an infant, for example, if you want a woman who is on welfare to go work to get decent daycare—and I mean very modest daycare for an infant—this would cost $1,000 a month in the Midwest. I am not talking about New York City or Washington, D.C. How can a woman earn $1,000 a month and still pay the rent, buy food? She can't. And so if she hits that cliff in terms of eligibility for daycare at $7.52 an hour, your premise is, or Honorable Duncan Smith's premise is that she is some sort of lazy person who is lacking in character and so therefore she would quit work. And I am saying that she is someone like me who very much wants to continue work but needs—honestly needs more support in order to be able to continue to work. And so that is a clarification I would make with regard to our agreement on that.

Chairman DAVIS. Mr. Larson is recognized for 5 minutes.

Mr. LARSON. Thank you, Mr. Chairman, and thank you, Mr. Tiberi, as well. I appreciate the spirit of which this hearing is being conducted and especially appreciated the value added that my colleague from Wisconsin brings.

And you underscore a point. I wasn't going to speak, but to look at the magnitude of this situation, it goes beyond anecdotes. And I am speaking, I think, with a great deal of knowledge just in my own staff here at the Capitol. When we talk about daycare, I think Ed Ziegler, the sterling professor of psychology, the father of the Head Start program for the Nation under the Nixon program, said it best: Daycare is nothing short of a cosmic crapshoot for people who are seeking to have their children be developed in a manner that, if they could stay at home themselves, which of course they would all prefer, but for the fact that they have to be out and employed.

So it underscores I think what you are saying, Representative Moore, the need for us to continue to augment; and as the chairman has said, when we get to these cliffs what is it at that cliff that we have to decide? Ziegler used to say, Why is it that we don't utilize public schools that are already on bus routes that are safe, where we can put people there and provide the kind of affordable daycare that is safe, that is fundamentally sound and would be helpful?

Take a look around, and especially if you are a young and expectant mother and you are in the workforce currently, you are pursuing a professional career. Take a look around at what kind of daycare there is for you, and then consider where you may have the means, the situation of so many fellow Americans that don't. I hope that underscores some of what you have to say, Representative.

Ms. MOORE. Well thank you for that commentary, Representative Larson, because it is. I can tell you what the alternatives are to having $1,000 a month to pay for decent daycare. You can have a loving mother or mother-in-law who will take care of your kids the 2 days of the week that she is not on dialysis. You can have a next-door neighbor take care of your kids, and maybe this will be a good family and that Chester the molester will not be a resident of that household. It is a crapshoot, as you said.

You can do as I did for so many years before I found this daycare that finally told me that I was going to hit the cliff, and I sent my kids down to the corner to a babysitter who sat my kids in front of a television with a stick, and if they moved she would hit them and beat them, so much and so often that my daughter who is now 42 refused to take her brothers down there again.

Or you can just hang a key around your kid's neck and your 8-year-old and 6-year-old kid and tell them to stay in the house, don't open the door, fix a peanut butter and jelly sandwich, and hope that you are lucky enough that nothing will happen to them while you are gone.

Those are the options that I know plenty of people who have resorted to those options. That is what happens. It is not that you are sitting there calculating the implicit marginal tax rate. You are just trying to figure out if you have to work and it is not—and if you don't work it is not because you have poor character, it is because you cannot figure that out. You are not lucky enough to be able to figure that out.

Mr. LARSON. I yield back.

Chairman DAVIS. I thank the gentleman. And as one of those kids with the key around his neck from when he was 7 years old, I care very deeply about this issue. And in no way has there been any attempt to prejudice any individuals who are caught in these situations. Again, though, it is absolutely critical as a nation, like Great Britain is doing, that we address all of the process issues to integrate agencies effectively and be willing to ask the hard questions. And with that, I thank the gentlewoman for her testimony and would ask for the next panel to come up.

Thank you very much.

Ms. MOORE. And just thank you, Mr. Chairman, and thank all of you for listening to my testimony.

Chairman DAVIS. Moving on to our third panel joining us today, several distinguished gentlemen who are going to share their thoughts on the issues of reforms and addressing the issues of taxation and benefits. Dr. Clifford Thies, Ph.D., professor of economics and finance at Shenandoah University; Dr. Eugene Steuerle, Ph.D. and senior fellow, the Urban Institute; Dr. Jared Bernstein, Ph.D. and senior fellow, Center on Budget and Policy Priorities; and Dr. Ike Brannon, Ph.D., director of economic policy and congressional relations, American Action Forum.

I would like to remind all of our witnesses the testimony is limited to 5 minutes. However, without objection, all of your written testimony will be made part of your permanent record.

Mr. Thies, please proceed with your opening statement.

STATEMENT OF CLIFFORD THIES, PH.D., PROFESSOR OF ECONOMICS AND FINANCE, SHENANDOAH UNIVERSITY

Mr. THIES. Good morning. I appreciate very much the emotion with which certain people have addressed the loss of health insurance upon passing over certain thresholds. In the Article I wrote on the Dead Zone 3 years ago, I myself got a little emotional at those points. It seemed so unfair as well as socially inefficient to have these cliffs over which people would fall, and there is an opportunity with health reform to address this.

We have grown a series of supports to provide an economic safety net. One of these supports, the EITC, has a positive incentive for working. It stands out in that regard. The impact it had in terms of increasing labor force participation was noticeable upon its enactment and upon its expansions. It does testify to the importance of these programs. Also, although they are anecdotal, there are lots and lots of anecdotes. Almost everybody knows anecdotes of people who were making the calculations about whether working more is worthwhile. And these people maybe sometimes are called gamers of the system; in truth, they are heroic.

Often my own mother, she would complain about not having health insurance and working. She said, Prisoners get health care when they need it. I said, Mom, if you need, you can go rob a bank.

Now, in Europe they have health insurance and it is paid for primarily by payroll taxes and sales taxes, and it has a much bigger apparent cost than our system does. Our system has a larger real cost in terms of the disincentive effect in terms of keeping people in a certain status in society. Instead of moving from addressing security, to moving to self-actualization in their work, instead of being engaged as a fully human person in terms of working with diligence and with judgment and with a degree of creativity in their work, they are trapped in a different strata, and not participating fully with the rest of us in a free society. We should want a seamless transition from the place where we have the economic safety net to the place where we—most of us at least in our lifetime, certainly our children will be in their lifetime, in terms of acting as a free person, self-actualizing, associating with other people on the basis of free association.

Now, I was interested in the other calculations of the numbers; the actual implicit tax rate is somewhat problematic because of the cliffs that are involved. The EITC phases in and phases out, that is pretty easy to calculate the implicit tax rate.

Well, how do you handle something where you have a cliff where you lose eligibility entirely, or the adults lose health insurance and then the children are still covered for a while and then they lose eligibility? So there is some art to making those calculations.

I wondered whether I should update the calculations I had in my 2009 article for this presentation but I, like everybody else, am waiting for the Supreme Court to speak on the issue of health-care reform. And then also we have the problem of the payroll tax going up, of the Federal income tax rate for the first bracket going up, and of the child tax credit going down. So I thought let me just have the same calculations I had several years ago.

The point is pretty clear, when you consider income after taxes, and plus benefits that you receive, that there isn't much incentive for a lot of our fellow Americans to work. Taking into account the net effect, the tax rate may be 50 percent for some, may be as much as 100 percent for others. We should have a big, robust, positive tangible effect for everybody in our system. This speaks to tax simplification and tax reform, so that all pay their fair share, the focus today being that the poor not pay more than that fair share on the marginal dollar of productivity.

And the payroll tax is a very big tax and it is paid twice, by the worker and by their employer. It is a very large tax. Why do we have that tax when we are trying to help people?

If you look at an alternative measure of income for the purpose of calculating poverty, based not on the official income that we currently base our poverty rate on, but based on income after taxes, plus benefits, at least for the State of Minnesota, the Urban Institute shows that you have about the same poverty rate. We push about as many people into poverty as we pull out, we pull the same people in and out yo-yoing them in the process.

Chairman DAVIS. Mr. Thies, could you sum up quickly so we could move on?

Mr. THIES. We want to have an integrated approach with a robust incentive to work at every phase of the income distribution.

Chairman DAVIS. Thank you very much.

[The prepared statement of Mr. Thies follows:]

The Implicit Tax Rate on Low Income Americans

Clifford F. Thies
Eldon R. Lindsey Chair of Free Enterprise and Professor of Economics and Finance
Shenandoah University

June 27, 2012

A few years ago, when I was a resident scholar at a D.C.-based think tank, I had the occasion to brief visiting delegations of parliamentarians from Europe on social insurance and social services here in the United States. I did this mostly by contrasting our programs to theirs.

Our social insurance and social service programs, I said, appeared to be less expensive. But, their programs were not as perverse as ours in terms of undermining the incentive to work. The main reason their programs were not as perverse as our programs was that, in Europe, social insurance and social services are not means-tested.

That is, in Europe, retirement benefits, health insurance and social services that are provided to some are usually provided to all, regardless of work, income, asset and other "tests" as are used in the United States. In contrast, here, you are generally denied benefits as you work more, have more income, have assets, and so forth.

As a result of the loss of benefits, people in the United States who are at the margin between being dependent on the government and being independent, may have little economic incentive to work. To be sure, there may be an inner motivation to work. And, there may be the idea that, in the long run, working can lead to a better future. But, there is no immediate, tangible feed-back reinforcing the inherent goodness of work; and, over time, as the habit of work wanes, we can suspect so too would appreciation for its inherent goodness.

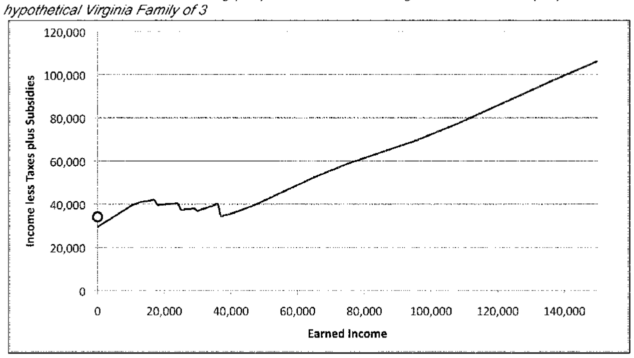
Since I gave those briefings, there have been some changes to the social insurance and social service programs of the United States that impact the incentive to work. Until recently, these changes represented a mixed bag, some improving the incentive to work, and some not. On the plus side, the complete end of the Social Security disallowance for earned income improved the incentive to work for people over their Social Security retirement age. On the other hand, the taxation of Social Security benefits for persons having other income weakens the incentive to work.

More recently, changes in health insurance may significantly change the effective tax rate facing low income Americans. Also, our long period of depressed economic conditions may have acclimated a large number of Americans to such thing as extended periods of unemployment, part-time work supplemented by food stamps and the like, and early retirement via disability. In addition to overall economic conditions, many individuals find themselves burdened by underwater mortgages, unproductive student loan debt, and back taxes and support payments that cannot be discharged through bankruptcy. An overall plan to spur economic growth may need to have a component that deals with those who are today counted as discouraged and as marginally attached to the labor force.

An article I wrote in 2009 concerning the way means-tested benefits and ordinary taxes affect the incentive to work of low-income Americans has received a lot of attention.[1] I showed, for a hypothetical Virginia family consisting of one adult and two children, that there was little change in the total of cash and benefits received from working more, until a level of income of about $40,000 was achieved. Only at that point was the virtue of work rewarded with an actual gain in standard of living. Prior to that point, additional earnings were mostly negated by reduced benefits.

Figure 1. The Dead Zone

Earned income less social security, federal and state income tax plus EITC, food stamps, Medicaid/SCHIP, Section 8 housing (line) versus Welfare cash grant and subsidies (dot) for a hypothetical Virginia Family of 3



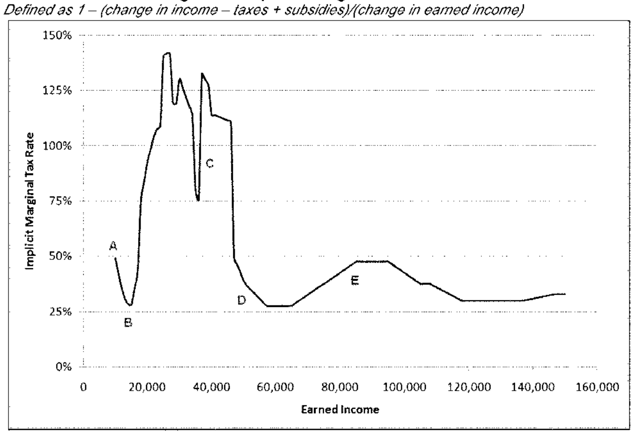
[1] http://mises.org/daily/3822

To see exactly what is happening, the chart below shows the implicit tax rate on the last $10,000 of earned income (initially by comparison to the welfare grant and then by comparison to income less taxes plus subsidies).

At "A", the marginal tax rate is quite high, essentially because of the generosity of the package of cash and noncash benefits provided to those on welfare. At "B", the marginal tax rate is relatively low (!) because of the Earned Income Tax Credit (EITC). From "B" to "D", we are in the Dead Zone, with implicit marginal tax rates mostly exceeding 100 percent.

Figure 2. Implicit Marginal Tax Rates

Defined as 1 – (change in income – taxes + subsidies)/(change in earned income)



At "C", the implicit marginal tax rate is momentarily "only" 75 percent. This is because, in the face of losing other means-tested benefits while the federal income tax kicks in, the children of the household still qualify for the State Children's Health Insurance Program (SCHIP). The lull in the onslaught is momentary, however, ending as soon as that prop is removed from the household.

At "D", the family is finally done with jumping through the hoops to qualify for the give-away programs. Now all it has to concern itself with is paying taxes. But there is no rest for the weary because, at "E", the child tax credit phases out.

Gregory Mankiw of Harvard University liked the basic point I made, which he and many other economists make themselves in their textbooks.[2] What I did was give concreteness to the argument. Mankiw said that the Congress should have CBO perform the calculations I attempted, so as to make the calculations more authoritative. While that would indeed make the calculations more authoritative, we should avoid thinking that the problem is one of making calculations. Ultimately, what we should want is to see is real progress in the standard of living of people at the low end of the income distribution, something we have not seen since the 1960s.

The basic point I made in that article is well established in economic theory. Assuming a goal of the tax structure is to redistribute wealth from some who have a high ability to produce to others who have less ability, and that high taxes rates

[2] http://gregmankiw.blogspot.com/2009/11/poverty-trap.html

diminish the incentive to produce, then the optimal tax structure involves zero or even a negative tax rate on those who have low earnings and a higher tax rate or progressively higher tax rates on those who have high earnings.[3] Such a profile of tax rates looks very different from what we effectively have, given our means-tested programs.

In our system, the loss of benefits as a person earns more, in conjunction with ordinary taxes, implies that the effective tax rate is very high for people with low earnings, when economic theory says that tax rate should be zero or even negative. My calculations indicate that the effective tax rate on low-income Americans is approximately 100 percent. "Supply side economics" should apply to all of us, including those of us who have low income.

Moving from theory to application, things get complicated very quickly. In 1962, to provide income security through an optimal tax structure, Milton Friedman proposed what he called the Negative Income Tax. Friedman's proposal involved a combination of a cash grant and a flat income tax.[4] He had intended the Negative Income Tax to replace much of the welfare system, not simply be an addition to it. Therefore, when the Nixon Administration transformed the proposal into an add-on to the welfare system called the Family Assistance Plan, Friedman opposed it. So too

[3] The classic reference of this is James A. Mirrlees, "An Exploration in the Theory of Optimal Income Taxation," *Review of Economic Studies* 38 (1971): 175-208. A useful survey of the literature is Robert Moffitt, "The Negative Income Tax and the Evolution of U.S. Welfare Policy." *Journal of Economic Perspectives* 17 (2003): 119-140.
[4] Ch. 12, "Alleviation of Poverty," in Milton Friedman, *Capitalism and Freedom*. University of Chicago Press, 1962.

did many of the big city mayors and governors of the country, who saw it as diverting welfare dollars from their control.[5]

Subsequent manifestations of Friedman's proposal as an add-on to the welfare system included the so-called McGovern Grant of George McGovern when he was the nominee of the Democratic Party for president in 1972; and, the initially modest Earned Income Tax Credit enacted in 1975. The EITC has grown so that it is, today, the largest cash disbursing part of the welfare system. The EITC, unique among income security programs and in keeping with the idea of the Negative Income Tax, reinforces the incentive to work over a certain income range. Unfortunately, because of the EITC's give-back region and the interplay of ordinary taxes and the means-testing of other income security programs, this reinforcement of the incentive to work is very limited.

According to Martin Anderson, little priority was given to comprehensive welfare reform during the Reagan Administration.[6] The problem, Anderson said, is that the cash grant needed to replace the welfare system would be too low relative to the package of cash and benefits given to those who qualified for AFDC. In addition, there were indications that liberalizing cash benefits resulted in less work, not more, as well as resulted in more welfare dependency and more family break-up; and, that cash benefits were easily diverted from the well-being of families to

[5] Daniel P. Moynihan, *Politics of a Guaranteed Income*. Vintage Books: 1973.
[6] Martin Anderson. *Welfare: The Political Economy of Welfare Reform in the United States*. Hoover Institution, 1978.

undesirable purposes. During the Reagan Administration, the EITC was expanded. But, perhaps more importantly in terms of the tax rates facing low-income Americans, Social Security taxes – which kick in at dollar one of earned income – were increased as part of the Social Security bailout.

The next major step in the evolution of our current income security system was the welfare reform movement of the 1990s. Many people were involved in the reform of welfare, including Governor Tommy Thompson of Wisconsin, President Bill Clinton and the Congressional Republicans elected in 1994. Welfare reform replaced the former AFDC program with Temporary Aid for Needy Families. Among other provisions, TANF involves time limits on eligibility.

Following the reform of welfare, there was a tremendous fall in welfare rolls, as well as very substantial declines in participation in the food stamp program and other income security programs. To what extent these trends were due to welfare reform as distinct from the vibrant economy of the 1990s is a tough question. Perhaps each – welfare reform and the vibrant economy – reinforced the other.

During the 2000s, the generosity of income security programs was significantly increased, including the food stamp program in 2002 and the EITC in 2006. In addition, Congress made extraordinary extensions of unemployment benefits in response to the recession of 2007-09. The combination of depressed economic conditions and the more generous welfare system was followed by an unprecedented increase in participation in the nation's income security programs. Conversely, labor force attachment has been dropping and many of those who are employed are employed part-time.

These developments are roughly consistent with the social experiments conducted during the 1970s to determine the probable results of a Negative Income Tax; namely, a reduction in work, not an increase. Many people are learning to subsist on part-time wages supplemented by cash and non-cash benefits from the government.

The possibility of revisiting welfare reform in conjunction with reforming the tax code is exciting. Friedman's Negative Income Tax idea was, after all, to be an income security program administered through the income tax system. Unfortunately, the way things have evolved is that the means-testing of our income security programs work almost exactly the opposite of his Negative Income Tax proposal. The combined effect of our income security programs, along with ordinary taxes, is to create a dead zone in which the effective tax rate on working is approximately 100 percent for people with low income.

I will offer, as one possibility of how welfare reform might be combined with tax reform, that part or all of the funds currently going into the EITC be used instead to pay the Social Security taxes of low-income Americans who would qualify for the EITC. This should include both the employee and the employer contribution. This proposal would create a zero bracket in the payroll tax for qualifying workers.

When Friedman proposed the Negative Income Tax, the combined employee and employer payroll tax rate was 6.5 percent. Today, ignoring its temporary reduction, the combined payroll tax rate is 15.3 percent. For most Americans, Social Security taxes are more significant than the income tax. My proposal would not only eliminate the give-back region of the EITC and so remove that perverse aspect of the EITC, it would help to simplify the tax code.

Milton Friedman once said that nobody should pay a tax rate of more than 50 percent. Certainly, nobody would say that low-income people should have a tax rate of more than 50 percent. Perhaps it would be sufficient, then, to merely develop an authoritative calculation of what is the effective tax rate on low-income Americans. But, while my calculations might not be as authoritative as CBO's, I'm not badly mistaken. When you look at the combined effect of the means-testing of our major income security programs, low income Americans are subject to an effective tax rate of about 100 percent.

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Chairman DAVIS. Mr. Steuerle, you are recognized for 5 minutes.

STATEMENT OF EUGENE STEUERLE, PH.D., SENIOR FELLOW, THE URBAN INSTITUTE

Mr. STEUERLE. Chairman Davis and members of the two subcommittees, thank you again for the opportunity to appear before you once again. As already noted, the Nation's real tax system is very different than the tax system we know just by looking at direct statutory rates such as the income tax and the Social Security tax. The implicit taxes that derive from phasing out various benefits in both expenditure and tax programs—I tend to call expenditure taxes because, like tax expenditures, they remain largely hidden from government and the public—and yet they actually are a major influence on behavior.

These expenditures, I want to be clear, are a classic liberal conservative compromise. Mr. Chairman, you commented earlier about needing to work together to solve this problem. One reason that one has to work together is because, in fact, it is a liberal-conservative compromise that got us there in the sense that liberals have favored these types of implicit taxes as a way of increasing progressivity, while conservatives have embarked upon them as ways of saving on budget revenues. Both of them are legitimate goals but have resulted in very, very high tax rates. And although low- and moderate-income households are especially affected and seem to be the subject mainly of this hearing, I remind you that you have these implicit taxes in the AMT and Pell grants and in dozens, if not hundreds, of programs, including most of the subsidies that are in the tax system.

At the Urban Institute we have done a lot of work on trying to calculate these taxes. The first graph that you see here on the screen is the same as in figure 1b of my testimony. It shows close to the maximum benefits for which a single head of household and two children may be eligible, and then how they phase out as income increases.

Rates are low or even negative up to about 10,000 to $15,000 of income. It is thereafter that they rise quickly.

In the next figure, which is the same as figure 3 of my testimony, I show the effect of tax rate for a household whose income rises from 10,000 to $40,000. Essentially income and Social Security taxes take away about 30 percent of earnings, and then universally available programs—by "universally" I mean they are available to all of us if we have children, there are no queues, and include items like EITC or SNAP—raise the rate to about 55 percent. And for those households who happen to be into welfare programs such as TANF or get housing benefits, the rate can rise well above 80 percent.

What used to be called a poverty trap has now moved to what Linda Giannarelli and I have called the twice poverty trap; that is, the high rates especially hit households who earn more than poverty-level incomes.

Many studies have attempted to show the effect of these rates on work and the results are actually mixed. Work subsidies such as the EITC generally encourage labor-force participation and may tend to discourage work at higher income levels, particularly for second jobs in a family, moving to full time work, or, as I note in my testimony, also for marrying someone who has a job.

Design matters greatly. For instance, Medicaid will discourage work among the disabled more than a subsidy system such as the health exchange subsidy that is in the health reform; on the other hand, that health exchange subsidy will discourage work for older people who are encouraged to retire earlier.

For the same amount of cash, a major conclusion is that a program that requires work will indeed lead to more work than one that does not. In that regard, the earned income credit and welfare reform have done better on the work front than did AFDC.

Other consequences need examining. Means testing and joint filing have resulted in hundreds of billions of dollars of marriage penalties for low- and middle-income households, and indeed not marrying is the tax shelter for the poor. Many programs do help those with special needs, although they vary widely in their efficiency and effectiveness. So, for instance, there is some evidence that a well-developed program can improve behavior such as school attendance and maternal health. At the same time, as an economist I have to question our ability to judge the long-term consequences of these programs merely from the empirical studies that we perform.

So just as a classic liberal-conservative compromise got us into this situation, so might it require a liberal-conservative compromise to get us out of it. And among the many approaches to reform that I think are worthy of consideration are:

One, seeking broad-based social welfare reform, far beyond even what we are discussing today, rather than adopting programs one-by-one with multiple phaseouts.

Two, starting to emphasize opportunity and education over adequacy and consumption. We can start moving the budget in the former direction rather than the latter. It doesn't necessarily require cutting back on programs. It means that the growth on government which continues would get redirected in a different way.

Three, we can put tax rates directly in the Tax Code so they are not so hidden.

Four, we can make work an even stronger requirement for receipt of various benefits.

Five, we could think about trying to adopt a maximum marginal tax rate for at least some programs combined.

And, six, I believe we can let child benefits go with the child, and wage subsidies go with low-income workers rather than combining the two. And the goal there is not just to favor work but also to try to start including in the social welfare structure many of these low-income, working, single people who basically are excluded altogether and have access to this system mainly by going to prison. Thank you.

Chairman DAVIS. Thank you very much Mr. Steuerle.

[The prepared statement of Mr. Steuerle follows:]

Statement of

C. Eugene Steuerle

On

Marginal Tax Rates, Work, and the Nation's Real Tax System

Joint Hearing of the
Subcommittee on Human Resources and
Subcommittee on Select Revenue Measures
Committee on Ways and Means

June 27, 2012

C. Eugene Steuerle is the Richard B. Fischer chair and an Institute Fellow at the Urban Institute.
Portions of this testimony are taken from other work by the author, particularly for *Tax Notes Magazine* and *The Future of Children*. I am indebted particularly to Adam Carasso, Linda Giannarelli, Elaine Maag, Caleb Quakenbush, Stephanie Rennane, and Katherine Toran for both past and current work with me on marginal tax rates. All opinions expressed herein are solely the author's and should not be attributed to any of these individuals or organizations with which he is associated.

Chairmen Davis and Tiberi and Members of the Subcommittees on Human Resources and Select Revenue Measures:

Thank you for the opportunity to be here today. In my testimony, I make six basic points.

(1) The nation's real tax system includes not just the direct statutory rates explicit in such taxes as the income tax and the Social Security tax, but the implicit taxes that derive from phasing out of various benefits in both expenditure and tax programs. What I have labeled "expenditure taxes" are like tax expenditures in the sense that both tend to hide the full impact of government and are seldom dealt with on a consistent basis.

(2) These taxes derive largely from a liberal-conservative compromise that emphasizes means testing as a way of both increasing progressivity and saving on direct taxes needed to support various programs. Although low- and moderate-income households are especially affected, middle income households face these expenditure taxes, too, as in the phase out of Pell grants and child credits, the gradual removal of "preferences" in the alternative minimum tax and of the exemption of Social Security benefits from taxation.

(3) At the Urban-Brookings Tax Policy Center and the Urban Institute's Income and Benefits Policy Center we have done quite a bit of work on calculating these rates, particularly for low and moderate-income households. Through such models as the "Net Income Change Calculator," or NICC, we can show their effect for individual states. Adding in health care makes the calculations more difficult, but when added in, these rates can be quite high, especially for households with children, commonly reaching 50 percent when moving toward full-time work or a second job in the household; for those getting housing and other assistance, the rate can easily jump to 80 percent or more.

(4) Many studies have attempted to show that the effect of these rates on work, and the results are mixed and ambiguous. Work subsidies such as the EITC generally encourage work for those who might otherwise not work or simply reside on welfare, but may tend to discourage work at higher income levels, particularly for second jobs in a family or moving to full time work. Design matters greatly. For instance, Medicaid will discourage work among the disabled more than a subsidy system such as adopted in health reform; on the other hand, health reform will probably encourage more people to retire early. Perhaps one of the most important conclusions is that for the same amount of cost, a program that requires work will indeed lead to more work more than one that does not. EITC and welfare reform have done better on the work front than did AFDC.

(5) In addressing these issues, other behaviors and consequences must also be considered. Means testing and joint filing has resulted in hundreds of billions of dollars of marriage penalties for low and middle income households. Many of these programs do help those with special needs,

although they vary widely in their efficiency and effectiveness. There is some evidence that well-developed programs can improve behaviors such as school attendance and maternal health. At the same time, long-run consequences are often hard to estimate.

(6) Just as a classic liberal-conservative compromise got us to this situation, so might it require a liberal-conservative consensus get us out of it. Many potential reforms replace hidden government with explicit government, which may make it look bigger. Some reforms may reduce benefits for some low-income households; others may cost more, hence raising tax rates for others not facing such high rates. Put another way, reform requires looking at hundreds of billions of dollars' worth of programs, since phase outs and means tests are everywhere. Reforming them means recognizing there will be winners and loser along the way. Among the many approaches to reform are (a) seeking broad-based social welfare reform rather than adopting programs one-by-one with multiple phase-outs, (b) starting to emphasize opportunity and education over adequacy and consumption; (c) putting tax rates directly in the tax code to replace implicit tax rates, (d) making work an even stronger requirement for receipt of various benefits, (e) adopting a maximum marginal tax rate for programs combined, and (f) letting child benefits go with the child and wage subsidies go with low-income workers rather than combining the two.

The Nation's Real Tax System

The tax rates faced by taxpayers include both statutory rates and all the various phase-outs of benefits in both expenditure and tax programs, as well as fees that are for the most part unavoidable. I have labeled these latter items expenditure taxes. Phase outs reduce or tax away particular program benefits typically on the basis of income or other personal characteristics of the household. Expenditure taxes should be distinguished from voluntary fees or charges for services received by the government. In the direct tax system, direct taxes are those that are compulsory. In contrast, most fees are voluntary. When those fees rise, it is generally because the cost of benefits voluntarily purchased by the taxpayer has increased, as when one makes greater use of national parks or inland waterways. Obviously, the distinction between taxes and fees is sometimes more difficult to make, but the separation is still useful (e.g., I view the "fee" for Social Security Part B more like a tax since it is hard to avoid, but one can debate the matter). In the case of expenditure taxes, a similar distinction might be drawn between those fees that are given freely in exchange for some public services and those reductions in benefits that are mandatory.

Identifying expenditure taxes does not make them good or bad. Some believe that expenditure taxes are useful ways of channeling net benefits to the most needy or of restricting participation levels. As a policy matter, each expenditure tax needs to be judged on its own merit. To make an informed judgment, however, requires that policymakers be fully aware of how these tax-like mechanisms work and interact and take into account their combined impact on the economy and on the operation of government programs.

Just like tax expenditures, clarifying the size of both tax expenditures and expenditure taxes helps prevent hidden government. When government actions are more apparent, voters and policymakers can make better, more informed judgments. Many expenditure taxes apply to lower income households through means testing of programs like SNAP (formerly Food Stamps) for which they qualify categorically, but they also apply to many middle-income families, as in Pell grants, child credits, the phase out of itemized deductions, and phase out of the exemption of Social Security benefits from taxation, the removal of exemptions from the alternative minimum tax. Although I will concentrate here on the programs affecting low-to-moderate income households, it is quite easy for middle-income households to face marginal tax rates of 40 percent or 50 percent or more (15 percent Social Security tax plus 15, 25, or 28 percent in the federal income tax, plus a few percent of state income tax, plus the phase out rates, less interactions).

What Causes Expenditure Taxes and Consequent High Tax Rates?

Congress enacted Social Security, Aid to Families with Dependent Children (AFDC), and various housing programs in 1935; the Food Stamp Act in 1964; Medicare and Medicaid in 1965; the EITC in 1975 (and subsequent expansions of the credit in 1987, 1990, 1993, and 2001, among others); the Child Care Development Block Grant in 1990; welfare reform in 1996 (which replaced AFDC with TANF); the State Children's Health Insurance Program (SCHIP) in 1997; and the child tax credit in 1997 (expanded and made refundable in 2001). The list could go on and on.

Each program, as well as its subsequent reforms, was the product of unique social forces and was designed to address a specific social need. Had they all been enacted as one comprehensive program, lawmakers might have been more inclined to coordinate and focus on the combined tax rates, combined subsidy rate, marriage penalties and subsidies, and combined incentive effects. So many items are now phased out in many of these programs that the nation's true tax system remains largely hidden.

Means testing particularly represents a classic liberal-conservative compromise. Conservatives sometimes favor hidden expenditure taxes because, relative to a direct tax, they make expenditure programs appear smaller and avoid raising the top rate of income tax (the one often of most concern to supply side economists partly because others are less likely to apply at the margin). Liberals often favor expenditure taxes because they allow benefits to be of concentrated more on those who are measured as being poorer. Programs with lower expenditure tax rates often extend net benefits to higher levels of income and may be less progressive.

Often both conservatives and liberals support their stances by arguing that high tax rates on benefit recipients have little effect on behavior. While this may or may not be true, as discussed below, one really wonders why as a society we worry about 40 percent tax rates on the rich if 50 or 100 percent tax rates on the poor have little or no effect. Are the poor really that different?

Note that we are quite inconsistent in how we decide when to means test or not. Public education, Social Security, and Medicare are more universal. Social Security and higher educational benefits and farm subsidies tend to be larger for those with higher incomes than those with lower incomes, though Social Security also applies a type of lifetime income test that tends to restore some progressivity. Head Start, TANF, and housing vouchers are concentrated on low income and are means tested at moderate levels. Child credits do not phase out until higher income levels. Medicaid provides a cliff effect: earn one more dollar and consequently lose a health insurance package that one dollar before was free. The new health exchange subsidies avoid that cliff and start phasing out at modest income levels but then stretch fairly high into the income distribution. The earned income tax credit phases in and then out.

What Does the Nation's Real Tax System Look Like?

At the Urban-Brookings Tax Policy Center and the Urban Institute's Income and Benefits Policy Center we have done perhaps the most extensive work anywhere on the size of these combined tax rates.

Let's begin by displaying two hypothetical cases for a more-or-less "universal benefit" and then a "maximum benefit" system for households with children. Case 1 (Figure 1a) considers a single parent household with children—the type of household most affected by these high tax rates—and shows federal income taxes, employer and employee portions of the Social Security tax, personal exemptions, child credits and dependent care credits, the earned income tax credit, SNAP, Medicaid, SCHIP, and the new health exchange subsidy (as if it was available in 2011). A focus on this set of programs is important because, in theory every household with children is eligible for these programs if its income is low enough. The benefits are generally not restricted by waiting lists and are universally available as long as recipients meet certain eligibility criteria, mainly income level, which can vary by state. In a sense, then, the tax rates levied by these programs apply to all households, though they may have moved out of the very high tax rate part of this regime when their annual earned incomes start to exceed \$40,000 or higher, and they have moved beyond the income cutoffs for several of the transfer programs. Put in terms of panel 1, these latter households have moved to the right along the horizontal axis beyond, first the high-benefit and low-or negative-tax rate regime (which applies to earnings of roughly \$0 to \$10,000), and then, the high-tax-rate regime (which applies to incomes of roughly \$10,000 to \$40,000).

Case 2 (Figure 1b) includes the same programs as Case 1 but also assumes the single parent with two children is receiving welfare cash assistance (TANF), housing assistance, and child care benefits (direct expenditures for child care). In many ways, it is an extreme case, since only a small minority of low-income families receive all these benefits. As a general rule, these additional programs are not universal, in contrast to those in Case 1. Rather, they are parceled out either through time limits for years of eligibility or through queues as to who may participate. Households are much less likely to benefit from the programs in Case 2 than those in Case 1. In Case 1, the family receives the most benefits at about \$10,000 to \$15,00 of earnings—mostly because the EITC is fully phased in by that earnings level, while most other benefits are either still phasing in or have not yet phased out. In Case 2, where the household is on TANF and receives housing, maximum benefits are still available when there are no earnings. Benefits drop off steeply as earnings start to exceed those amounts.

The health benefit graph (Figure 1c) displays what the health system at the top of Case 1 and 2 looks like in isolation from the other programs. There are legitimate debates over how to deal with these calculations and their incentive effects, but it is such a large portion of the social welfare system that I felt it would be misleading to leave it out.

Figure 2 then shows the effective marginal tax rate that derives from the combination of income, Social Security, and state taxes, combined with the phase out of the various benefits shown in Figure 1a and 1b. As can be seen, tax rates begin to spike somewhere above \$10,000 or \$15,000. This is summarized in Figure 3.

There we calculate the effective average marginal tax rate if this household increases its income from \$10,000 to \$40,000. That is, how much of the additional \$30,000 of earnings is lost to government through direct taxes or loss of benefits? The average marginal tax rate in the first bar of Table 3, 29 percent, is based simply on federal and state direct taxes, including Social Security and the EITC. The rate rises appreciably as the family enrolls in additional transfer programs in bars 2 and 3. For a family enrolled in all the more universal non-wait-listed programs like SNAP, Medicaid, and SCHIP, the average effective marginal tax rate could be 55 percent. Enrolling the family in additional waitlisted programs, like housing assistance and TANF, ratchets the rate up above 80 percent.

Put another way, while we might think of the income tax rate schedule as showing rates of 0, 10, 15, and 25 percent respectively, the true rate schedule faced by these families includes rates like -40 percent (from the initial phase-in of the EITC) and 50 and 80 percent.

The high tax rates especially affect the choice of a household with children to work full-time a bit above the minimum wage or to marry or stay married. I will return to these issues below. However, for those in the universal system, the structure does encourage labor force participation, and those in TANF also face a variety of incentives to keep or take a job.

Some caveats are in order. A number of eligible households do not apply for benefits, such as the food subsidies for which they are eligible. We have performed some analyses of the population as a whole at the Urban Institute and find that the average rates across households will be lower than what you see in the table because of less than full participation in the programs. By the same token, we have not included the child care grants in these calculations. Add those in, and the rate can exceed 100 percent (though keep in mind that those receiving those particular grants must work to receive them).

Figure 1a

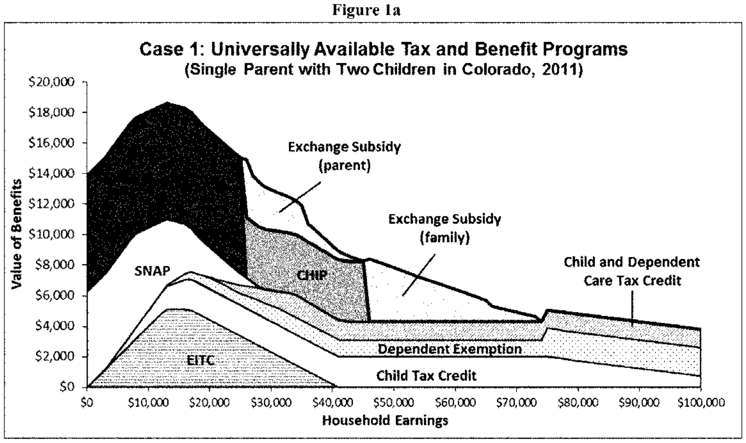


Figure 1b

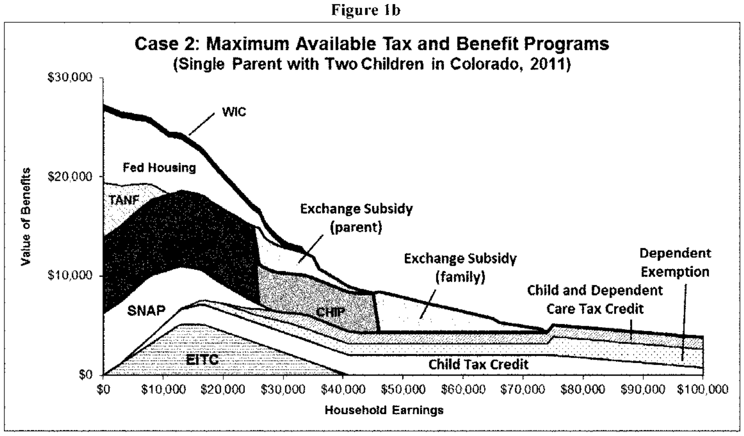


Figure 1c

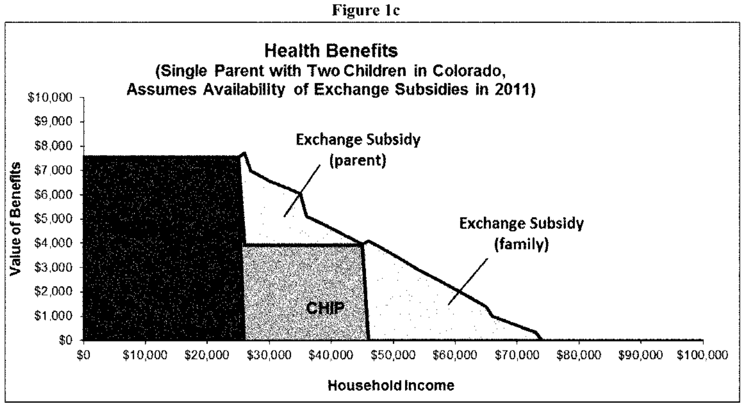
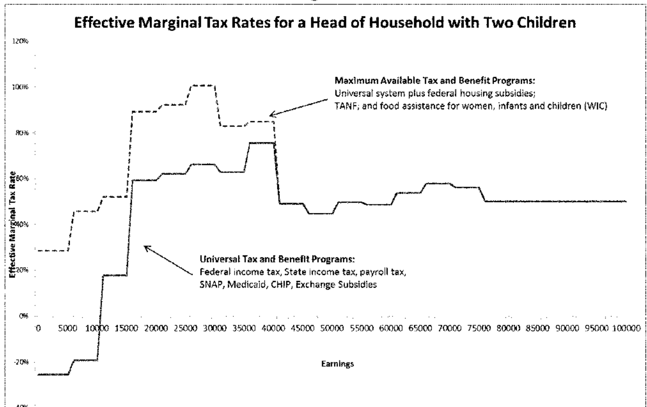
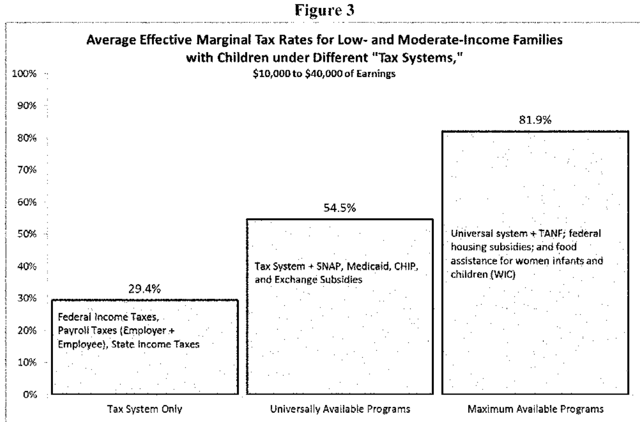


Figure 2



Average effective marginal tax rates facing a single parent with two children living in Colorado. The effective marginal rate is the the marginal tax rate faced in the formal tax system (federal, state, and payroll) in addition to the rates arising from the reduction in disposable income from the loss of transfer benefits. The tax rules used for federal and state income taxes are for CY2011. The payroll tax rate does not include the temporary reduction of the employee portion of the tax. Hypothetical exchange subsidy values were calculated to display the eventual impact of the Affordable Care Act for a worker without employer provided coverage based on CBO estimates discounted back to 2011.

Figure 3



Average effective marginal tax rate for single parent with two children residing in Colorado under three systems between $10,000 and $40,000 in earnings. Tax rules used for federal and state income taxes are for CY2011. The payroll tax does not include the temporary reduction of the employee portion of the tax. Hypothetical exchange subsidy values were calculated to display the eventual impact of the Affordable Care Act for a worker without employer provided coverage based on CBO estimates, discounted back to 2011. C. Eugene Steuerle and Caleb Quakenbush, The Urban Institute, 2012.

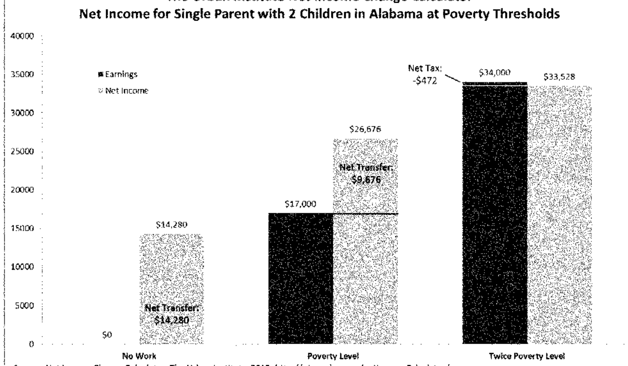
The Net Income Change Calculator. The Urban-Brookings Tax Policy Center and the Income and Benefits Policy Center have also collaborated with government and foundations to produce a Net Income Calculator (NICC), which can be found at http://nicc.urban.org/netincomeCalculator/.[i] It allows individuals to generate a state by state analysis of tax and transfer benefits available to individuals and families as income, weekly hours, wage levels, and program participation varies. The calculator does not currently include a calculation for various health care programs, in part because of the complex issues related to their valuation. Nonetheless it is especially useful in developing specific state data for those who are interested.

Figure 3 below shows the type of calculation that can be done. The example chosen was a family participating or potentially participating in a variety of programs (in this case, TANF, SNAP, housing and child care assistance) in Alabama. As can be seen, with no work at all this family generates $14,000 in benefits. If it earns poverty level income of about $17,000, its total income would rise to about $26,700 or close to $13,000. Once again, we see that rates are moderate for getting into the workforce, in part because of the EITC. However, if the family earns about twice the poverty level, or an additional $17,000, income would rise by only about $6,900—an effective average marginal tax rate of about 60 percent, to which must be added any loss of health insurance benefits.

Many years ago, the high taxation of welfare recipients who went to work was labeled a "poverty trap." In doing these calculations a number of years ago, Linda Giannarelli and I decided that the poverty trap had been largely removed but had been replaced by what we called the "twice poverty trap." These numbers reconfirm that analysis.

Figure 4

The Urban Institute Net Income Change Calculator
Net Income for Single Parent with 2 Children in Alabama at Poverty Thresholds



Source: Net Income Change Calculator. The Urban Institute, 2012. http://nicc.urban.org/netincomeCalculator/
Assumes 40 hours of work per week, child care costs of $250/month when parent is working, and monthly rent costs of $600 before subsidy. Programs participated in: TANF, SNAP, and child care and federal housing subsidies. Taxes: Federal income, state income, and payroll taxes (employee only). All tax and transfer rules and federal poverty levels are for 2008. Funding for NICC came from various grants from the Annie E. Casey Foundation, the John D. and Catherine T. MacArthur Foundation, and HHS/ASPE. NICC's Calculations are performed by an adapted version of the TRIM3 microsimulation model, which is funded and copyrighted by HHS/ASPE and developed and maintained by the Urban Institute.

The Effect on Work

Economic theory tells us that distortions in behavior increase disproportionately with the marginal tax rate. However, these distortions can take different forms: less work, more work, and other behavioral shifts such as avoidance of marriage. Many empirical studies have attempted to isolate the net effect of these rates on work, and the results are mixed. Generally speaking, programs like the EITC and various work-related experiments show that those programs tend to encourage labor force participation. But they tend to tend to discourage work at higher income levels, such as taking a second job in the family. This, of course, is what we might expect, since in a phase-in range the EITC increases rewards from work while providing no income to those who don't (in economic terms, the substitution effect is positive and there is no income effect). By the time one reaches the phase-out rate, income is higher as well as marginal tax rates, and other programs are also phasing out. Therefore, disincentives are fairly high at this level.

Welfare reform also attempted to cut the Gordian knot by making benefits conditional upon work. Generally speaking, work did increase after reform, although there is some dispute on how much was due to the EITC, welfare reform, or the better economy. My own view is that one major reason for the increased work effort was that governors started telling their welfare administrators that they were going to be judged by how many people they got off welfare, rather than how many clients they served. Perhaps one of the most important conclusions is that for the same amount of cost, a program that requires work will indeed encourage work more than one that does not. EITC and welfare reform have done better on the work front than did AFDC.

Design matters greatly. For instance, Medicaid will discourage work among the disabled more than a subsidy system such as adopted in recent health reform; on the other hand, health reform will probably encourage more people not now on Medicaid to retire early. I believe those number are reflected, though indirectly, in CBO's estimates of the effect of health reform on the budget and economy. Many workers face discrete choices to work or not work or try to take another job; it is often not easy to vary hours on any one job.

In my view, few of these empirical studies do a good job at telling us the long-term effect on behavior. Looking at the data over time, I conclude that the "income" effect—the consequence of having higher income—often is more important than the tax effect. Don't forget also that the tax effect by itself at times have a reverse income effect, in that some people will work more to generate the same net income that they might need. Some evidence comes from other programs. For instance, the availability of Social Security for almost a decade more than when it was first created seems clearly to have induced earlier retirement, independently of whether there was any tax effect. There are also psychological factors we are only beginning to assess. For instance, once on disability and sometimes unemployment, people develop different life patterns that become more habitual; for some, being out of work for a long time can also add to depression, which then rebounds on ability later to work. As already noted, the disabled are especially reluctant to give up Medicaid. The signals that government shares with its people can be powerful, such as whether work is of intrinsic value to society; at the same time, government choices may reflect rather than develop such societal values.

Finally, asking whether government benefit programs provide disincentives to work may be the wrong question. Yes, they often do. Any such effects must be contrasted with the good they may do so as to form a judgment of their merit. Here, I think the more important question may be how we can create a social welfare structure that does the maximum good by minimizing distortions and other unintended or undesired consequences. When relative comparisons are made, I think we have considerable prospect at improving upon a structure that has done a moderately good job at reducing hunger and poverty, but a mediocre job at providing opportunity and investment, rather than just adequacy and higher levels of consumption, to a significant portion of our population.

Other Consequences.

Marriage Penalties. Means testing and joint filing has resulted in hundreds of billions of marriage penalties for low and middle income households.

Essentially, when moderate-income couples marry, their marginal tax rate moves up from, say, 25 percent, to the 50 and 80 percent ranges shown above. For instance, a moderate income male marrying a working mother with children can easily cause her to lose EITC, SNAP, Medicaid, and other benefits as well.

Marriage penalties arise because of the combination of variable U.S. tax rates and joint, rather than individual, filing by married couples for benefits and taxes. If graduated taxes were accompanied by individual filing or if all income and transfers were taxed at a flat rate, there would be no marriage penalties. The EITC, by the way, can provide both subsidies and penalties, and Social Security generally provides very large marriage bonuses.

Someone looking at our system from Mars would conclude that we don't want moderate income families with children to marry, since we penalize them, but we do want older households (at ages when children are likely to be gone) to marry, since we subsidize them.

Games Encouraged by Means Testing. One thing we have learned in public finance is that taxes have significant effects on portfolio behavior even if there is less certain effect on work and saving. Not getting married is the major tax shelter for low- and moderate-income households with children. In many low-income communities around the nation, marriage is now the exception rather than the rule.

Marriage penalties or subsidies are assessed primarily for taking wedding vows, not for living together with another adult. Those who do not feel morally compelled to swear fidelity in religious or public ceremonies for the most part do not suffer the penalties. Our tax and welfare system thus favors those who consider marriage an option—to be avoided when there are penalties and engaged when there are bonuses. The losers tend to be those who consider marriage vows to be sacred.

These effects of marginal tax rates extend well beyond the marriage patterns of low-income families. Divorced couples allocate child support so as to maximize future college aid. Some couples avoid remarriage to avoid losing Social Security or pension benefits. As noted, the disabled sometimes avoid work so as to keep Medicaid, while some of the unemployed delay going back to work.

Options for Reform

It is impossible in a single testimony to deal with the many ways our social welfare system might be reformed to provide better results. Today that system strongly emphasizes growth in health and retirement benefits, while middle income families and children are facing a situation where their share of the budget is scheduled for rapid decline even while they are being left with ever more debts to pay off.

I believe we are at a major fiscal turning point in our history. At one level, it is forced on us by an unsustainable budget, but at another level it gives us the opportunity to reconsider broader changes to our tax and social welfare structure. In that regard, I believe all of the following deserve strong consideration:

1. **Adopting a broader social welfare reform.** An integrated approach to reform would stop adopting all these tax systems one at a time, with little consideration of how they fit together.

2. **Emphasizing opportunity and education more and adequacy and consumption less.** Long-term reform could also put more emphasis on opportunity, education and work and less on adequacy and increasing consumption levels.

3. **Putting more tax rates directly into the tax code.** A transparent system would replace some implicit taxes with explicit ones, thus facing the same political obstacles as eliminating tax expenditures. Government would have to admit what it is doing. Just as eliminating tax expenditures appears to be increasing size of government when it is not, so also does substituting direct for expenditure taxes appears to be raising taxes when it may not actually raise them.

4. **Making work an even stronger requirement for receipt of other types of benefits.** This type of approach need not reduce benefits overall, since some or all of any additional saving could be applied to those who do work.

5. **Adopting a maximum marginal tax rate.** A partial approach at integration would attempt to create some maximum tax rate for several or many programs.

6. **Letting child benefits go with child, work subsidies go with low-wage workers.** The EITC provides wage subsidies to low-income workers raising children, but then leaves out other low-wage workers and usually creates high tax rates when two earners marry. Reform could separate out the subsidy for children from that from low-income workers.

Innovative approaches need to be tried. Catholic Charities, for instance, supports a National Opportunity and Community Renewal Act for a pilot project that is people-focused and case managed, based on local community opportunities. In the suggested programs under this experiment, a person might qualify for help, but the exact nature would depend on agreement between the case manager and client, allowing them together to tie together and reallocate resources for which the client is eligible. That reallocation would likely increase labor force participation, as it would be largely aimed at improving opportunity and addressing issues that cause the poverty in the first place.

Conclusion

For several decades now, policymakers have created public tax and transfer programs with little if any attention to the very high tax rates that they inadvertently imposed. Combined effective marginal tax rates from dozens or hundreds of phase-outs can be very high and certainly lead to hidden and confusing government. The rates are especially high for low-to-moderate income households with children and include hundreds of billions of dollars of marriage penalties as well. These high tax rates also extend into many middle-income programs as well.

These developments are in no small part the consequence of a half-century of social policy enactments of roughly similar design. Liberals wishing to keep programs progressive and conservatives wishing to keep budget costs low have together put a substantial portion of household subsidies and assistance onto this platform, yet with no consistency with other programs such as public education or Social Security and Medicare. These penalties can be reduced in various ways but, given their size and magnitude, not without major reconsideration of this multi-decade set of developments and a principled approach to creating a social welfare system for the 21st century.

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[i] Initial development of the NICC was funded by the Annie E. Casey Foundation as part of the Low Income Working Families Project. Funding for the update of the 2008 rules was provided, in part, by HHS/ASPE. Additional funding came from the John D. and Catherine T. MacArthur Foundation. NICC's development built on an earlier tool, the Marriage Calculator, developed at the Urban Institute under contract with HHS/ACF. NICC's calculations are performed by an adapted version of the TRIM3 microsimulation model. The standard version of TRIM3 is funded and copyrighted by HHS/ASPE and developed and maintained by the Urban Institute. We are further working with the TRIM3 model to try to determine just how many households are subject to these high rates, which depend upon both family structure and participation levels.

Chairman DAVIS. Mr. Bernstein.

STATEMENT OF JARED BERNSEIN, PH.D., SENIOR FELLOW, CENTER ON BUDGET AND POLICY PRIORITIES

Mr. BERNSTEIN. Chairman Davis, Ranking Member, Representative Doggett, I thank you for inviting me to testify today. My first point, however, is that I believe that it is essential to broaden the question at the heart of this hearing. For policymakers to best understand the impacts of the policies under review, we must investigate not just any work disincentives they may engender, but also work incentives. For example, as has been heard numerous times today, the Earned Income Tax Credit, an important wage subsidy for low-income workers, has been found to have large work-incentive effects. It lifts millions of families out of poverty, working families. Surely this is why it was one of Ronald Reagan's favorite anti-poverty programs.

And that raises another necessary dimension along which these programs must be evaluated: To what extent do they achieve their poverty-reduction targets; in other words, to examine only the marginal tax rates and work disincentives associated with our anti-poverty programs, risks and incomplete understanding of the impact of the programs on work, on poverty and on well-being?

So research on these questions finds the following. While benefits of means-tested programs are, by definition, reduced as incomes rise beyond a certain point, their work disincentives differ. And a number of significant programs, including the EITC and SNAP, formerly food stamps, are found to have either positive or neutral effects on labor supply.

The EITC extensively studied in this regard has yielded the following finding from a recent comprehensive review. The overwhelming finding, the empirical literature, is that the EITC has been especially successful at encouraging the employment of single parents, especially mothers. A recent exhaustive review of the poverty reduction effectiveness of the full scope of our safety net and social insurance programs found "the combination of the means tested and social insurance transfers in the system have a major impact on poverty, reducing deep poverty, poverty and near-poverty rates by about 14 percentage points in the U.S. population as a whole.

The next finding from that study is particularly germane to today's hearing. Quote, "This poverty reduction impact is only negligibly affected by work incentives, which, in the aggregate, have almost no effect on the pretransfer rates of poverty in the population as a whole."

In other words, what is notable about this research is that it finds these significant and quantitatively large poverty-reduction effects after accounting for any work disincentives implicit in the programs.

Other recent research has found positive generational effects of safety net programs on later education and earnings outcomes of children from families that receive such benefits. For example, one study finds that raising a poor family's income by 3,000 a year—and that is a fairly typical amount for a poor family to receive from the child tax credit or the EITC before age 5—is associated with a 17 percent increase in earnings and an average of 135 hours of additional work per year compared to similarly low-income children whose families do not receive the benefits of these safety net programs.

One poverty expert summarized the findings as, quote, a remarkably strong body of research, much of it based on large-scale, well-implemented, experimental research designs showing that supplementing the earnings of parents helps raise families out of poverty and improves the school performance of young children.

This research clearly suggests that reducing those benefits would, net of any work disincentive effects, lower income, raise poverty, and harm future generations in terms of their educational and earnings outcome.

Finally, to the extent that work disincentives exist, policymakers should consider ways to reduce or eliminate them. In the final section of my testimony I offer three ways to do so. First, lower marginal tax rates by extending phaseout ranges, though of course this increases costs. Provide work supports such as child care and transportation assistance. And third, increase number of jobs available to low-income workers through demand-side policies.

Given the persistent weakness in the low-wage labor market in recent years, I want to be sure to stress the importance of this last point. Research over the last few decades has shown that the most effective work incentives for working-age members of low-income families are tight labor markets with rising pretax wages. In this regard, policies such as the job creation measures in President Obama's American Jobs Act will prove far more effective in incentivizing work than lowering marginal tax rates on safety net benefits.

Conversely, it would be a significant policy mistake to require recipients of benefits to work without first ensuring adequate job availability. Even in a climate of strong work incentives, without adequate job availability, this is a policy recipe for rising poverty and the accompanying strain on families and children. Thank you.

Chairman DAVIS. Thank you Mr. Bernstein.

[The prepared statement of Mr. Bernstein follows:]

Testimony before the Subcommittee on Human Resources of the Committee on Ways and Means

Work Disincentives and the Safety Net

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6/27/2012

Introduction

Chairmen Davis and Tiberi and ranking members Rep. Doggett and Rep. Neal, I thank you for inviting me to testify on this important question of our safety net and tax benefit programs and their impact on work.

My first point, however, is that I believe it is essential to broaden the question at the heart of this hearing. For policy makers to gain a full understanding of the impacts of the policies under review, we must investigate not solely any work disincentives they may engender, but also work *in*centives. For example, the Earned Income Tax Credit, an important wage subsidy for low-income workers, has been found to have large work *in*centive effects.

The EITC also lifts millions of working families out of poverty (surely, this was why the EITC was Ronald Reagan's favorite anti-poverty program) and that raises another necessary dimension along which these programs must be evaluated: to what extent do they achieve their poverty reduction goals?

In other words, while it makes sense to examine the marginal tax rates and work disincentives associated with our anti-poverty programs, to stop there risks an incomplete understanding of the impact of the programs on work, poverty, and well-being.

A review of work disincentives, work incentives, and poverty reduction yields these central findings:

--While benefits of means-tested programs are, by definition, reduced as incomes raise beyond of certain point, their work disincentives differ, and a number of significant programs, including the EITC and SNAP, are found to have either positive or neutral impacts on labor supply.

--A recent, exhaustive review of the poverty reduction effectiveness of our safety net and social insurance programs found that "...the combination of the means-tested and social insurance transfers in the system have a major impact on poverty, reducing deep poverty, poverty, and near-poverty rates by about 14 percentage points in the U.S. population as a whole in 2004."

--Importantly, the study concluded that "...this impact is only negligibly affected by work incentives which, in the aggregate, have almost no effect on the pre-transfer rates of poverty in the population as a whole."

--Recent research also finds positive generational effects of safety net programs on later education and earnings outcomes of children from families that received such benefits. In the full accounting that I'm advocating, these benefits too must be assessed against any costs of work disincentives.

Finally, to the extent that work disincentives exist, policy makers should consider ways to reduce or eliminate them. In the final section of my testimony I offer three ways to do so:

--lower marginal tax rates by extending phase out ranges (though this increases costs);

--provide work supports, such as child care and transportation assistance;
--increase the number of jobs available to low-income workers through demand side policies.

Given the persistent weakness in the low-wage labor market in recent years, I want to be sure to stress the importance of this last point. Research over the last few decades has shown that the most effective work incentives for working-age members of low-income families are tight labor markets with rising pre-tax wages. In this regard, policies such as the job-creation measures in President Obama's American Jobs Act will prove far more effective in incentivizing work than lowering marginal tax rates on safety net benefits.

Conversely, it would be a significant policy mistake to require recipients of benefits to work without first ensuring adequate job availability. Even in a climate of strong work incentives, without adequate job availability, this is a policy recipe for rising poverty and the accompanying strain and families and children.

Evidence Regarding the Impact on Work

By construction, the benefits from means-tested safety net programs are reduced or eliminated once the income of beneficiaries rises beyond a certain level. That is, benefits face marginal tax rates—which could be 100%--once incomes surpass a particular program parameter. This has led policy makers to question the behavioral impacts—for example, regarding labor supply—on program recipients who face these "benefit cliffs" or high marginal rates.

In some cases, since higher earnings can reduce benefits, often quite steeply, the prediction is that beneficiaries of means-tested programs would reduce work to maximize benefit receipt. However, program parameters matter and can greatly influence the actual behavioral responses of beneficiaries.

Consider, for example, the EITC. For a worker from a low-income family with two children, every pretax dollar earned returns $1.40 between income levels of $1 and about $17,000. At income above these levels, the wage subsidy begins to phase out at a rate of 21%, and it is fully exhausted at about $42,000. In this regard, it is incorrect to conclude that workers exposed to the phase-out rate do not benefit from the program, though their incentive to work more is clearly diminished in the phase-out range.

It is thus an empirical question as to the net effective of these incentives on labor supply, and considerable research has been devoted to just this question. One authoritative review of this literature concluded that "...the overwhelming finding of the empirical literature is that EITC has been especially successful at encouraging the employment of single parents, especially mothers."[1]

Research also investigated the role of the early 1990s EITC expansion in helping to incentivize single parents, mostly moms, to move from welfare to work. One study found that the

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[1] Nada Eissa and Hilary Hoynes, "Behavioral Responses to Taxes: Lessons from the EITC and Labor Supply," October 10, 2005, http://www.econ.ucdavis.edu/working_papers/05-29.pdf.

refundable tax credit had a larger effect than the welfare law in generating the considerable employment gains that occurred in those years.[2]

Both the EITC and Child Tax Credit are only available to working parents. Thus, they have unambiguously strong work incentives at the "extensive" margin, meaning they significantly increase the incentive of non-workers to enter the labor market. Their impact on hours work--the "intensive" margin--is more ambiguous, depending on where a worker locates on the EITC schedule, and is thus an empirical question. In fact, various studies have found large, positive effects at the extensive margin and little impact on hours worked. Ben-Shalom et al (2011) summarize this point: "The evidence suggests that the [EITC] has had a positive impact on the employment rates of single mothers but no effect on their hours of work if working…"

Thus, even with its work disincentive effect in its phase-out range, on net, the EITC is widely recognized as encouraging work, and, as discussed next, reducing poverty. In announcing this hearing, Rep Davis pointed out that "Americans should believe with confidence that hard work pays off." Surely, we would all agree, with no less the President Ronald Reagan, that the EITC meets this venerable criterion.

Of course, the American system of safety net programs goes well beyond the clearly pro-work, refundable credits discussed above. There are many more means-tested programs targeted at poverty reduction, nutrition, retirement security, and subsidized housing. Fortunately, a group of academic poverty analysts recently released an exhaustive review of the impact of the full set of anti-poverty programs, including means tested benefits and social insurance programs, such as Social Security, Social Security Disability Insurance, Unemployment Insurance, and others (the authors are Ben-Shalom, Moffitt, and Scholz, or BMS).

The research question of this work is the "holistic" one that I view as essential in evaluating these programs: do they, on net (factoring in both work incentives and disincentives) accomplish their goal of improving the economic conditions of their target populations? Their main finding is in this regard particularly germane to today's hearing:

"First, the combination of the means-tested and social insurance transfers in the system have a major impact on poverty, reducing deep poverty, poverty, and near-poverty rates by about 14 percentage points in the U.S. population as a whole in 2004. Second, this impact is only negligibly affected by work incentives which, in the aggregate, have almost no effect on the pre-transfer rates of poverty in the population as a whole."

Of course, since a relatively small share of the total population participates in anti-poverty programs, it is reasonable to look more closely at the participant population themselves. BMS provide a quantification of any disincentive effects in the following way. They first calculate the pre-transfer poverty rate (and deep poverty rate) for recipients of various programs. They then factor in estimates of behavioral effects--work disincentives--and recalculate these pre-transfer poverty rates absent the disincentives. These simulated rates will be lower since work

[2] Jeffrey Grogger, "The Effects of Time Limits, the EITC, and Other Policy Changes on Welfare Use, Work, and Income among Female-Head Families," *Review of Economics and Statistics*, May 2003.

disincentives lower incomes and raise poverty. Finally, they calculate the post-transfer poverty rates.

This enables us to quantify what might be regarded as a core question of this hearing: accounting for work disincentives, do these programs still have substantial poverty reduction effects? Suppose, for example, that pre-transfer poverty rate for recipients of TANF were 50% and post-transfer rates were 20%. We might conclude that TANF lowered poverty rates by three-fifths. But suppose that in the absence of work disincentive, we estimate that poverty rates among this population would have been half as large—25% versus 50%. In this case, accounting for the impact of work disincentives, poverty reduction attributable to the program is only five percentage points, not 30. Not accounting for work disincentives, we'd argue the program quite impressively reduces poverty by three-fifths. But accounting for disincentives, we'd see it reduces poverty by only one-fifth.

Table 1 shows these results with the key variable in the last column: how important are the behavior responses for both poverty reduction and for deep poverty reduction (for families under half the poverty line)? For most programs, the differences between columns one and two are small relative to the base, less than 10% of the poverty reduction.

Still, the general impression from the table would probably surprise those expecting large disincentive impacts. In the popular imagination, for example, TANF is thought to generate large work disincentives among the poor. Yet, the poverty rate among TANF families after accounting for estimates of the actual behavioral effects on labor supply is just about the same as before such an accounting.

Moreover, the poverty reduction effects dominate. TANF benefits lift 17.5% of families out of deep poverty, and less than two of those percentage points can be attributed to behavioral effects. Unemployment compensation reduces poverty by 13 percentage points, while work disincentives account for less than one of those points. While work disincentives show up in this analysis, they are quantitatively small relative to poverty reduction.

SNAP, formerly food stamps, does not show up in BMS's table because their read of the literature suggests food assistance has no impact on labor supply.[3] However, my CBPP colleague Stacy Dean points out that "Over the last two decades, the share of SNAP households that are *working* households has risen significantly. In 2010 more than three times as many SNAP households worked as relied entirely on welfare benefits for their income. Nearly half of all SNAP households with children have earned income."

Dean attributes this increase in part to the fact that the SNAP benefit formula incentivizes work, similarly to the EITC incentives described above. "For every additional dollar a SNAP recipient earns, her benefits decline by only 24 to 36 cents — much less than in most other programs. Families that receive SNAP thus have a strong incentive to work longer hours or to search for better-paying employment." I return to this insight regarding such pro-work mild phase outs at the end of this testimony.

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[3] BMS note a study that used the introduction of the Food Stamps program in the 1970s to gauge its impact of labor supply. The estimates on labor supply, they note, were negative but "small and almost always insignificant."

Generational Impacts

The central point of this testimony is that in order to fairly and fully evaluate our safety net, any net work disincentives must be considered against benefits like poverty reduction, as above. But recent research goes beyond the short-term impacts of higher family income and looks at the longer term impact on children in these families, both in terms of educational and employment outcomes. Some of these findings include:

--One recent study finds that raising a poor family's income by $3,000 a year (a fairly typical amount for a poor family to receive from the CTC and EITC) between a child's prenatal year and fifth birthday is associated with a 17 percent increase in earnings, and an average of 135 hours of additional work per year, compared to similarly low-income children whose families do not receive the increase in income.[4]

--Researchers analyzed ten anti-poverty and welfare-to-work experiments and found a consistent pattern of better school results for children in programs that provided more income. Each $1,000 increase (in 2005 dollars) in annual income (the equivalent of a full Child Tax Credit for one child) sustained over two to five years, led to modest but statistically significant increases in young children's school performance on a number of measures, including test scores. While the study did not specifically analyze the EITC's impact, the researchers noted that their results are most germane to "income-boosting policies that link increases in income to increases in employment" — an apt description of the EITC.[5]

--Researchers analyzed administrative data from a large urban school district and the corresponding U.S. tax records for all families in that school district. They found that even under conservative assumptions, additional income from the EITC and CTC leads to significant increases in younger student test scores.[6] Another study using different data--nearly two decades worth of survey data on mothers and their children--concluded that additional income from the EITC raises the combined math and reading test scores of students by similarly large magnitudes.[7]

--Gordon Berlin, the president of one of the nation's leading research organizations—MDRC, with a long history of rigorous evaluation of anti-poverty and welfare-to-work programs—summarizes these results, noting:

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[4] Greg J. Duncan, Kathleen M. Ziol-Guest, and Ariel Kalil, "Early-Childhood Poverty and Adult Attainment, Behavior, and Health," *Child Development* (January/February 2010), pp. 306-325

[5] Duncan, Morris, and Rodrigues, 2010

[6] Raj Chetty, John N. Friedman, and Jonah Rockoff, "New Evidence on the Long-Term Impacts of Tax Credits," Statistics of Income Paper Series, November 2011, http://www.irs.gov/pub/irs-soi/11rpchettyfriedmanrockoff.pdf

[7] The figures in the Dahl and Lochner study are expressed in 2000 dollars.
Gordon Dahl and Lance Lochner, "The Impact Of Family Income On Child Achievement: Evidence From The Earned Income Tax Credit," NBER Working Paper No. 14599, December 2008, http://www.nber.org/papers/w14599.

> [There is] a remarkably strong body of research — much of it based on large-scale, well-implemented, experimental research designs — showing that supplementing the earnings of parents helps raise families out of poverty and improves the school performance of young children…We have reliable evidence involving thousands of families in multiple studies demonstrating that "making work pay" causes improvements in young children's school performance.[8]

This research clearly suggests that reducing these benefits would, ***net of any work disincentive effects***, lower income, raise poverty and harm future generations in terms of their educational and earnings outcomes.

Lowering Work Disincentives

A full assessment of the impact of the US safety net suggests we are getting a good "bang-for-our-bucks" in terms of poverty reduction and positive outcomes for children in beneficiary families. Yet, as Table 1 shows above, "net" work disincentives can be found in some of these programs ("net" meaning that unlike the EITC, the net of work incentives and disincentives is negative). How could policy makers reduce or eliminate them?

--End cliffs; lengthen phase out ranges: Means-tested programs, by definition, cease their benefit payout at some designated income level. Some programs, like SNAP and TANF, have steep cliffs—their benefits phase out quickly once family income reaches a certain threshold. Other programs, like the CTC or the EITC, phase out more slowly, and in the case of the CTC, starting from a relatively high income level (over $100,000 for married couples).

In the context of today's hearing, steep cliffs and high phase out rates cause high marginal tax rates and thus theoretically disincentivize work (as I've stressed, however, this is an empirical question). To get rid of them is technically simple: Congress would simply need to lower the rate at which benefits are reduced for each extra dollar a family earns.

Of course, this would make the programs more expensive, though the net cost would be reduced to the extent that the change incentivized more work by program recipients. How much more expensive is beyond the scope of this testimony, though if members are interested in learning more about such options, I would be happy to pursue such research.

The larger point is this: there is deep bipartisan agreement that our economy needs safety net programs to catch vulnerable families, particularly in periods of market failure, like the Great Recession from which we are still climbing out. Yet, partially for fiscal reasons, these programs are generally means-tested—their benefits are tied to income.

Once benefits are tied to income, marginal tax rates that can disincentivize work are created. That is an unavoidable outcome of the structure of these programs as I've just described. An important point stressed throughout is that the actual impact of such disincentives cannot be

[8] Gordon L. Berlin, remarks at National Summit on America's Children, May 22, 2007, http://www.mdrc.org/publications/456/presentation.html.

assumed. It is an empirical question, and in most cases, the research shows little negative impact.

--***Work supports:*** As shown in Table 1, the research on the behavioral impacts of marginal tax rates on safety net programs shows that they have minimal impact on poverty reduction. Therefore, while reducing those rates could help mitigate what effects exist, a more promising margin to further incentivize work among safety net beneficiaries would be to increase work supports: policies to help low-income, often low-skilled workers, who are often parents of young children, get and keep jobs.

These include assistance with child care, transportation, job training, job placement, wage subsidies, housing, and even mobility, as such workers may be stuck in areas with less opportunity, yet unable to relocate to more promising areas.

--***More Job Opportunities:*** Finally, the sole focus of the discussion so far has been on the "supply-side" of the equation—examining how individuals respond to incentives created by safety net programs. Yet, even with perfectly aligned incentives, the absence of enough jobs is a far more influential determinant of employment outcomes of workers from low-income (or any income) families.

The marginal tax rate arguments implicitly assume that jobs are available to program recipients, but that they don't take them because the increase in the after-tax income (including benefit losses) doesn't meet their reservation wage. But that assumption is far less relevant at high unemployment than at full unemployment. And the low-wage labor market has been characterized by high-unemployment for years.

For example, Figure 1 below shows unemployment rates by education level for persons 25 years and up for those with less than high-school, high-school, and all. The rates for less-educated workers are consistently above the average, and the least-educated, unemployment has been in double digits since the fall of 2008. Data from the Economic Policy Institute reveal that the hourly earnings of low-wage workers have been flat or falling for the past few years (a continuation of a longer-term trend).[9] This combination of high unemployment and falling real earnings provide a clear sign of weak labor demand.

My own work has found that the benefits of a tight job market—one characterized by very low unemployment—are significantly greater for those at the low end of the wage scale. For example, for each percentage point lower unemployment, the increase in real hourly wages for low-wage workers is at least twice that of high wage workers.[10]

In this regard, if this committee wants to support the most effective work incentives for working-age members of low-income families, they should consider those demand-side policies that quickly raise the number of jobs and employ the most jobseekers. For example, President Obama has proposed temporary fiscal relief to states to attack the persistent flow of layoffs of

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[9] EPI data show that real hourly wages at the 10th and 20th percentile are down 3-4% since 2007 (forthcoming, State of Working America, 2012).

[10] See, for example, Bernstein and Baker, *The Benefits of Full Employment*, Economic Policy Institute, 2003, Figure 4E.

public sector workers from states facing steep revenue shortfalls. Infrastructure programs, such as addressing the maintenance backlog at our public schools, could also help quickly create needed employment, as would the passage of a robust transportation bill. Particularly given today's weak demand climate, such policies will prove far more effective in incentivizing work than lowering marginal tax rates.

Conversely, it would be a significant policy mistake to require recipients of benefits to work without first ensuring adequate job availability. Even in a climate of strong work incentives, without the jobs, this is a policy recipe for rising poverty and the accompanying strain and families and children.

Conclusion

Work disincentives in the form of marginal tax rates on benefits are, by construction, a feature of means-tested, poverty reduction programs. The question is thus not whether they exist, but what is their impact on poverty reduction and the well-being of economically vulnerable families and their children? This is decidedly an empirical question.

The research reviewed here finds that in virtually every safety net program that has been empirically evaluated, poverty reduction effects swamp any work disincentives. That is, even accounting for any poverty-inducing impacts, the net increase in income and reduction in poverty rates of families that participate in the American safety net are substantial. As one comprehensive study summarized it:

"First, the combination of the means-tested and social insurance transfers in the system have a major impact on poverty, reducing deep poverty, poverty, and near-poverty rates by about 14 percentage points in the U.S. population as a whole in 2004. Second, this impact is only negligibly affected by work incentives which, in the aggregate, have almost no effect on the pre-transfer rates of poverty in the population as a whole."

Recent research has added an important finding to this summary: the poverty reduction that occurs thanks to these programs has significant, positive effects on the future education, employment, and earnings outcomes of the children in recipient families. In this regard, measures that reduce benefits will be far more likely to lead to lower incomes, higher poverty, and worse child outcomes than to increased work effort.

However, to the extent that Congress wants to mitigate any work disincentives in means-tested programs, I recommend three areas of policy intervention. Extending phase-outs lowers any marginal tax rates on benefits, but it raises program costs. Work supports, such as child care assistance, have been shown to be extremely useful in helping low-income parents find and keep work. And most importantly in today's weak demand climate, demand side measures such as those put forth by President Obama in the American Jobs Act are essential. No matter how cleverly we align incentives, if there are not enough jobs for job seekers, those incentives will be ineffective and poverty will rise.

I thank my CBPP colleagues Arloc Sherman, Indi Dutta-Gupta, Will Fischer, and Stacy Dean for help in preparing this testimony, though any mistakes are my own.

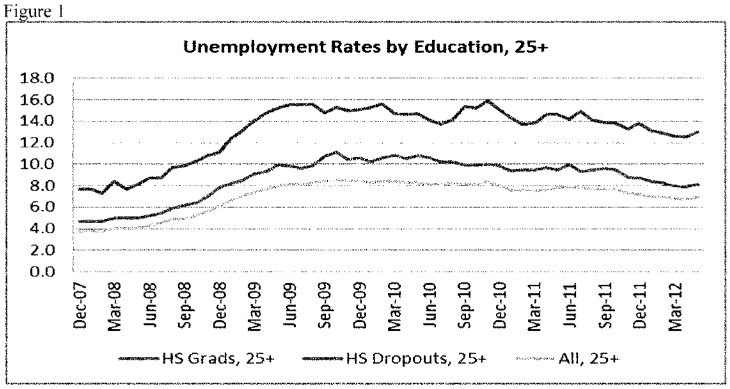
Table 1: Poverty Reduction Impact of Safety Net Programs, Accounting for Work Disincentives

	Poverty Rates		
Safety Net Program	Pre-transfer	Pre-transfer (accounting for behavioral effects)	Post-transfer
SSI	80.2%	78.6%	72.2%
TANF	81.1%	80.6%	74.1%
Housing Asst	80.9%	74.7%	66.0%
Social Sec	49.2%	48.6%	12.5%
Disability Ins	70.5%	67.8%	40.7%
Medicare	54.2%	54.0%	14.0%
Unemployment Comp	53.1%	52.6%	40.1%
Workers Comp	53.9%	51.5%	4.6%

	Below 50% of Poverty		
	Pre-transfer	Pre-transfer (accounting for behavioral effects)	Post-transfer
SSI	73.0%	70.5%	39.2%
TANF	66.4%	64.8%	48.9%
Housing Asst	67.7%	61.3%	25.5%
Social Sec	36.8%	36.4%	2.4%
Disability Ins	60.0%	56.9%	12.8%
Medicare	41.6%	41.5%	0.4%
Unemployment Comp	35.2%	33.8%	17.6%
Workers Comp	42.3%	40.1%	0.7%

Source: BSM, Table 9

Figure 1



Source: BLS

Chairman DAVIS. Mr. Brannon.

STATEMENT OF IKE BRANNON, PH.D, DIRECTOR OF ECONOMIC POLICY AND CONGRESSIONAL RELATIONS, AMERICAN ACTION FORUM

Mr. BRANNON. Thank you very much, and I want to thank the committee for the invitation to speak here.

As a tax economist, the one thing I have realized through the years looking at the research is that tax rates matter. And very high tax rates, no matter where you are at in the income ladder, tend to deter employment and how much people want or are willing to work. And one of the things we have seen from a plethora of research in the welfare rolls is that because of all these various programs Mr. Steuerle has pointed out, you have marginal tax rates that regularly reach 40 percent for low-income people and can in certain situations go up as high as 80 percent or even 100 percent if you take into account the various State and local programs. No one really designed the programs to be this way.

To quote a former Treasury Secretary, just like the tax system, we should have a welfare system that "looks like it was designed on purpose." Every program was designed well and was put in by well-meaning people, but when you have 12 or 13 different programs at the Federal level, the State level, and sometimes at the local and regional level, these things act to create tremendous disincentives.

I think this is something that appeals to a number of people on the committee, and I suspect that is why you had the Honorable Duncan Smith here to talk about what they are doing in the United Kingdom. To me that makes a lot of sense. Instead of having several different programs that might be at odds and, combined, create tremendous disincentives to work, it makes a lot more sense to have one overarching program.

It is very difficult to implement, I understand that, especially when you consider my hometown of Mossville, Illinois. People who are low income there get benefits at the Federal level, they get certain benefits at the State level, and they also get benefits from the township itself. Having a Federal Government design one overarching welfare reform program can be very, very difficult, and it might be impossible to tell the States and the townships to butt out.

But nevertheless, we need to do something so that people aren't facing 70 or 80 percent tax rates. Both this Congress and previous Congresses have looked at this program and there have been bipartisan efforts to do this.

One thing I would just like to recommend that this committee look at again, in 2002 and 2003 there was discussion about reforming the unemployment insurance system. One of the things we see with the unemployment insurance system is that if the unemployment benefits go on for 26 weeks, what happens is that when 100 people get laid off, about 30 or 40 percent find new jobs the first month, another 5 or 10 find jobs the second month, and then hardly anyone finds jobs until month 7, and then the majority of people who are still unemployed find employment that seventh month. If you extend it to 9 months, the magic month is 10 months. If you extend it to 12 months, the magic number is 13 months.

One of the suggestions—a bipartisan effort was put forth in the Senate Finance Committee in 2002 and 2003—was to change that to something they called personal reemployment accounts, where, when people were laid off, instead of being given a monthly benefit as long as they didn't have a job, they were simply given an account, money that they could use to support their family or to get additional training or education or something like that. It totally eliminates the marginal disincentive that unemployment insurance provides to recipients against work.

Doing such a thing might be difficult and impossible for other welfare programs, but it is a model that people need to recognize.

People respond to incentives, and as Congresswoman Moore pointed out, they might not have college degrees but the typical welfare recipient is able to figure out whether or not it is worth their while to work. What we don't want to do is make sure people get just enough to get by and then provide disincentives for them to work.

Chairman DAVIS. Thank you very much.

[The prepared statement of Mr. Brannon follows:]

AMERICAN ACTION FORUM

Testimony before the Ways and Means Committee
How Welfare and Tax Benefits can Discourage Work
Ike Brannon, Ph.D.[1]
Director of Economic Policy, The American Action Forum
June 27th, 2012

I would like to thank Chairmen Davis and Tiberi, Ranking Members Doggett and Neal, as well as the other members of the subcommittees for the invitation to address the committee on this topic.

During my 20 years as a professional economist I have come to the conclusion that marginal tax rates matter a *lot*: the proportion of each dollar of income that a person keeps to spend or save has a tremendous effect on how much (and whether) we work, how much we save, and when we retire.

What's more, this is true across all income classes. While the bulk of the academic research and political debate tends to focus on the marginal tax rates on small businesses and upper income households, the truth is that even middle and lower-income households can face high effective marginal tax rates exceeding 40 percent, thanks to the phase-outs of poorly-designed welfare and entitlement programs. Regardless of a person's income, high marginal tax rates deter work, effort, and reported income.

In the 1970s and 1980s the labor market literature described men between 30 and 55 as the "hard core" employed. Regardless of what happened to tax rates, the economy, or the broader economic landscape men in this cohort worked—they had to, since most of this cohort was married and supported a family.

However, this is no longer the case. The labor force participation rates for thirty-something and forty-something men has been trending down for almost two decades, for a variety of reasons. First, fewer people are choosing to get married at all: only 51 percent of all adults 18 or older are married today, the lowest this has ever been[2]. Men who aren't married and are without a family have fewer obligations keeping them in the work force.

Men who do marry are doing so later: today, the average age of a first marriage is now 29 for men and 27 for women[3], which is two years higher than it was just a decade ago. What's more, men who do get married are much more likely to have a spouse who is working than twenty or thirty years ago, as we have seen a dramatic rise in women's labor force participation rates—especially among married

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[1] These comments represent my own and not necessarily the opinions of the American Action Forum.
[2] Morello, Carol: "Married Adults at Record Low." *Washington Post*, December 14 2011.
[3] U.S. Census Bureau, 2010 Community Survey.

women—over the last three decades. In short, we are in an economy where more and more people have options to toiling at a job for forty hours a week—and if it isn't worth their while they will work part-time and/or live off the financial support of their spouse, their parents, their savings, or welfare.

None of these options are necessarily problematic: we can all conjure the image of a graduate student bunking with his family, or a husband who remains at home to raise their children, or empty nesters scaling down their lifestyle and retiring early to take care of their parents. However, I submit that these scenarios do not describe the vast majority of people dropping out of the labor force.

To be sure, the main reason that we have seen greater numbers of people unemployed the last four years than at any time since 1982 has been our moribund economy, but not a few of the 12.7 million people currently unemployed are not working because they have decided it is not worth their while, and recent policy changes have led many more to reach that conclusion.

High Implicit Marginal Tax Rates Deter Labor Force Participation

There has been a lot of work—and contentious debate—over how high marginal tax rates on upper income earners and small businesses deter work and reported income; indeed, it is the primary point of contention between the two parties with regards to tax policy today, it is safe to say. In the spirit of comity and quest for brevity I will focus on people in the lower portions of the income distribution.

Most people imagine that our tax code is uniformly progressive, with effective marginal tax rates gradually rising with income. However, the combined effects of our tax code and the myriad welfare programs result in a very jagged marginal tax rate profile for lower-income individuals. For instance, the earned income-tax credit program phases out benefits for low-income earners at a rate of $1 for every $6 earned, with benefits ceasing for households earning above roughly $50,000. 27 million families received the benefit in 2009.[4] SNAP benefits (i.e. food stamps) are another benefit for those at or near poverty that quickly phases out as incomes increase, and nearly 47 million people receive them.

The reason for the relatively rapid phase-outs is that some in Congress wanted to make sure that these benefits disproportionately helped lower-income families that pay no taxes, and the right was willing to accept these limitations to keep benefit costs down. As a result, people at the bottom of the distribution see their benefits quickly diminish as their obtain jobs and start to work. A working parent in a family of four may see an effective marginal tax rate above twenty percent at an income between $40,000 and $50,000 a year—a result that makes no economic sense at all to anyone on either side of the aisle.

There are also situations where the cost of earning more money can exceed 100 percent. For instance, the Obama administration has encouraged states to implement "broad-based categorical eligibility" for SNAP benefits, meaning that they are to deem an applicant eligible if he is receiving another low-income assistance program or merely received a brochure inviting him to apply. Making enough money to be ineligible for TANF will thus trigger the loss of all SNAP benefits as well. Restricting eligibility of SNAP benefits to actual TANF beneficiaries would save $11.7 billion over the next decade, incidentally.

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[4] "Policy Basics: The Earned Income Tax Credit." The Center for Budget and Policy Priorities, February 2012.

Recent Changes to Welfare Programs have Depressed Work Incentives

In the wake of the Great Recession, Congress substantially altered eligibility rules for various welfare benefits. For instance, it extended the length of unemployment insurance benefits to 99 weeks, exempted a portion of UI benefits from taxation, awarded a weekly $25 bonus to recipients, eliminated extended benefit experience rating, and for a time covered 65 percent of COBRA expenses after a layoff.

The government also relaxed asset and net income tests for SNAP benefits, increased the maximum benefit *twice* (October 2008 and then in April 2009), excluded more income from the benefit formula, and took other steps to expand the ranks of eligible food stamp recipients.

The result of this munificence is that the statutory safety net generosity for non-elderly heads or spouses markedly increased since 2008. University of Chicago economist Casey Mulligan estimated that it increased by nearly six percentage points from 2008 to 2009, reaching nearly fifty percent of the average laid-off person's income, including foregone taxes[5].

One thing that economists know—and the data show—is that when the net benefits to working are lower, people are less likely to find work. For instance, increasing the number of weeks that a worker receives unemployment insurance is commonly done whenever there is a recession, although 99 weeks is well beyond what was done in previous recessions. What we observe when benefits last 26 weeks, as is normally the case, is that a fair proportion of people find jobs the first month or two, a trickle of others find jobs in months three through six, and then most of the rest become employed in month seven, when benefits expire. When we extend benefits to nine months we see the same pattern, except that the magical month when the bulk of the unemployed rejoin the work force becomes month ten. Or if we extend it to 52 weeks then it becomes month thirteen. Most people would rather not work if they can afford not to, it turns out, and I include myself among that number.

In essence, these changes have increased the effective marginal tax rate on lower and middle income workers. Mulligan estimates that the effective marginal tax rate for workers receiving the standard mix of benefits for unemployed workers has gone up by over four percentage points since 2008.[6] People with relatively modest incomes are losing as much as forty percent of each dollar earned, and this has definitely had an impact on labor market behavior. This includes the effect of the "temporary" two percentage point reduction in the employee portion of the payroll tax.

Incidentally, Mulligan estimates that the brunt of the increase in the cost of federal income security programs resulted *not* merely as a consequence of the severe recession, but primarily due to the increased generosity of the benefits. Government spending on unemployment insurance and SNAP is at least triple of what it would have been if the real benefit and eligibility rules had remained as they were in 2009.[7]

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[5] Mulligan, Casey B. "The Expanding Social Safety Net." NBER working paper no. 17654, December 2011.
[6] Mulligan, Casey B. "*The Labor Market and the Great Recession: How Redistribution Distorted the Economy.* Oxford Press, 2012.
[7] Mulligan, "*The Labor Market and the Great Recession.*"

PPACA will Exacerbate the Cost of working for Lower-income Earners

The Affordable Care Act will make health insurance available to individuals whose employers do not provide health insurance through the creation of various state-run health exchanges. Low-income workers will receive a subsidy to purchase health insurance, which the law begins to phase out when a family's income rises above 133 percent of the poverty level. As a result of the claw back, the effective marginal tax rate facing low-income earners will go up even higher: Economists Alex Brill and my boss, Doug Holtz-Eakin, estimate that this subsidy phase-out can add as much as ten percentage points to the effective marginal tax rates of the subsidy recipients.[8] On top of the slough of already generous benefits it is sheer folly to add yet another that serves to further increase the effective cost of employment for the lower and middle class.

No one is accusing people receiving these benefits and eschewing work to be lazy: People generally behave rationally, respond to incentives, and are well aware of the opportunity costs of their choices. For example, a couple with a young child at home may sensibly conclude that it does not make sense for the husband to take additional hours of work or for the wife to take a part-time job because of the subsequent reduction in benefits this would trigger.

The longer-term problem with the lower labor market participation rates among this cohort is that it can be self-reinforcing: the longer people go without a job the more their skills atrophy or become outdated and their contacts become stale and it becomes more difficult for them to obtain a job, not to mention the stigma that being out of work for an extended period of time has in the eyes of many employers, unfairly or not. This is especially damaging for younger workers, who need not only to acquire experience and skill but also a familiarity with the ways of the workaday world. Five years of intermittent work at the beginning of one's ostensible career can nip it in the bud.

A former Treasury Secretary (William Simon) once remarked that we should have a tax code that looks like it was done on purpose. The same can be said for our array of welfare benefits and entitlement programs. The creation (and more importantly, the recent expansion) of each one was done with good intentions, but the cumulative effect has been to create a system that discourages people from working, while costing our government tens of billions of dollars it cannot afford. And it is important to note that the enormous ballooning in cost is *not* due to the recession, and that it is the very design and recent munificence of the benefits that are exacerbating the unemployment we are currently experiencing.

Nearly twenty years ago the Congress and Administration worked together to craft substantive bipartisan reforms of our welfare system to great success. Millions of Americans that had given up looking for a job returned to the labor market and managed to transition surprisingly well, thanks in no small part to a well-designed system. In a mirror image of our current situation many people attributed the unemployment rate reaching below four percent to the booming economy, but the truth of the matter is that the reformed system that encouraged everyone to look for (and stick with) a job had a lot to do with the booming economy in the first place. It is time we looked at these programs again, holistically, with an eye towards fixing a system that no one can rightfully deny is irredeemably broken.

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[8] Holtz-Eakin, Douglas and Alex Brill, "Another Obama Tax Hike." *Wall Street Journal*, February 4th 2010.

Chairman DAVIS. We will move on to questions now. I would like to recognize Mr. Tiberi, the chairman of the Select Revenue Subcommittee, for 5 minutes.

Chairman TIBERI. Thank you. Mr. Bernstein, I have a chart that you will see on the TV monitor. In your testimony you note that, "for each percentage point lower unemployment, the increase in real hourly wages for low-wage workers is at least twice that of high-wage workers." That is in your testimony.

In January of 2009 you were the coauthor of an administration report titled, "The Job Impact of the American Recovery and Reinvestment Plan." In that report, you may remember, you forecast the unemployment rate today would be 5.7 percent with the administration's stimulus plan passing. As we know, today's unemployment rate is at 8.2 percent and has been above 8 percent for a post-Depression record of 40 straight months.

Is it your testimony that low-wage workers have disproportionately lost out on higher wages due to the elevated unemployment rates we have seen, especially compared with the unemployment rates you forecast in the administration's trillion dollar stimulus plan as it became law?

Mr. BERNSTEIN. Yes, I think the research is very clear on this, as I cited in my testimony. The wages of low-wage workers are, in economics terms, more elastic to the unemployment rate than wages of higher-income workers. And in fact, their unemployment rates are higher as well.

Chairman TIBERI. So what happened?

Mr. BERNSTEIN. Well, you are asking about the forecast?

Chairman TIBERI. Yeah.

Mr. BERNSTEIN. Clearly a different topic than marginal tax rates on safety net programs. When we—that was the administration forecast for unemployment. That is the same one that shows up in the administration's first budget. It is the forecast by what is called the troika: OMB, Council of Economic Advisers, and the Treasury.

That forecast was made by an incoming administration that was just forming in the fourth quarter of 2008. At that time, unbeknownst to us, the economy was cratering, GDP was falling at a rate of almost 9 percent. Now, if you look at the statistics from that time, as we did, it looked like the economy—that the recession was far, far more mild than that. And that is why the forecast for unemployment that you saw was actually the median forecast of all the professional forecasters at the time. You are absolutely right in that we missed the depth and severity, but so did almost everyone else.

I will say that once the Recovery Act was implemented, it was a matter of two quarters later, by the third quarter of 2009, GDP was rising again. And I think that is a real mark of how successful it was in breaking the back of the "great recession," albeit the unemployment rate continues to rise.

Chairman TIBERI. Thank you. Mr. Brannon, you testified on the additional work penalty that the new exchange subsidies—work penalty that the new exchange subsidies provided by ObamaCare would create.

I would like to highlight the fact that these subsidies also impose a marriage penalty through the Tax Code, and that is because they key off the Federal poverty guidelines; and under the Federal poverty guidelines, the poverty level, let's say, for a family of two, is at 135 percent of the poverty level for a single individual rather than double. That means that, for example, two single individuals earning $22,000 a year would lose about $1,400 dollars a year in subsidies if they became married in one household earning 44,000 rather than 22,000 each.

Can you expand on that?

Mr. BRANNON. Well, the major problem with the Affordable Care Act in terms of how it is increasing the marginal tax rates in general is that it provides a subsidy to people who go to the exchange and buy health insurance if they are below the poverty rate, and then the phaseout is relatively steep in order to contain costs.

And so research that my boss, Doug Holtz-Eakin, and Alex Brill did on the subject basically indicated the marginal tax rates for certain individuals will go up anywhere from 5 percentage points to 10 percentage points based on the phaseout of the subsidies to the exchange associated with the Affordable Care Act.

Chairman TIBERI. Even on the lower end?

Mr. BRANNON. Even on the lower end.

Chairman TIBERI. So this impacts low-income individuals at the lower marginal rates and not just in this area of the Tax Code.

Mr. BRANNON. That is right.

Chairman TIBERI. Thank you. I yield back.

Chairman DAVIS. Thank you. The chair now recognizes Mr. Doggett for 5 minutes.

Mr. DOGGETT. Thank you Mr. Chairman. Do each of our witnesses agree that it is important to maintain in its current form the Earned Income Tax Credit?

Mr. THIES. Yes, the positive part yes. I would like, if it is possible, to eliminate the phaseout or blend that into the Tax Code.

Mr. STEUERLE. I would actually expand it to try to figure out ways to include single people. And by the way, I would do it as a substitute for the type of Social Security tax break that I believe is both on Keynesian and supply-side grounds, a weaker incentive for recovery than could be some expansion of the earned income credit that could be cheaper.

Mr. BERNSTEIN. I would add that the expansions that Congress supported to the EITC in the Recovery Act have proven to be extremely helpful in all of the ways you have heard this morning, and I would try to ensure that those expansions remain a permanent part of the program.

Mr. DOGGETT. Mr. Bernstein, let's talk about health care just a little bit.

If I have a high-tech employee in Austin who has a great idea for a start-up, but a family of children with serious illnesses, it is an informed decision for that person to stay with their group health insurance rather than go out and benefit society perhaps by creating a tech start-up.

Similarly, if I have a poor person who can qualify—and in Texas it is very difficult because the State under Governor Perry is mainly about trying to prevent anyone from getting health care—but if they manage to qualify for benefits in the State of Texas for health care, with a sick family, and they choose not to seek a higher-wage job in order to maintain that eligibility for Medicaid, that also would appear to be not an indication of a lack of willingness to work but of an informed decision to try to provide health-care protection.

We attempted to respond to both types of informed decisions with the Affordable Care Act, and, over time, want the availability, particularly the expansion of access for poorer people to health care, remove any cliff or disincentive to work, to create new jobs and new businesses, and new economic opportunities.

Mr. BERNSTEIN. Yes, Congressman, I think you are adding precisely the kind of nuance that I tried to reflect in my testimony which must be brought to these criticisms by my colleagues here on the panel of the implicit tax rates in the Affordable Care Act. There are a lot of moving parts. You just mentioned a number of them. One of the most important is that the Affordable Care Act expands Medicaid, therefore pushing out and lowering any marginal tax rates or work disincentives associated with that program, quite significantly.

And one of the studies that I brought with me today simulates this impact and predicts that the Affordable Care Act, accounting for the disincentives you heard here but the incentives that I just mentioned, would actually increase the employment of single mothers. The Affordable Care Act also reduces job lock which is what you mentioned. It is a highly inefficient problem for people stuck in the wrong job because they will lose coverage if they leave. It increases subsidies for small business. And by the way, if it successfully lowers health costs as expected, that will of course be very positive for job creation as well.

I think what I tried to express in my testimony is that you simply can't do what some of my colleagues have done today, which is look at the marginal tax rates and assume that they reduce labor supply. You have to get into the actual functioning of these programs and look at the empirical outcomes. Now, we can't do that with the ACA yet, because it is not in place, with one exception—Massachusetts. Massachusetts has a health plan much like the Affordable Care Act, and there is a very nice study that looks at the employment effects of health reform in Massachusetts compared to neighboring States which face the same economic conditions but don't have that health-care difference, and it finds no employment effects at all.

So I would be very wary of the simple prediction that says if a tax rate bumps up X it must have Y effect, without considering the kinds of nuances that I think occur in the real world.

Mr. DOGGETT. Thank you very much I yield back.

Chairman DAVIS. Thank you. The gentleman's time is expired. Mr. Marchant from Texas is recognized for 5 minutes.

Mr. MARCHANT. Thank you, Mr. Chairman.

Mr. Steuerle, Mr. Steuerle, economists and researchers have noted for decades that the interaction between welfare and tax benefits can create little incentive for low-income families to work. Is that still pretty much the consensus among economists?

Mr. STEUERLE. Well, I tried to point this out in my testimony. What has happened over the last 2 or 3 decades is we have moved out what used to be called a "poverty trap" to what I now call the "twice poverty trap."

So Mr. Bernstein is right that if you ask about what those reforms have done, they have probably increased labor-force participation. What the research is showing is that although it has increased labor-force participation and particularly for, say, welfare mothers who didn't work, the incentive can only be clearly positive in going from welfare to an earned income credit, or going from welfare to a welfare where you require work. The incentive is only positive towards participating in the labor force.

What has happened, however, is that once you earn a little bit of money, once you get to about 10,000 or 15,000, that is when the disincentives largely strike. And so that is also one reason why we get mixed effects dependent on how you are measuring work.

There is also something we haven't even discussed. You can actually decrease productivity but increase number of workers. So if a second earner doesn't take a job at $40,000 (a full-time job), but a couple of low-income workers work for 10 hours, you can increase labor-force participation, yet decrease output.

I realize I am giving you a more complicated message. But the disincentives have basically moved up the income distribution.

The same thing occurs with the Affordable Care Act that we were just discussing. You have moved away from this disincentive in Medicaid and now you have moved the disincentive higher in the income distribution. So I pointed out in my testimony, for instance, that the Affordable Care Act probably will very much help the disabled to go work who are afraid of losing their Medicaid, but it will probably encourage more elderly people near to retirement to retire because now they can get health care without having to retire. So it is a complicated story in how tax rates discourage work. But the question is how much and for whom. And is this particular design, once you accept a social welfare structure, better than some other design?

Mr. MARCHANT. Another part of the testimony of Secretary Smith was that they had seen some disparity in those that are disabled. And as you know in our system now, we have over the last few years we have almost 700,000 more people on our permanent—our disability rolls than we did before the recession.

So I would like each of you to make a comment about whether you think this disability, this enrollment in disability has to do with obtaining the benefits of Medicare or, slash, Medicaid, and is there a—in his case he said there was very little incentive for someone that was disabled in the U.K. to go into the ranks of the employed—and do we have a similar trap in our system now?

Mr. Thies.

Mr. THIES. I would say if people have a robust incentive to work, then we could rely on their good judgment about whether they are permanently disabled or not in applying, and that when we don't have that robust incentive to work, we might suspect that the person is not balancing the considerations that person faces individually, and we face as a Nation in terms of having a safety net in place, and nevertheless wanting everyone who can to work to the extent that they can.

Mr. MARCHANT. Mr. Steuerle.

Mr. STEUERLE. Mr. Marchant, you are asking what I think is the toughest question in all social welfare policy: how do we design a program for the disabled? As I mentioned, among those near to retirement, disability insurance, for instance, favors retiring on disability rather than old-age insurance. If you retire on disability at 62, you get 30 percent higher benefits than if you retire on old-age insurance. So it creates an incentive, if you have moderate disabilities, to try to figure out if you can qualify for the system.

Among those who really are disabled and have huge medical needs, the system has huge disincentives, once you get that Medicaid, to go back to work. You are really scared not just about losing your health insurance. But even if you take a job that has health insurance, you are not sure how long you are going to last on the job. And then you are afraid of having to get back in the system.

So I don't have an easy answer for you. Disability, reforming disability I think is absolutely required. I think there are too many disincentives in the system to go to work, but it is a tough issue to handle. I think there are some margins where we clearly can make the system better.

Mr. BERNSTEIN. Two very brief points, Congressman.

First of all, and this is just repeating something that I think Gene said a minute ago, the Affordable Care Act, by pushing out, extending, expanding Medicaid eligibility, including to the disabled, actually reduces a work disincentive; and it is pro-work inducing for folks with mild disabilities such that they can go to work. So it kind of reduces a cliff there, which is helpful.

My second point is I think implicit in your question was the idea—and numerous folks have looked at this—the extent to which disability rolls are rising faster than we might expect them to, faster than they have in prior years. And there is a question, are some long-term unemployed people simply using disability as a replacement for unemployment insurance? I am sure that—research suggests there is some of that going on, but one of my colleagues has looked at those numbers. Adjusting for age in the population, as the population ages there is going to be more disability, and that has created significant upward pressure on the rolls as well. So at some level, it pushes back on that idea that folks are illegitimately getting on the rolls.

Chairman DAVIS. Thank you. The gentleman's time has expired. The chair recognizes Mr. Neal for 5 minutes.

Mr. NEAL. Thank you, Mr. Chairman.

Just a point that Mr. Bernstein mentioned earlier. One of the things that is significant about that Massachusetts plan is the consumer satisfaction rate. It remains pretty popular across the board. Small business, large business, it was carefully negotiated, and I think that bears noting in the discussion that we are currently having. Once it was implemented and people had a chance to see the fruit of the investment, it has been fairly well met. And I don't know anybody in the State, Republican or Democrat, who are talking about going back to the previous system, including the Massachusetts Hospital Association. They have all made sure that it would work, and regardless of what the Court does tomorrow, the people in Massachusetts, again—left, right, and center—they are committed to making this plan work and nobody talks about breaking it out.

Let me just, Mr. Bernstein, before I go back to Mr. Brannon, because I raised an issue with you, I spoke earlier of one of the things that we did in 1996 with the welfare reform bill, which, in the end, was a series of artful compromises. We did talk about job training, transportation incentives, child care, daycare; but also one of the things that was very, very important, and it was done on a bipartisan basis, was the whole notion of child support. Would you speak about that experience, because I think it bears noting as we go forward.

Mr. NEAL. You may.

Mr. BERNSTEIN. The Council of Economic Advisors did a study when I was back at the White House and they looked at the impact of the Affordable Care Act on businesses small and large and they wrote as follows, creating a well functioning insurance market also prevents an inefficient allocation of labor away from small firms by leveling the playing field among firms of all sizes in competing for talented workers in the labor market, which is a complicated way of saying what you said very plainly, which is that since large firms are much more likely to offer comprehensive health insurance for their workers a system like the one we have today outside of Massachusetts gives them an advantage and a disadvantage from the worker's perspective in terms of job lock. If you have a more comprehensive system as the Affordable Care Act would present, small firms then lose that competitive disadvantage to large firms in competing for talented workers.

Yes, child support is one of the many work supports that I would argue go far further in incentivizing work than tweaking marginal tax rates, whether it is quality childcare, transportation assistance, job training and education, subsidized employment, which by the way was a program that worked very well in the Recovery Act in incentivizing employment. These kinds of work supports have been shown to be much more consequential in helping people move from welfare to work than changes in marginal tax rates.

Mr. NEAL. And Mr. Brannon, in New England where we saw the textile industry leave and then we saw the old line manufacturers begin to depart over the last 50 years, I must tell you based upon that solid old manufacturing history I never met anybody, the families that I have known all of those years, that were inclined to extend unemployment benefits if they thought they could get another job in a similar industry.

Mr. BRANNON. Well, I also come from a major manufacturing center. Mossville, Illinois is the home of Caterpillar Tractor Company. In the early 1980s Caterpillar went through the recession with the rest of the country, and basically over 50 percent of the blue collar employees from Caterpillar's factories in Mossville and East Peoria and Morton were laid off. We had a great example of that just in our hometown. What happened was that anyone who had any home building done, any work on the side, basically hired someone who did it for cash, presumably with no taxes paid. And who were these people? These were blue collar Caterpillar workers. So people might indeed be working but they are not necessarily reporting their income. I think you see a lot of that.

Mr. NEAL. But you weren't suggesting then that people with that strong history of work and a good solid work ethic didn't want to go back to work if they could find a good job or similar to the one that they lost?

Mr. BRANNON. No. I think if you have a blue collar job and you get laid off for 2 or 3 or 4 months, it becomes a rational decision. I think if you realize you are getting exactly half your salary it might make sense for you to take a few months off. When I was a professor in Wisconsin I knew people who worked at Oshkosh

Truck. And what they would do when they knew they were going to have to lay off workers is they would ask for volunteers. And there are all kinds of people who would volunteer to be laid off for a month or two because they had various other things they wanted to do. Some of it was they had jobs that they wanted to do on the side in winter.

Mr. NEAL. Thank you. Thank you, Mr. Chairman.

Chairman DAVIS. Thank you. The chair now recognizes Mr. Berg from North Dakota for 5 minutes.

Mr. BERG. Thank you, Mr. Chairman. And I thank the panel for being here. This is obviously a critical debate and issue and probably won't be totally solved today. But obviously our goal is to lift people out of poverty and try and create a system that encourages the end result where people are self-sufficient. So I guess the thing that obviously is clear today is the programs and the tax, if these are combined, really create an unintentional barrier to help lift people out. And so I guess we talked about the dead zones and the poverty traps. And I guess my question is real simple, is how do we fix this to encourage people to work? So if we could just—Mr. Thies, do you want to start?

Mr. THIES. Well, I think if we could address the payroll tax it comes in at dollar one of earnings. And so while the Federal income tax is highly progressive, has a very generous zero bracket, the working people of low income and moderate income today are paying much higher taxes than did people during the 1960s when the payroll tax was 3 to 4 percent and the employer matched that.

Mr. STEUERLE. Mr. Berg, actually my first comment reflects the previous discussion on unemployment compensation and on disability. There is some evidence, and I think all the members on this panel agree, that if you design a program so that you have quicker, earlier, intervention it seems to make a lot of difference. In some cases for the unemployed and the disabled it is the habits that are developed in these periods of unemployment and disability that will continue. And so there are some proposals that are trying to figure out ways to give more incentives to employers, for instance, to try to intervene early so as to affect those habits. So that is one area we can work. I mentioned a lot of other relative shifts I think we can make. I think once we agree we are going to have a social welfare structure we are going to have to struggle with this work disincentive issue. The issue is not going to go away. And so the question is what are some relative shifts we can make? One of them is that I think we could make work a greater requirement for some other benefits.

Another one that I think of, along the lines of a much broader thesis I have been examining, is that our social welfare budget keeps expanding every year. It doesn't matter whether the Republicans are winning or Democrats are winning. If the economy doubles in 50 years or 30 years, typically we will devote more to that budget. Maybe we will devote 90 percent more if the Republicans win and 110 percent more if the Democrats win. It is still growing. We can orient that growth not so much towards consumption and adequacy, and, quite honestly, not so much toward paying very high cost health care and retirement benefits, but shift it more towards incentives for work.

I have a variety of other proposals at the end of my testimony. I don't want to take too much time here, but I would be glad to discuss them more with you.

Mr. BERNSTEIN. Congressman, if we are going to have means tested programs that phase out as incomes rise, which is very much a function of our safety net, we are going to have these marginal tax rates. So my answer to your question is the best that we can do is to have that phaseout be as long and gradual as possible, but of course there is a tradeoff there with cost. I think the evidence is quite clear that that helps in the case of the EITC or in certain States with food stamps where that marginal tax rate is kept low.

Second, work supports are critically important, as we have mentioned earlier, such as transportation and childcare assistance. I would argue that these are more important than the marginal tax rates in terms of work. And third, and this is key, the adequate availability of jobs. And that takes you more to the demand side. I certainly wouldn't think of adding work requirements to other programs that don't currently have them in a climate where there is simply inadequate job availability.

Mr. BRANNON. I just want to pick up on something Mr. Steuerle said about the importance of people entering the workaday world and learning how that works right away before they get trapped. To that I just want to add one other thing, that the minimum wage can often be a disincentive for young people, especially teenagers, to enter that workaday world. I just want to encourage the Congress to think long and hard before they increase the minimum wage again.

Mr. BERG. Thank you very much. I yield back, Mr. Chairman.

Chairman DAVIS. I thank the gentleman. The chair now recognizes Mr. Larson from Connecticut for 5 minutes.

Mr. LARSON. Thank you, Chairman Davis. And again I want to commend you and Mr. Tiberi for the spirit and bipartisanship in which this is held. I had the recent opportunity, well, about a year ago, to travel to China, and got in a heated debate, and one this committee is familiar with, about China currency and also the trade disparity that exists between our countries. And former Ambassador Zhen made this point. He said, do you know, how many people do you think we have lifted out of poverty in China. And I did not know, to be honest. And it was around 320 million, which is the entire population of the United States. They were able to do so by investing in their infrastructure. And to prove that point we drove from Beijing to lower Mongolia and witnessed all the investment in infrastructure.

I raise this point because, Mr. Bernstein, you pointed out the adequacy of jobs. And after all the discussion about marginal tax rates and incentives versus disincentives fundamentally people aren't going to be able to work if jobs aren't available to them. And so while there has been much ballyhoo about how we are going to create jobs here we sit in a Congress where we have yet to take up after more than 100 days a transportation bill as the season eclipses, and fundamentally the President's request of last September to have his bill taken up in terms of jobs is not.

Mr. Bernstein, I will ask you, and then I have a question for Mr. Steuerle also. What would the effect of passing the President's jobs plan be on incentives for millions of Americans that currently can't find a job. And then, Mr. Steuerle, the German system where they incentivize people staying in work by instead of paying unemployment they provide the company with direct subsidy to retain the person in that job instead of having them go outside to work.

Mr. Bernstein.

Mr. BERNSTEIN. Right. If I may poach for a second on Gene's question. We actually now have a work sharing program here, and I think it is exemplary, and I commend the Congress for passing it. There is—and some of my colleagues up here may well agree with what I am about to say, even though I know they are more focused on the tax rate side of this. There is no better social welfare program, no stronger social welfare program for reducing poverty than an adequate availability of good jobs for low wage people, than a tight labor market, a full employment labor market, where instead of an excess supply of lower wage workers there is an excess demand for them. And I think we saw that most clearly in the second half of the 1990s where there were a lot of moving parts, welfare reform, the EITC, a higher minimum wage, lots going on, but even in the midst of all the disincentives that we have been talking about today we saw the employment rates of less skilled, disadvantaged workers, of poor workers, of single moms, go to the highest rates on record and poverty rates drop to some of their lowest rates on record. So simply put, no better program.

Mr. LARSON. Mr. Steuerle.

Mr. STEUERLE. Mr. Larson, I think you make a very good point. I think we can learn a lot from the German system, although it extends far beyond just the part that you mentioned. The German system is especially good at sponsoring apprenticeships and favoring education of people who don't go to college, not just those who do go to college—something I don't think we do a very good job of in this country. My colleague, Mr. Lerman, works a lot on this issue and perhaps has talked to you about that already. I mentioned earlier that I think you can change the incentives in unemployment and disability and engage the employer in the sense that maybe you can experience rate these programs a little more so there is some greater consequence for the employer. It is not so much that the employer has to pay the full burden, but it would be nice to have somebody who would help with this early intervention, which sometimes is harder for the government to do.

So I think there are ways in which we really could learn from the German system.

Mr. LARSON. George Will used to express frequently that government works best when it is a collective enterprise. And by using the term "collective" I think what he meant is, know what he meant was that by embracing our academic private sectors, labor sector and government pulling together we do have this engine of growth in opportunity.

What models would you suggest or do you have any that we should follow to achieve those goals and address some of the concerns that our chair has raised about coming to the precipice of this cliff and making sure that we are doing the right things?

Mr. STEUERLE. Well, this actually fits in a bit with what Jared Bernstein was just saying. The long term engine for all of this is economic growth. And I keep mentioning that we think the economy is going to expand over time. So I really encourage you to think about how we restructure our social welfare system in a very broad sense as we move forward 5, 10, 15, 20 years from now. If you look, for instance, at the government budget put forward by President Obama. I would say the same thing if there was a Republican budget. We are planning on spending about $1 trillion more per year in another 10 years. Yes, about $1 trillion more. Now, it turns out almost all of it right now is going for interest on the debt and Social Security and Medicare and Medicaid, but not the children, in ways that for the most part don't favor employment at all. If we think about how government shifts its resources more towards favoring employment, we can go a long way. Then the other advantage we get is that if we get it (economic growth) then the relative wage from working starts growing and growing relative to simply living off a subsidy from the government. So you can affect partly through marginal tax rates the relative hurdle or point at which going to work and engaging in the market makes one better off.

Mr. LARSON. Would you agree with Mr. Stiglitz that the war cost of some $3 trillion and having the two wars and the tax cuts paid for——

Chairman DAVIS. The gentleman's time has expired. Thank you.

Mr. Bernstein, on page 9 of your testimony you say it would be a, quote, significant policy mistake to require recipients of benefits to work without first ensuring adequate job availability. This is exactly the same argument that some made against welfare reform in the 1990s, that it was wrong to require work without guaranteeing, quote, adequate job availability, closed quote, for everyone, which makes me wonder, how do you define adequate job availability?

Mr. BERNSTEIN. That is a fair question. And I was there at the time thinking, writing about welfare reform. I didn't mean to imply that there should be a guaranteed job for everyone. What my statement in my testimony was meant to stress, that absent stronger labor demand, right now if you look at the low wage labor market, for example, you will find that there are far more job seekers than there is job availability. Obviously that is partly a function of the recession. But even in a stronger economy when the business cycle is expanding the low wage labor market is often characterized by excess supply and not enough jobs. If you look at welfare reform, which I would argue was quite successful in moving people from welfare to work through this period of full employment in the latter 1990s that I mentioned, it has actually been quite unsuccessful ever since, even with relatively low overall unemployment rates into 2000. So while welfare reform is largely regarded as a success in this regard it really hasn't been over the last decade or so as the job market has weakened.

So my point is simply kind of, as Gene and I were just reflecting, that you have to have a very strong demand side functioning on the low wage labor market if you are going to require work and expect it to reduce poverty.

Chairman DAVIS. Would any of the other panelists like to comment? Mr. Thies.

Mr. THIES. Yes. It is understandable during a period of depressed economic conditions that through statutory means and administrative discretion the public and the private charity system also will relax eligibility standards, extend unemployment benefits and so forth because of the objectively more difficult circumstances facing people who are vulnerable. Having said that, it is understandable that when we do have a robust recovery we are going to revisit some of those things.

Chairman DAVIS. Mr. Steuerle.

Mr. STEUERLE. Just very quickly to repeat something I said earlier, is if we had taken more of the stimulus money and put it into job subsidies, particularly for lower income people, that that could have cost less and it would be a better change in stimulus because these people are more likely to consume. It would have been a better supply side incentive because you would have a better set of work incentives than some of the just across the board way we spent some of the other money.

Chairman DAVIS. Thank you. Mr. Brannon, would you like to have the last word?

Mr. BRANNON. Yeah. Casey Mulligan, the University of Chicago economist who testified in front of the House Budget Committee a couple of months ago, pointed out that if you look at what happened to the array of welfare programs in 2008 and 2009 we dramatically increased spending on a wide variety of them, and again we did each one of those individually. I come back to Mr. Duncan Smith's point that we really have a haphazard welfare system that creates terrible disincentives to work in all kinds of places. And as Mr. Steuerle has pointed out, not only at relatively low incomes, but it also has disincentive effects at higher incomes. And it seems to me it is beyond time for us to redesign a system and think about it more holistically rather than program by program and come up with something that removes these disincentives.

Chairman DAVIS. Great. I want to thank all of our witnesses for coming today, for your patience through the early changes in the schedule. It has been very helpful, the insights that you have provided how tax policy and welfare policy can create disincentives as well as incentives to work. And hopefully we will continue to work together in the time ahead to address the broken processes that we have between the various agencies to harmonize this and to get to the point that Mr. Brannon talked about at the end in a hopefully bipartisan way.

If members have additional questions they will submit them to you in writing. We would appreciate it if you would reply to the committee so we can have those inserted into the record. Thank you again. And with that I conclude the hearing.

[Whereupon, at 12:20 p.m., the subcommittees were adjourned.]

[Submissions for the Record follow:]

Anne Stevenson

ANNE STEVENSON
Massachusetts Resident and Voter[1]
email: *anne.stevenson@alumni.tufts.edu*

June 26, 2012

Dear Ways and Means Committee,

This testimony is with regards to the Ways and Means Committee hearing on **How Welfare and Tax Benefits Can Discourage Work** currently scheduled for **June 27, 2012.**

My main concern is that I would like for Congress to distinguish between and place paramount TANF programs which are means tested and provided to needy women and children below the poverty line, as opposed to the predatory TANF programs bankrupting the country by placing any unfit or unwilling father--even millionaires who abandon their kids--onto the welfare roles.

For your convenience, I have attached a copy of an article I wrote on this issue for the Huffington Post entitled *"Top 5 HHS Programs Endangering Women And Children."* This article can also be found on line at:

http://www.huffingtonpost.com/anne-stevenson/top-5-hhs-programs-endang_b_1511613.html

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 and the Temporary Aid to Needy Families (TANF) program it created transformed welfare policy by drastically reducing and shifting federal assistance away from the homes of mothers and children and into the homes of violent male offenders. The original intent of welfare reform was to require States to function as collection agencies, recovering financial support from parents who had willfully abandoned their parental responsibilities to their children. These policies have drastically backfired because:

(a) it dedicated billions in TANF to programs for childless fathers that are not needs based,

(b) the HHS Office of the Inspector General (OIG)[2] and the Government Accountability Office[3] determined that the programs lacked oversight and are riddled with fraud, and

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[1] *Contact Information attached but I request it be withheld from the public to protect my safety and privacy.*
[2] *"Rollup Review on States' Reporting of Undistributable Child Support Collections as Program Income"* HHS OIG report A-05-11-00025, September 30, 2011 (http://oig.hhs.gov/oas/reports/region5/51100025.asp)
[3] *"HEALTHY MARRIAGE AND RESPONSIBLE FATHERHOOD INITIATIVE: Further Progress Is Needed in Developing a Risk-Based Monitoring Approach to Help HHS Improve Program Oversight"* Government Accountability Office Report to the Chairman, Subcommittee on Income

(c) **State welfare programs adjusted their environment to have a greater need by casting a wider, less transparent net.**

Instead of helping children, welfare reform created a new breed of dangerous Welfare Kings through HHS Office of Child Support Enforcement when it began using non-needs based TANF programs to subsidize the homes and legal battles of the unfit, unwilling, and violent fathers like mass murderer John Muhammad, the Beltway Sniper.[4]

Futhermore, I have also attached for your convenience a copy of the June 2011 letter from OCSE Director Vicky Touresky to Senator John Kerry which declined to provide Senator Kerry with the information he requested, or follow up on his concerns regarding misappropriated funds. Touresky states that OCSE does not have any obligation to oversee OCSE program funding once the checks are cut from the Federal office to the State programs. Instead, Touresky referred Senator Kerry's concerns over OCSE fraud to the HHS OIG, who months before took the position that they lack jurisdiction to investigate a State child support program.

So who is watching the hen house?

I. TANF PROGRAMS FOR MEN ARE NOT NEEDS BASED.

Unlike the welfare programs for women and children which had restrictive income eligibility requirements, TANF diverts billions of dollars through the U.S. Department of Health and Human Services (HHS) Office of Child Support Enforcement (OCSE) to non-needs based programs exclusively available to unfit and unwilling fathers, such as Healthy Families Initiatives, Responsible Fatherhood Initiatives, and Access and Visitation Initiatives. These program's TANF benefits are not needs based and are available to all fathers-even billionaires.

Benefits from Responsible Fatherhood programs to abusers include:[56]

- Child support obligations are suspended
- Free attorney representation in the family courts to fight for custody
- Free housing
- Direct cash incentives
- Free groceries
- Free car maintenance, gas, and other transportation costs

Security and Family Support, Committee on Ways and Means, House of Representatives, September 2008. http://www.gao.gov/new.items/d081002.pdf

[4] "Parental Rights And Wrongs" By Liz Richards, Washington Times, http://pmashilohlopez.wordpress.com/2011/07/04/from-the-washington-times-parental-rights-and-wrongs-by-liz-richards/

[5] "*OCSE Responsible Fatherhood Programs Early Implementation Lessons*" Jessica Pearson, Center for Policy Research, Inc. David Price, Policy Studies, Inc. June 2000
With comments: http://www.nafcj.net/ocsefr.htm
Original Text: http://www.eric.ed.gov/PDFS/ED463839.pdf

[6] HHS Around the Regions 2005 Activities: http://fatherhood.hhs.gov/Partners/regions/regions06.shtml

- Free healthcare and dental care

These TANF benefits are not intended to directly reach children, their purpose is to reward the unfit and unwilling fathers who lost custody of them. The above-referenced HHS reports show that 80% of participants are court ordered into Fatherhood programs, and many are recruited directly from prison. The incentives are structured so that the State will only benefit if children are removed from loving homes, then arbitrarily placed with male offenders who previously lost custody. If the programs do not successfully increase in the percentage of noncustodial fathers who file for and win custody, they will not get paid.

The programs also punish the majority of responsible fathers who willingly provide love and support to their children. Using the virtually unregulated child support system as a vehicle and the father's will to evade prison time as collateral,[7] the fathers are told they can risk their liberty and property attempting to pay down arrears, or alternatively, sue the mother for custody using a variety of federally funded "supports." Children in safe homes do not need rehabilitation, so often times a "need" is created by the State by placing children deliberately in an unsafe home.

The effect of these Fatherhood and welfare reform policies is to place the middle class on welfare by "leaving no family member undiagnosed" when they come into contact with the family courts.[8] At the beginning of a custody case, only the offender is sick, but if one violent offender gets custody, the whole family needs treatment. Consequently, it is also not uncommon for courts and social services agencies to appoint dozens of federally funded family court mental health and legal professionals onto the case to sustain the deadly custody rights of a single violent father.[9]

Lastly, the redundant HHS programs that purport to satisfy the "to work" component of welfare reform are already funded via the Department of Labor and the Department of Education. HHS fraud costs tax payers $60 billion per year, and it is not improving. When you start to look at how many contracts are going to the same network of providers like Manpower, Maximus, Goodwill Industries, etc. with inside connections to HHS Administration, it is also worth asking yourselves if and when Congress will investigate these conflicts of interest?

II. THE GAO DETERMINED THAT OCSE FATHERHOOD PROGRAMS ARE RIDDLED WITH FRAUD.

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[7] *"Giving Noncustodial Parents Options: Employment and Child Support Outcomes of the SHARE Program"* Irma Perez-Johnson, Jacqueline Kauff, and Alan Hershey, Mathematica Policy Research, Inc., October 2003

[8] *"Unified Family Courts: Treating the Whole Family, Not Just the Young Drug Offender"* American Bar Association/Robert Wood Johnson Foundation, November 2000 http://www.rwjf.org/reports/grr/029319s.htm

[9] *"Pedophilia in the Justice System"* By Kieth Harmon Snow, Conscious Being Alliance, May 1, 2012 http://www.sott.net/articles/show/245202-Pedophilia-in-the-Justice-System

In 2008, the GAO released a report entitled *"HEALTHY MARRIAGE AND RESPONSIBLE FATHERHOOD INITIATIVE: Further Progress Is Needed in Developing a Risk-Based Monitoring Approach to Help HHS Improve Program Oversight"* [10] that concluded that these programs were riddled with fraud and not performing. The GAO concluded that HHS failed to create oversight mechanisms or standard performance goals prior to disbursing $500 million in grants to hastily chosen programs meant to serve children living in high-risk families:

> *"HHS...lacks mechanisms to identify and target grantees that are not in compliance with grant requirements or are not meeting performance goals... Our review of grantee case files found documentation of grantees that were not meeting performance targets...or* ***not in compliance with grant requirements****, such as providing only those services allowed under the grant."*

Report Highlights:

$500 Million Unconditionally Given To Activists: *Operating under a deadline that allowed HHS 7 months to award grants, HHS shortened its existing process to award Healthy Marriage and Responsible Fatherhood grants to public and private organizations. During this process, HHS did not fully examine grantees' programs as described in their applications, including the activities they planned to offer, and this created challenges and setbacks for grantees later as they implemented their programs.* –P. 2

Failure to Implement Uniform Standards, Policies, and Procedures: *HHS uses methods that include site visits and progress reports to monitor grantees, but it lacks mechanisms to identify and target grantees that are not in compliance with grant requirements or are not meeting performance goals, and it also lacks clear and consistent guidance for performing site monitoring visits.* –P.2

Embezzlement and Fraud Was Likely Vastly Under Estimated: *Moreover, we did not survey organizations that received money from grant recipients to provide direct services, subawardees. Since making the initial awards, 4 organizations have relinquished their grants, 1 organization had its grant terminated, and 1 new grant was awarded. There are 6 organizations currently pending non-continuation of award funds.*

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[10] *"HEALTHY MARRIAGE AND RESPONSIBLE FATHERHOOD INITIATIVE: Further Progress Is Needed in Developing a Risk-Based Monitoring Approach to Help HHS Improve Program Oversight"* Government Accountability Office Report to the Chairman, Subcommittee on Income Security and Family Support, Committee on Ways and Means, House of Representatives, September 2008. http://www.gao.gov/new.items/d081002.pdf

Please recall that the irresponsible programs are recruiting violent offenders directly from prisons[11] to help them obtain legal and physical custody of the child victim witnesses they hurt, yet the GAO cannot directly account for the activities or the funding going into the programs.

Although groups cannot use TANF money for attorneys, the literature shows that some groups like Illinois Council on Fatherhood[12] provides fathers with legal advice and exceptional access to judges, Michigan is providing dads with legal assistance,[13] and the Montrose County, Colorado Fatherhood program[14] match up fathers with "Fatherhood Coaches" who also just happen to be attorneys who want to help them with their child support and custody problems.

You should ask yourselves who represents the victim child's interests while their violent noncustodial fathers use concealed child support and federal assistance to build up legal arsenals to take custody and silence them? HHS programs are actually a deadly investment given that (a) abusive men win custody of their victims 70% of the time[15] when they ask for it, and (b) regardless of the gender of the victim, it is a public safety issue when DOJ studies[16] show men perpetrate more than 95% of violent assaults against women. The Center for Disease Control's 2010 National Intimate Partner and Sexual Violence Survey[17] also concluded that men are raped by other men more than 93% of the time, and women are raped by men more than 98% of the time.

Programs like the Massachusetts Department of Probation's[18] provide "treatment" to thousands of untreatable, incurable violent offenders and sociopaths targeting their victims through the courts Although violence is a voluntary act, HHS now invested our tax dollars into rehabilitating the incurable who choose to assault the most vulnerable members of society. Some Studies[19] of male DV perpetrators show that 50% of them are sociopaths and another 25% have sociopathic tendancies. Psychopaths are people who feel no emotional connections to others and have zero regard for the rules and regulations of society, they do not respond to therapy, and cannot be rehabilitated. Dr. Robert Hare reports that psychopaths make up 1% of the general population, but 25% of the prison population:

> *"Violence is not uncommon among offender populations, but psychopaths still manage to stand out," he says. "They commit more than twice as many violent and aggressive acts, both in and out of prison, as do other criminals ... The recidivism*

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[11] National Fatherhood Initiative: http://www.fatherhood.org/page.aspx?pid=375
[12] http://www2.prnewswire.com/cgi-bin/stories.pl?ACCT=104&STORY=/www/story/02-15-2008/0004756780&EDATE
[13] http://www.michigan.gov/dhs/0,1607,7-124--187565--,00.html
[14] Montrose County, Colorado http://www.montrosecounty.net/DocumentCenter/Home/View/1721
[15] http://www.stopfamilyviolence.org/info/custody-abuse/overview/batterer-manipulation-and-retaliation-denial-and-complicity-in-the-family-courts
[16] http://www.umbrellanek.org/documents/DV%20General%20Fact%20Sheet.pdf
[17] http://www.cdc.gov/ViolencePrevention/NISVS/index.html
[18] http://www.mass.gov/courts/probation/pr062707.html
[19] http://www.lovefraud.com/blog/2010/03/01/staggering-statistics-about-domestic-violence/

rate of psychopaths is about double that of other offenders ... The violent recidivism rate of psychopaths is about triple that of other offenders."

Respectfully, would you as a member of Congress, allow your child to be cared for by convicted murderers and felons? If you believe these "fathers" are harmless, why do you pass budgets that provide for armed guards to protect Congressional hearings and family courts? These programs have no legitimate purpose because here is no epidemic of "fatherlessness" that in itself harms children.

There is no "fatherlessness crisis" that would justify such ruthlessly irresponsible program spending. We are a nation of strong single mothers who raised Presidents like Bill Clinton and Barack Obama, both of whom were rescued from the clutches of fathers who were irresponsible, violent addicts by their mothers. These Fatherhood programs now undermine and punish mothers who try and rescue their children and stay off public assistance, while punishing good fathers and abetting the irresponsible, no matter how rich or poor.

III. OIG DETERMINED THAT OCSE PROGRAMS ARE RIDDLED WITH FRAUD.

In 2011, the Office of the Inspector General released a report[20] called *"Rollup Review on States' Reporting of Undistributable Child Support Collections as Program Income"* that concluded 21 of the 23 States audited failed to properly report program income, and were hoarding tens of millions in child support collections by [intentionally or unintentionally] failing to make sufficient efforts to locate the children the resources are intended to benefit. Only a hand full of counties out of the several hundred contained in the relevant States were audited, and a review of the initial reports shows discrepancies that indicate the problem may be much larger than what the Administration is willing to admit.

The State agency classifies child support as "undistributable arrears" when it collects a child support payment but cannot identify or locate the custodial parent or return the funds to the noncustodial parent. Federal mandate requires that at the time when State law deems the funds "abandoned," States must recognize and report the unallocated funds as program income in order to offset program costs. The Federal policy is that abandoned collections are then split 66% Federal share, 34% are retained by the State. However the OIG determined that all of the states States had [intentionally or unintentionally] devised various "set up to fail" support distribution systems that allow the Agency to improperly hoard the child's money in State coffers by mislabeling it "abandoned property."

Examples of "set up to fail" policies the OIG listed include:

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[20] *"Rollup Review on States' Reporting of Undistributable Child Support Collections as Program Income"* HHS OIG report A-05-11-00025, September 30, 2011 (http://oig.hhs.gov/oas/reports/region5/51100025.asp)

- send checks to the wrong address,
- illegal liens on accounts
- create massive arrears, give dad the tax benefit, then garnish the tax benefit,
- put child support it in trust accounts during litigation-that lasts more than 3 years,
- retroactively abate arrears, then keep it for themselves without telling either parent.

The OIG determined that while some States claimed to be unaware of Federal reporting requirements, *"These deficiencies occurred because States did not have adequate controls to ensure that undistributable child support collections were recognized and reported as program income in accordance with Federal requirements."*

In each instance, the OIG recommended solutions that failed to require State agencies to improve disbursement methods to ensure delivery of the funds to the child's home. Instead, the OIG's focus was to ensure the increased the State's accuracy and compliance with Federal reporting requirements to ensure that the Federal HHS office received its' 66% share of program income.

The audits were done for support collected between 1999-2007, 23 states audited, but only a couple counties within each state were audited---NOT the entire state's child support system. So the fact that like Michigan may have audited 18 counties out of a total of 85 counties, and that those 18 counties stole $8 million from Michigan families is significant. What would the number be if they did audit the whole state?

But the 2011 roll up report is also incorrect for another reason---it appears to have under estimated the original auditor's findings. The 2011 "roll up" report is a collection of the findings in the original 23 states, most of which were complete by 2009. So I obtained copies of the original audit reports for every state, and found that many states were caught with their hands in the cookie jar for millions and millions of dollars, but the 2011 has them down as owing $0 sometimes.

(1) **Cook County, Illinois: (102 Counties in IL, not sure why it appears only 1 is audited)**

2011 Roll Up Total: $1.8 million

2005 report: $3.4 Million
http://oig.hhs.gov/oas/reports/region5/50400039.pdf

(2) ***Michigan*: (85 counties, only 18 audited?)**

2011 Roll Up Total: $5.3 million

2006 report: $8 Million
http://oig.hhs.gov/oas/reports/region5/50500033.pdf

(3) **Georgia: (159 counties, none audited, just the state program---so my impression was that the county courts contracted by the State who collected support independently but not through state coffers were never reviewed)**

2011 Roll Up Total: $238,000

2007 report: $1.2 million
http://oig.hhs.gov/oas/reports/region4/40603506.pdf

(4) ***California:* (58 Counties, only 3 audited)**

2011 Roll Up Total: $1.45m

2007 report: $3.3 Million

- Orange county: $2.2 million
  http://oig.hhs.gov/oas/reports/region9/90600040.htm
- Riverside County: $245,000
  http://oig.hhs.gov/oas/reports/region9/90700049.htm
- Los Angeles county: $878,000
  http://oig.hhs.gov/oas/reports/region9/90800024.asp

But the LA county report is perhaps inaccurate for another reason, because at the same time the OIG conducted the audit, Attorney Richard Fine sued LA County for holding $14 million in child support collections from LA county children.[21] He won the case, and the county had to disburse the $14 million to the families. But this total is not included in the OIG's report.

IV. TANF CHILD SUPPORT PROGRAMS ADAPT TO ARTIFICIALLY INCREASE NEED FOR THEIR OWN SERVICES

These reports and others reflect the fact that TANF's generous collection incentive policies may have in effect created a child support vacuum as States to adapt their practices to reflect a greater demand and need for resources that are ultimately withheld from needy families. This 2011 report[22] found that although the **American Recovery and Reinvestment Act of 2009 provided generous matching funds on State support collections:**

[21] www.articles.latimes.com/1999/feb/20/local/me-9885
[22] **http://www.gao.gov/products/GAO-11-196**

*"In fiscal year 2009...**child support collections failed to increase nationwide for the first time in the history of the program in fiscal year 2009… Also in fiscal year 2009, the number of CSE cases currently receiving public assistance increased…"***

Recovery Act: Thousands of Recovery Act Contract and Grant Recipients Owe Hundreds of Millions in Federal Taxes
http://www.gao.gov/products/GAO-11-686T

This Government Accountability Office report recently came out which shows that these HHS grant recipients owe us struggling tax paying families hundreds of BILLIONS in taxes.

GAO REPORT: Child Support Enforcement: Better Data and More Information on Undistributed Collections Are Needed

http://www.gao.gov/products/GAO-04-377

Medicare and Medicaid Fraud, Waste, and Abuse: Effective Implementation of Recent Laws and Agency Actions Could Help Reduce Improper Payments

http://www.gao.gov/products/GAO-11-409T

Child Support Enforcement: Departures from Long-term Trends in Sources of Collections and Caseloads Reflect Recent Economic Conditions

http://www.gao.gov/products/GAO-11-196
In fiscal year 2009, the child support enforcement (CSE) program collected about $26 billion in child support payments from noncustodial parents on behalf of more than 17 million children. The CSE program is run by states and overseen by the Department of Health and Human Services (HHS). States receive federal performance incentive payments and a federal match on both state CSE funds…The Deficit Reduction Act of 2005 (DRA) eliminated this incentive match beginning in 2008, **but the American Recovery and Reinvestment Act of 2009 temporarily reinstated it for 2 years**….

In fiscal year 2009, the CSE program experienced several departures from past trends. For one, **child support collections failed to increase nationwide for the first time in the history of the program in fiscal year 2009… Also in fiscal year 2009, the number of CSE cases currently receiving public assistance increased** …*Preliminary HHS data show that total CSE expenditures grew by 2.6 percent in fiscal year 2008 as many states increased their own funding to maintain CSE operations when the federal incentive match was eliminated*...In contrast to fiscal year 2008, *a different picture emerged in fiscal year 2009, when the incentive match was temporarily restored but total CSE expenditures fell slightly by 1.8 percent, which HHS officials told GAO was due to state budget constraints.* **Most states nationwide have not implemented "family first" policy options…because giving more child support collections to families means states retain less as reimbursement for public assistance costs.**

Administrative Expenditures and Federal Matching Rates of Selected Support Programs
http://www.gao.gov/products/GAO-05-839R

V. CONCLUSION

The more federal dollars were receive the less States collected in support. States refuse to distribute child support to "families first," and are instead keeping the money for themselves-without accounting for it. When the OIG identified the embezzled funds, they did not help "struggling agencies" find the children it was intended to benefit, the OIG instructed States to properly report…So the feds could have their 66%. This policy entirely lacks accountability or consequences for this fraud. Subsequent reports demonstrated that the problem has continued to worsen, and there are [still] no protocols and procedures in place to define, identify, and track these monies.

The [unlawful] programs are supposed to be ADMINISTRATIVE, but they used quasi judicial power to create, amend, and enforce court orders without judicial authorization. The agency does not provide due process, nor do they have to show you their files. Judges have to look the other way because if they object, they will lose their HHS funding, and at the same time the judge has to accept responsibility for the agency's badly managed and even crooked interference when litigants are hurt.

Instead of fixing these programs, Obama's proposed budget includes billions more in incentives to disburse and collect support to the programs with no oversight. If the core mission of the child support program is to collect and disburse support to needy children, this is an administrative function which in 2012 should be handled electronically through the treasury. There is no need to create billion in incentives to involve the support agency in taking over the judicial branche's functions in custody cases.

Fred Sottile, the Founder and President of the LA chapter of Fathers 4 Justice says in his view:

> *"The President should spend his efforts creating laws and policies that actually encourage father/child relationships, instead of just pretending to promote father/child relationships in extortion based OCSE programs that deprive children and blame dads for being absent."*

Linda Marie Sacks, Co-Chair of the Family Court Committee of the Florida chapter of the National Organization for Women:

> *"The vast majority of fathers do not abuse children, and there are many instances where courts have unjustly deprived children of good fathers. The problem is that the programs punish children living with healthy strong mothers by incentivizing courts to cash in by arbitrarily minimizing and even eliminating moms from the picture.* Since *there is virtually no oversight of OCSE funding, we have often found that this funding used to help pedophile rapists and violent predators get custody of child victim witnesses through the family courts. Studies show abusers are winning custody 70% of the time, and we think the programs will have*

catastrophic results on the next generation if this unsafe trend of maternal deprivation continues."

Liz Richards, Director for the National Alliance for Family Court Justice and a certified witness for the Department of Justice agrees.

> *"HHS is the source of the funding which is fueling the court corruption problems. Judge are making their rulings according to the program grant requirements and not by the case evidence. Past ACF officials like Wade Horn, Ron Haskins, and others were closely associated with the fathers rights groups and leaders, and essentially turned the dept into a pro-father, abuse cover-up agency."*

I can identify no legitimate purpose for these programs and request that Congress take the following actions:

(1) Revoke or reduce funding to Administration for Children and Families (ACF) child support incentives, Access and Visitation (AV) programs, and gender based funding to child support agencies.

(2) End collateral child support/custody funding mandates.

(3) Overhaul Office on Child Support Enforcement (OCSE) on the federal level to remove staff with conflicts of interest and bias.

(4) Audit OCSE to find out where our tax dollars are actually going, and then implement rigorous transparency, oversight, and accountability measures on programs.

In 2011, we ask why the Obama Administration inexcusably ignored the pleas of desperate hard working parents and doubled the budget for these pork barrel projects, starving them out of their home. It's time to get serious about deficit reduction, and require the president to exercise fiscal restraint on programs which would target and extort families under the most trying circumstances.

I declare under penalty of perjury that the foregoing is true and correct. This declaration was executed in Cambridge, Massachusetts on June 26, 2012.

Anne Stevenson

June 26, 2012

HUFF POST POLITICS

THE INTERNET NEWSPAPER: NEWS BLOGS VIDEO COMMUNITY

Top 5 HHS Programs Endangering Women and Children

Posted: 05/14/2012 12:15 pm

The so-called "War on Women" is raging, and billions of your tax dollars are being misused to fuel it via the U.S. Department of Health and Human Services (HHS). The solution is to remove the middle class from the welfare roles and do away with gender-based funding incentives.

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 and the Temporary Aid to Needy Families (TANF) program it created transformed welfare policy by drastically reducing and shifting federal assistance away from the homes of mothers and children and into the homes of violent offenders. In an article entitled "How Federal Welfare Funding Drives Judicial Discretion in Child-Custody Determinations and Domestic Relations Matters" fathers and rights activists Lary Holland and Jason Bottomsly explain that this policy has backfired because the incentives are structured so that the state will only benefit if children are removed from loving homes:

"In essence, the federal guidelines wanted the states to function as collection agencies, recovering financial support from parents who had willfully abandoned their parental responsibilities to their children. The result, however, was different from the intent and **has caused the state welfare programs to adjust their environment to have a greater need**, which has caused the program to collect from willing parents that would ordinarily provide a loving environment for their children absent a court order limiting a parent's involvement. Despite the original intent of the IV-D welfare program, it now provides an incentive for the states to use their family courts to produce forcibly absent parents in order to increase the states' IV-D welfare caseload."

These HHS policies created a new breed of dangerous Welfare Kings through HHS Office of Child Support Enforcement when it began subsidizing the homes and legal battles of the unfit, unwilling, and violent fathers. At the beginning of a custody case, only the offender is sick, but if one violent offender gets custody, the whole family needs treatment. Consequently, it is also not uncommon for dozens of family court mental health and legal professionals onto the case to sustain his deadly custody rights through HHS programs.

The top 5 HHS programs endangering women and children are:

1. **Child Support Enforcement (Access and Visitation Programs and Responsible Fatherhood Initiative)** A 2011 report from the Office of the Inspector General demonstrates that the States are collecting child support, but not disbursing it to the children it is intended to benefit. So where is the money going? Although previous graduates include mass murderer D.C. Sniper John Muhammad, the 2012 HHS budget reflects President Obama's $1 billion endorsement of the fraud-riddled fatherhood industry.

Using the virtually unregulated child support system as a vehicle and the father's will to evade prison time as collateral, the fathers are told they can risk their liberty and property attempting to pay down arrears, or alternatively, sue the mother for custody using a variety of federally funded "supports." Unlike the welfare programs for women and children which had restrictive income eligibility requirements, HHS Responsible Fatherhood program benefits are not needs based and are available to all fathers-even billionaires. Benefits from Responsible Fatherhood programs to abusers include:

- Child support obligations are suspended
- Free attorney representation in the family courts to fight for custody
- Free housing
- Direct cash incentives
- Free groceries
- Free car maintenance, gas, and other transportation costs
- Free healthcare and dental care

While many upstanding fathers honestly complain about TANF programs and the courts victimizing them, the dirty little secret in the fatherhood industry it that the grant recipients who train court personnel, social services, and child support personnel are often fathers rights groups like the Fathers and Families Coalition, the Children's Rights Council (Founder David Levy sits on the board of the Supervised Visitation Network) and the National Fatherhood Institute.

Clearly, judges understand the danger abusers pose, which is why their courts are guarded with armed deputies and not unarmed social workers. HHS programs are actually a deadly investment given that (a) abusive men win custody of their victims 70% of the time when they ask for it, and (b) regardless of the gender of the victim, it is a public safety issue when DOJ studies show men perpetrate more than 95% of violent assaults against women. A 2011 CDC study also shows that men are raped by other men more than 93% of the time, and women are raped by men more than 98% of the time.

2. **Incarceration/Reentry Programs.** The purpose of these programs is to recruit violent offenders who are still incarcerated directly from prison, then help them gain custody of victims. It is unclear to me how a child benefits from the dangerous influence of a violent offender insofar as it reduces support to the home they are recovering in. The program paints the offender as the victim and domestic violence as a disease they are afflicted with, curable by the removal of witnesses to their crimes.

Although violence is a voluntary act, HHS now invested our tax dollars into rehabilitating the incurable who choose to assault the most vulnerable members of society. Studies of male DV perpetrators show that 50% of them are sociopaths and another 25% have sociopathic tendancies. Psychopaths are people who feel no emotional connections to others and have zero regard for the rules and regulations of society, they do not respond to therapy, and cannot be rehabilitated. Dr. Robert Hare reports that psychopaths make up 1% of the general population, but 25% of the prison population:

"Violence is not uncommon among offender populations, but psychopaths still manage to stand out," he says. "They commit more than twice as many violent and aggressive acts, both in and out of prison, as do other criminals ... The recidivism rate of psychopaths is about double that of other offenders ... The violent recidivism rate of psychopaths is about triple that of other offenders."
Recipients include:

- *Massachusetts Probation Department:* The Probation Department conducts all pre-trial mediations in the MA family courts. As of 2007, the department claims to have helped 1,600 male offenders with their custody cases, including Springfield inmate Shawn Suarez who was recruited into the custody switching program from jail, was released, won custody, then was sent back to prison on another violation. In 2011 and 2012, several high ranking administrators in the Probation Department were indicted by the DOJ and charged with conspiracy and fraud under the Racketeer, Influence, and Corrupt Organizations Act.
- *Colorado's "Parenting From Prison"* received grants to implement programs which recruit violent offenders who are still incarcerated directly from prison, then help them gain custody of children.
- *CT Child Rapist and mass murderer Joshua Komisarjevsky*'s nine-year old daughter was brought to visit him 55 times while in prison awaiting trial for murdering and raping 11-year old Michaela Petit, and also killing her sister Haley (age 17,) and their mom. Prior to murdering and raping the Petit family, Komisarjevsky gained sole custody of his daughter, who he promptly handed over to his parents to raise. The same parents who he blamed for his crimes after being found guilty of 17 counts, including the three homicides, and sentenced to death.

3. **Foster care.** Despite the fact that the National Center for Child Abuse and Neglect found that children are six times more likely to die in the State's care than those with their parents, it is assumed by some politicians that if you are poor, then you must need the US Department of

Health and Human Services programs to tell you what's best for your own family.

- *In 2012, Colorado Governor John Hicklenhooper* ordered an overhaul of the State's child welfare system after the Denver Post reported 43 children were murdered as a consequence of social workers who dropped the ball.
- *In 2011, San Francisco Department of Child Protective Services* paid out4 million to a former foster child who suffered years of abuse after his sister was beaten and starved to death by the foster parent. Another report showed that more than 1,000 CA foster homes matched the addresses of registered sex offenders, 600 of whom were high risk.
- *This report talks about the 1.5 million mothers who say they were "coerced," "manipulated," and "duped" into handing over their babies for adoption.* These women say sometimes their parents forged consent documents, but more often they say these forced adoptions were coordinated by the people their families trusted most... priests, nuns, social workers, nurses or doctors."
- This report by ABC News reporter Diane Sawyer showed that **25% of all foster kids were on psychotropic drugs**, and the States did not do enough to oversee them.

4. **Center for Faith Based and Neighborhood Partnerships.** With an annual budget of more than $20 million, the Center gives grants directly to religious groups exempt from anti discrimination laws, such as churches and mosques, as well as nonprofits affliated with them. Often partnered with the above-referenced Fatherhood industry programs, the Partnership's purpose is to "build and support partnerships with faith-based and community organizations in order to better serve individuals, families and communities in need." HHS Secretary Kathleen Sebelius explains that:

"Faith leaders are trusted partners in local communities. You have a unique ability to reach people, especially the most vulnerable, with the tools and information they need to get healthy, stay well, and thrive."

The consequence of this policy is that unsubsidized secular nonprofits that provide community services such as childcare, education, and healthcare cannot compete with the radical anti-woman nonprofits the Obama administration gives preference to. Examples include:

- *Catholic Charities* received **$650 million** from HHS between 2008-2011, despite the fact that they have lobbied to uphold their discrimination based policies that deny adequate healthcare to women, children, and the LGBT community. This includes policies which refuse women birth control, abortion, and rape counseling to the more than 10,600 children allegedly raped by some 4,392 preists as of 2002.
- *Atlanta based New Birth Missionary Baptist Church* received $1 million from HHS to support accused pedophile Bishop Eddie Long's $3 million salary and benefits package, as well as anti-gay marriage lobbying efforts. In 2012, the SEC announced charges against his successor, Fatherhood promotor Ephran Taylor who "was actually peddling was a giant Ponzi scheme, one aimed to "swindle over $11 million, primarily from African-American churchgoers," that reached into churches nationwide, from Long's megachurch in Atlanta to Joel Osteen's Lakewood Church congregation in Houston."

- *"Final Defendant Pleads Guilty to Medicaid Fraud in Scheme Involving Homeless and Pregnant Teenagers "* (3/22/2012). This press release from the GA Office of the Attorney General regarding God's Promise Center, a business located in Henry County which purported to be a residential treatment program for homeless teenage girls.

Domestic violence is a multibillion dollar industry complete with its own ambiguous gender neutral lingo often causes victims in profitably dangerous homes. The CDC estimated that in 2003 Americans spent $8.3 billion on the domestic violence industry, which does not take into consideration the nearly 8 million work days per year that victims miss as a direct consequence of being assaulted, nor the costs associated with the children they care for who might also be abused. With as much as $585 billion also spent subsidizing the child abuse industry, so it's no wonder some unethical abuse industry professionals cash in by keeping the public in danger and placing children in dangerous homes.

DEPARTMENT OF HEALTH & HUMAN SERVICES

ADMINISTRATION FOR CHILDREN AND FAMILIES
370 L'Enfant Promenade, S.W.
Washington, D.C. 20447

JUL 05 2011

The Honorable John Kerry
Member, United States Senate
One Bowdoin Square, 10th Floor
Boston, MA 02114

Dear Senator Kerry:

I am writing in response to your inquiry dated March 18, 2011, on behalf of your constituent, Anne Stevenson, regarding her child support enforcement concerns.

Ms. Stevenson alleges numerous abuses and claims the California Department of Child Support Services, the state courts and other agencies committed fraud.

The Office of Child Support Enforcement does not investigate allegations of fraud against child support enforcement agencies nor does it intervene in court matters. Ms. Stevenson may want to file a formal complaint with the Office of the Inspector General, which is the branch of government that investigates allegations of fraud, misappropriation of funds and other administrative abuses. Ms. Stevenson may contact the Office of the Inspector General at:

Office of Inspector General
Office of Public Affairs
Department of Health and Human Services
330 Independence Avenue, S.W.
Room 5541, Cohen Building
Washington, DC 20201
Phone (202) 619-1343, Fax (202)260-8512
Email: paffairs@oig.hhs.gov

I hope this information is helpful to you and your constituent. If you need further assistance, please feel free to contact our office again.

Sincerely,

Vicki Turetsky
Commissioner
Office of Child Support Enforcement

Center for Fiscal Equity

Comments for the Record
U.S. House of Representatives
Committee on Ways and Means
Subcommittee on Human Resources
Subcommittee on Select Revenue Measures

Hearing on How Welfare and Tax Benefits Can Discourage Work
Wednesday, June 27, 2012

By Michael G. Bindner
Center for Fiscal Equity

Chairmen Davis and Tiberi and Ranking Members Doggett and Neal and members of the subcommittees, thank you for the opportunity to submit comments on these issues. These comments are an update to comments we submitted last September. We find, however, that they are just as valid.

Let me first highlight our main point – which is that simply putting people to work in low wage jobs is not enough. Indeed, if child care and pay are inadequate and these jobs have no future than removing disincentives to work is simply code for slavery. This should NOT be the goal of public policy in 21st century America. Instead, the focus should not be on making people go to work as soon as possible, but instead giving them the skills to make full use of their potential – which most likely involves making up for badly funded rural and inner city schools, where the lack of funding bears some relationship to their ethnic backgrounds. Failure to recognize the racist roots of poverty in America simply perpetuates the sins of the past. That is simply honesty, not playing the race card.

The work opportunities available to most TANF participants can easily be described as low wage work and, without significant resources in human development, are likely dead-end jobs. Such jobs often receive tax subsidies, such as the Earned Income Tax Credit and the recently expired Making Work Pay tax credit. One must look askance at any programs which transfer the responsibility for providing adequate wages from the employer and the consumer to the taxpayer.

The expired Making Work Pay tax credit enacted as part of the Recovery Act subsidized low wage labor where the preferred option would be a higher minimum wage, forcing employers and ultimately consumers to pay for the services they receive. Minimum wage laws are necessary because they level the playing field so that employers cannot initiate a "race to the bottom" by allowing workers to compete against each other to offer ever lower wages, often leaving families in the impossible position of having to bid well below what would otherwise be a reasonable standard of living in order to survive.

Increases to minimum wages and benefits, such as mandatory sick leave are, by far, the best incentive to get people to work. Mandatory sick leave would also help the prospects of health care reform, as parents would no longer be forced to resort to emergency room care because the doctor's office is closed during working hours, thus decreasing costs for all.

Another area that will help make work more attractive is income support for families. Such support addresses real market failure in the employment market. It is entirely appropriate to use tax benefits to assure that all families receive a decent wage.

The United States Department of Agriculture estimates that it should cost $1,000 per month per child to provide a decent level of subsistence. The federal government could easily guarantee half of this amount using tax reform, with states providing the other half with coordinated tax benefits.

This credit would replace the earned income tax credit, the exemption for children, the current child tax credit, the mortgage interest deduction and the property tax deduction – and possibly the 10% tax rate. Any consumption tax prebate should also be included in this total. This will lead employers to decrease base wages generally so that the average family with children and at an average income level would see no change in wage, while wages would go up for lower income families with more children and down for high income earners without children.

This shift in tax benefits is entirely paid for and it would not decrease the support provided in the tax code to the housing sector – although it would change the mix of support provided because the need for larger housing is the largest expense faced by growing families. Indeed, this reform will likely increase support for the housing sector, as there is some doubt in the community of tax analysts as to whether the home mortgage deduction impacted the purchase of housing, including second homes, by wealthier taxpayers.

One major obstacle in getting TANF recipients into the working world is the quality of skills they bring to the table. Indeed, a recent survey of the vocabulary of TANF recipients in public housing puts it below the level of the average seven year old. Not seventh grader, seven year old.

State based efforts to improve TANF participants to a level of basic – or even advanced literacy – should be applauded. Indeed, provisions to not only provide remedial education to all who require it should be a mandatory part of TANF reform, not just in states that chose to.

Literacy training must also be provided to fathers if required. Indeed, to facilitate this, the restriction on benefits to intact families must be abolished. Furthermore, compensation for this training should be as rewarding as work, so participation should be compensated at the minimum wage.

In addition to the wage, participants should also receive the same Child Tax Credit as those who work, as well as the same level of health insurance, which could be offered to them as if they were employees of the education provider – thus ending the second class care they receive through the Medicaid program, as well as the need to pay benefits through large, yet underfunded, social welfare bureaucracies at the state level. Public housing should be replaced with residential training programs for both parents and children.

Program participants must be treated as adults. If they are, they can be expected to behave as such. All too often, the fiscal, welfare and immigration policy of the United States seems designed to provide a pool of low wage workers for the food service industry – from the field to the fast food counter. **While these jobs may provide some degree of upward mobility, at times they are akin to slavery.**

In the 21st Century, we can do better than that. If some products cannot be produced without what amounts to subsistence wages, than perhaps those products should not be produced at all, either at home or abroad. **It should not, indeed it must not, be the policy of the United States Government to shield consumers from paying decent wages to those who feed us.**

Establishing a decent level of income through paid remedial training, increased minimum wages and increased family support through an enhanced refundable child tax credit will also **reduce the need for poor families to resort to abortion services in the event of an unplanned pregnancy.**

Indeed, if state governments were to follow suit in increasing child tax benefits as part of coordinated tax reform, most family planning activities would be to increase, rather than prevent, pregnancy. It is my hope that this fact is not lost on the Pro-Life Community, who should score support for this plan as an essential vote in maintaining a perfect pro-life voter rating.

Thank you again for the opportunity to present our comments. We are always available to members, staff and the general public to discuss these issues.

Contact Sheet

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571-334-6507
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Committee on Ways and Means
Subcommittee on Human Resources
Subcommittee on Select Revenue Measures

Hearing on How Welfare and Tax Benefits Can Discourage Work
Wednesday, June 27, 2012

All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears:

This testimony is not submitted on behalf of any client, person or organization other than the Center itself, which is so far unfunded by any donations.

Cherie Boeneman

Cherie R. Boeneman
286 E. Thirteen Mile, #101
Madison Heights, MI 48071
June 25, 2012

The Hon. Geoff Davis
The Hon. Pat Tibiri
Subcommittee on Human Resources
Committee on Ways and Means
U.S. House of Representatives

Re: Hearing on How Welfare and Tax Benefits Can Discourage Work

Dear Sirs:

I am a 55 year old woman from Madison Heights, Michigan. I have, until three and ½ years ago, worked my entire adult life. I was laid off from a major drug store chain where I had been an assistant store manager. The company took the older, salaried assistants, put us on midnights and then discontinued the entire shift for all but a handful of stores in the state. After we were gone, they reestablished midnight shifts with hourly assistants. I had worked there for almost 6 years.

Since then, I have lost my health insurance and unemployment benefits, while helpful, ran out a year and a half ago. I have no income, no assets or bank account. I live with my 78 year old mother who has to keep working part time just to keep a roof over our heads. This, in spite of the fact that she is in the midst of her second round of

chemotherapy for Non-Hodgkin's Lymphoma. Our condo, which we purchased for $70,000 in 2005 is now worth about $15,500 (which is what the last identical unit sold for).

I have never quit seeking work, except for those times when my mother needed me to take her to the doctor and hospital appointments. I have sent out hundreds upon hundreds of resumes, filled out on-line and on premises applications and have had some interviews but no employment. I have made use of MI Works Program for those over 55 years of age. While the resume makeover has been quite helpful, it has not been enough to get me work. I try to remain hopeful but it is increasingly a struggle. Creditors pursue me at every opportunity and I have every desire to pay my bills, I simply have no way to do so. I struggle with despair and depression every day. There seems to be no hope. Sometimes, I just want to end it because there seems to be no place for me in the world anymore.

Added to my struggle is the fact that I have Asperger's Syndrome. The social deficits alone make keeping a job quite difficult. Nevertheless, until recently, I have managed to deal with these issues. Many people with Asperger's are chronically underemployed or unemployed, in spite of being bright and talented individuals. I happen to have a Master's degree but that has not changed my situation at all.

So now, finally, in sheer desperation, I turn to SSI. It is truly my last hope. And I am ashamed because I had to file. I would really, truly rather have a job. Please do not say that Welfare and tax breaks are disincentives to work. They are LIFELINES for people who want the dignity of work.

Are corporate welfare and tax breaks for the wealthy disincentives for THEM to work? You say they are job creators. Then I guess the answer would be, "No." I worked my entire life, I paid into Social Security, Medicare and Unemployment. They are not entitlements. They ARE lifelines. Please stop trying to destroy what is left for the poor, elderly and disadvantaged. If you don't the country you will have left will no longer be America the Beautiful.

Sincerely,

Cherie R. Boeneman

cc. The Honorable Sander M. Levin

CLASP
policy solutions that work for low-income people

Elizabeth Lower-Basch
Center for Law and Social Policy
Testimony for the Record

June 27, 2012

Hearing on How Welfare and Tax Benefits Can Discourage Work

Subcommittee on Human Resources
Committee on Ways and Means
U.S. House of Representatives

elowerbasch@clasp.org

1200 18th Street NW • Suite 200 • Washington, DC 20036 • p (202) 906.8000 • f (202) 842.2885 • www.clasp.org

Thank you for the opportunity to submit testimony for the record on this important topic. CLASP develops and advocates for policies at the federal, state and local levels that improve the lives of low-income people. Much of CLASP's efforts focus on improving low-income people's connections to the workforce and access to quality jobs. Stable employment in a well-paying job is the best pathway out of poverty and into the middle class. Moreover, employment is one of the key ways that people contribute to society. However, we also believe that public benefits are essential to fill the gaps when work does not generate enough income or provide needed benefits, jobs are scarce, or employment is not an option. We believe that it is possible to have a system of income and work supports that prevents material hardship, strengthens families, and rewards work. When our current system of benefits — whether implemented as programs or through the tax code — falls short of this goal, it should be improved.

Making Work Pay

To begin, it is important to recognize the significant progress that we have made toward this goal during the last two decades. Prior to the improvements of the 1990s, low-income single mothers were often made worse off by going to work — even though welfare benefits were (and remain) meager, mothers who began to work would often lose Medicaid coverage for themselves and their children, while incurring child care and other work expenses. This is no longer the case, as the result of a set of critical program improvements that were designed to "make work pay":

- *EITC and CTC*: During the 1990s, the Earned Income Tax Credit (EITC) was transformed from a modest refundable tax credit into the largest federal source of income support and asset-building assistance for low-income working families. The EITC provides low-income working families with a tax credit representing a portion of their earnings. If the amount of the credit exceeds the family's tax liability, the excess amount is paid to the family, typically in an annual lump sum. In 1990, the maximum value of the EITC was just $953, with the credit fully phased out once earnings exceeded $20,264. The expansions of the early 1990s effectively ensured that parents who worked steadily, even in very low-wage jobs, would have higher incomes than they had on welfare. In the 2000s, improvements to the refundable Child Tax Credit (CTC) made it another important work support for low-income families.

- *Child care.* Parents need child care to work. Quality child care is expensive and often far out of reach for low- and middle-income families. Research is clear that parents are more likely to work when they have reliable child care, and they find it challenging to work when they do not. Simply put, helping families pay for child care makes it more likely they can get and keep a job. The 1996 welfare reform law increased federal funding for child care both directly, and through states' ability to use Temporary Assistance for Needy Families (TANF) block grant funds for child care. While families on and leaving welfare generally continued to receive priority for services, the new resources expanded the availability of child care to other low-income working families. Between 1996 and

2000, combined federal and state spending for child care tripled, the number of children receiving child care subsidies nearly doubled, and states were able to initiate a set of new initiatives to promote child care quality. Yet, since 2002, federal funding for child care has been relatively flat with only modest increases. Today the Child Care and Development Block Grant reaches only one in six federally-eligible children and the number of children served is projected to soon reach a 15-year low (Matthews, 2012).

- *Health Insurance:* Congress took action during the 1980s and 1990s to broaden health care coverage for families and children outside of welfare. Originally andwith few exceptions, Medicaid coverage for families was limited to those receiving cash welfare, so loss of welfare meant a risk of lost medical coverage for parents and children. Low-wage jobs have increasingly become unlikely to provide health insurance coverage, and it is often unaffordable even when offered. Between 1986 and 1991, Congress extended Medicaid eligibility to more low-income children, regardless of their families' welfare status. The delinking of Medicaid for adults from receipt of cash assistance, and the creation of CHIP, the Children's Health Insurance Program, helped assure that parents could go to work without losing health insurance coverage for their children and often could continue their own coverage.

- *TANF:* Under AFDC, earnings were disregarded from the benefits calculation for only a limited time after recipients started work; after that point, benefits were reduced nearly dollar for dollar. Nearly all states have changed the ways that their TANF cash assistance programs treat earned income, allowing recipients who go to work to keep a greater portion of their earnings for a longer time than under AFDC. Although time limits and other countervailing pressures prevent most recipients from taking advantage of the opportunity to combine welfare and work (Matsudaira and Blank, 2008), this policy change allowed welfare offices to unambiguously tell recipients that they would be better off if they worked.

- *Supplemental Nutrition Assistance Program (SNAP, formerly known as food stamps):* While the federal eligibility and benefit calculation rules for SNAP have been largely stable over the past two decades, during the 2000s, most states adopted policies and practices that had the effect of making it easier for eligible workers to receive and retain benefits. These include longer recertification periods and simplified change reporting. Many states have also used broad based categorical eligibility to streamline benefit access and modestly expand eligibility to low-income workers.

As a result of these changes, the employment rates of less educated single mothers shot up during the 1990s and are now comparable to those of similarly situated single women without children (Trisi and Pavetti, 2012b). That is a truly dramatic change of the sort that is rarely seen in public policy. Moreover, the EITC and CTC have also been critical portions of the safety net in the recent deep recession, lifting an estimated 9.2 million people — including 4.9 million children — above the poverty line in 2010 (Charite et al, 2012). Medicaid and CHIP have also been quite effective in maintaining insurance coverage for low-income children in the face of the recession, so much so that the share of uninsured children declined slightly from 2000 to 2010, even though coverage from employer-sponsored insurance fell by nearly 12 percent (Gould, 2012). At least for low-income families with children, we have been remarkably successful in building a system of benefits and tax supports that both promotes work and helps low-income workers meet their families' basic needs.

Plateaus and Cliffs

Recognizing this key success does not mean we should not pay attention to the question of possible work disincentives in the benefit and tax structures. It is true that the interaction of various programs' phase out ranges can create long income "plateaus," where gains in earnings are partially offset by loss of benefits, leaving workers and their families only modestly better off as earnings rise. As Steurle testified before this committee, one of the effects of the expansion of means-tested programs for low-income families has been to shift the area in which there are such plateaus, and thus possible work disincentives, to a somewhat higher income range — what he refers to as the "twice poverty trap" as opposed to the former "poverty trap."

Moreover, our benefits system is riddled with "cliffs" — situations where a small change in earnings results in a sudden loss of a benefit. These are far more visible to recipients than gradual phase outs, and thus much more likely to have behavioral effects. Moreover, such cliffs violate our basic notions of fairness, our sense that our benefits systems should never leave a worker *worse* off as a result of an earnings gain. Some areas where workers experience benefits cliffs in our current system include:

- Our current system of Medicaid and CHIP creates two cliffs for working parents. The first comes at the earnings level where parents lose access to Medicaid. (As of January 1, 2012, in the median state, the Medicaid eligibility threshold for working parents is only 63 percent of the federal poverty level (Heberlein et al, 2012).) The second comes at the much higher income level point where children lose access to health insurance through CHIP. These cliffs will both be eliminated when the health insurance subsidies provided under the Affordable Care Act (ACA) are implemented, as shown in the graphs in Steurle's testimony. At least, they will in those states that adopt the Medicaid expansion under ACA. Currently, only 18 states, including DC, extend Medicaid eligibility to parents at or above the federal poverty level. If the remaining states do not adopt the expansion, working parents will continue to hit a cliff where they lose Medicaid coverage, and will not gain access to the tax-based subsidies until their family income reaches the federal poverty level.

- Another major cliff occurs at the gross income limit for SNAP benefits. Households with high child care, child support, housing or medical expenses may reach the gross income limit while their net income (after applying the appropriate disregards) is still low enough to qualify them for benefits. This is one of the reasons why more than half of the states have used broad based categorical eligibility to effectively raise the gross income limit under SNAP (FNS, 2012); if Congress eliminates this option in the Farm bill, it will create a new benefit cliff for recipients in those states.

- Working parents in many states experience cliffs at the point where they lose eligibility for child care assistance. Eleven states have designed their child care programs to avoid cliffs by establishing higher exit eligibility level that allows families to stay on child care assistance even if their incomes grow to exceed the initial eligibility cut-off. However, given the very limited pool of funding for child care assistance, there is an acute tradeoff between serving more low-income families and reducing the benefit cliff. Congress should expand funding for child care assistance so that more families can get the help they need to go to work. Making the child and dependent care tax credit refundable would also help reduce the cliffs that families experience when they reach the child care subsidy limits.

It is worth noting that low-income childless adults face a very different schedule of benefits and phase-outs. They do not receive the child tax credit and are only eligible for a very modest Earned Income Tax Credit. In some cases, especially when they are non-custodial parents, they may face very high effective marginal tax rates beginning with the first dollars earned, because a portion of their earnings is withheld to meet their child support obligations CLASP therefore strongly supports proposals to expand the EITC for childless adults in order to help "make work pay" for all workers.

Young low-income adults are particularly likely to live in multi-generational households and to be the second or third potential earner in these households. Programs that treat all household members' earnings as equally available to the family may result in high effective tax rates for these young adults. Therefore, it may be appropriate to consider excluding from the benefits calculation the earnings of young adults who are not the head of households, in order to encourage work. It is also worth exploring proposals such as those of Gordon Berlin (2007) to provide earnings tax credits that are based on individual, rather than household, income.

Do These Incentives Matter?

Having established that the combination of public benefits and tax policy does create, at least for some workers, a set of income plateaus and cliffs, an important next question is whether workers actually respond to these incentives by reducing their work effort. In fact, economic theory predicts that workers could respond to lower effective wage rates either by reducing paid work (because the relative value of non-market activities including caregiving, household production, and leisure increases) or by increasing work effort in order to achieve a desired target level of after-tax and after-benefit income. In order for incentives to matter in either direction, workers must be aware of the effects of benefit and tax policy, must think of them when they make their choices, and must have the ability to control their hours of work and/or their wages.

The research literature on this question suggests that any work disincentives caused by the phase out are relatively limited in their scope, and are certainly modest compared to both the work-incentive effects of the Earned Income Tax Credit and Child Tax Credit and the overall anti-poverty effectiveness of the safety net (e.g. Ben-Shalom et al, 2011). Very few if any low-income workers are fully aware of the complex system of phase outs and threshold that affect their eligibility for benefits. They are likely to receive only indirect and delayed information on the effects of earnings changes on benefits, which reduces the degree to which these effects actually influence behaviors.

Qualitative studies of low-income parents confirm that when faced with the decision about whether to accept an offered promotion that would result in a modest increase in wages, the phase-out of public benefits is rarely a consideration. By contrast, low-income workers do talk about the effect the position would have on their work schedules and commutes, and sometimes turn down promotions that would shatter fragile child care arrangements (Seefeldt, 2008).

Studies focused on the EITC indicate that the availability of the credit has a far stronger effect encouraging low-income parents to work in the first place than its phase-out has in reducing work effort. This should not be surprising to anyone — because of the nature of our employment system, workers have far more control over the decision whether or not to work than over how many hours per week to work. Workers who do wish to reduce their work hours in order to meet personal or family responsibilities often find themselves unable to do so without paying a very high price in reduced hourly wages and benefits. To the extent that the phase-out of the EITC has any effect on work effort, it appears to be concentrated on second earners within a family (Eissa and Hoynes, 2005).

Tradeoffs

It is important to recognize that there is a very real tradeoff in program design between the cost of a program and the steepness of the phase-out, which results in plateaus and cliffs. We need to be honest in acknowledging that eliminating cliffs and slowing the phase-out of benefits both increases benefits to higher earning recipients and adds new less-needy individuals or families to the pool of eligible recipients.

Some conservative organizations have been promoting an inaccurate narrative that means tested benefits are growing out of control. They rarely acknowledge that, prior to the recent recession, the growth in non-medical spending was overwhelmingly driven by the program changes that were made to make work pay. In fact, for families with the least labor market income, the safety net has become even more fragile, as the TANF program only reaches a small share of even the poorest families (Trisi and Pavetti, 2012a).

To the contrary, these organizations give a deliberately misleading portrayal of our safety net. First, they come up with an inflated value for the amount we spend on safety net programs, by combining spending on programs that provide funding for schools and communities with spending on programs that provide direct benefits to individuals and families. Then they divide this figure by the number of poor families. Hearing how much the government supposedly spends per poor family, the listener is left to conclude that the safety net for poor families is quite generous, that the government is wasting a lot of money, or both.

Sometimes, these figures are followed by an acknowledgement that not all of the benefits of these programs go to poor families. The implication then is that if we strengthened the means testing of these programs to cut the near poor out, we could save significant money without harming the most vulnerable "very poor." This has two major problems:

- The official poverty threshold is helpful for statistical purposes, but is far below the levels needed to achieve a modestly acceptable standard of living in most areas. When work expenses, particularly child care, are taken into account, many families with incomes as high as twice the poverty level have as much difficulty meeting their basic needs as families with incomes below the poverty level.

- Making programs more means tested implies either creation of new benefit cliffs or increasing the phase-out rate for benefits, and therefore increasing the implicit marginal tax rate. In other words, it makes the problems highlighted by this hearing worse. If you are serious about being concerned about the work disincentives under benefit programs, and not just using them as a rhetorical cudgel to criticize such programs, you should strongly oppose such changes. For example, you should reject the current proposals to eliminate categorical eligibility under SNAP.

What about Work Requirements?

Some have suggested that the solution to possible work disincentives is to add work requirements to more programs. However, as discussed in the first section, low-income parents already unambiguously experience earnings gains as they move into work. The challenge that remains is that they do not always experience significant gains as they move from some work to "more work" (more hours or weeks of work per year, or higher wages). A work requirement aimed at promoting "more work" would be hard to define and would require an unacceptably high level of government intrusion into both the lives of low-income workers and the businesses that employ them. Moreover, the target population would be quite large and such a requirement would necessitate a significant new bureaucracy. Given the lack of evidence that work disincentives caused by phase-out rates are a real factor, this proposal would almost certainly create more problems than it solves.

Work requirements are often couched as "building on the successes of TANF," which does have a strong work requirement for participants. There is no doubt that welfare reform understood broadly — including the changes made under TANF, but also the improved work incentives under the EITC, Medicaid coverage, and expanded funding for child care assistance — did increase employment rates of single mothers. But work requirements were only one piece of this package.

It is also important to recognize that the work requirements came at a real price in terms of adequacy of support. While the share of poor single mothers who are working increased in the wake of welfare reform, so did the share of poor single mothers who are "disconnected" — neither working, nor receiving cash assistance. In 2010, during the height of the recession, 38 percent of poor single mothers were disconnected in this way (Gabe, 2011). While many of these families receive SNAP, not all do. If disconnected families were also turned away from SNAP benefits, there is little question that more children would go hungry, with long-term developmental and economic consequences.

Finally, one of the key lessons from TANF is that we simply have not done a good job of figuring out how to enforce work requirements in a way that is helpful and respectful and distinguishes between those who are capable of work with the right incentives and those who are not. Instead, we have created a system where job search programs often have far more to do with discouraging welfare receipt than finding work, and that fails to provide meaningful help to many of those with the greatest barriers to employment. We need to get this right before we should even consider expanding work requirements to a broader set of programs.

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Recapturing the Vision

RECAPTURING THE VISION

ReCapturing the Vision International, Inc

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Dear Congressmen Davis & Tiberi:

This letter serves as a formal proclamation that ReCapturing the Vision, International, Inc. is against any attempts to cut OFA-funded programs that seek to provide at-risk families with the opportunity for self-empowerment and socioeconomic mobility. Programs, such as ours, that provide marriage education and promote the development of life-skills will help to break the vicious cycle of inter-generational poverty. Compromising the delivery of such programming would be extremely detrimental for our communities and our country as whole.

Sincerely,

Dr. Jacqueline Del Rosario

President/CEO ReCapturing the Vision