



Background for Connecticut Legislative Briefing on “Cliff Effects”

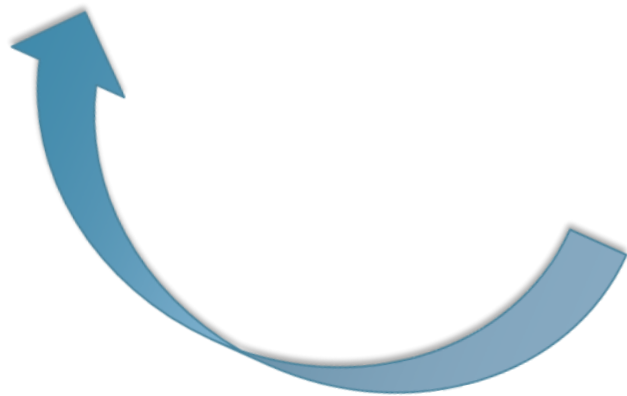
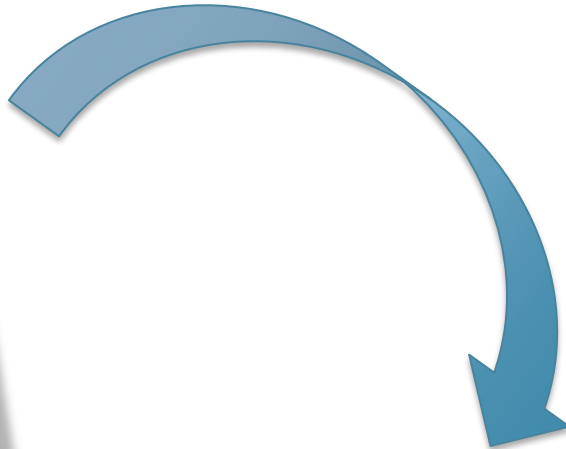
Marybeth J. Mattingly

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Public Service That Makes a Difference®





Persistent Challenges

- ▶ Growing Income Inequality
- ▶ Limited Opportunities
 - ▶ Education
 - ▶ Out of School
 - ▶ Jobs
 - ▶ Social Networks
- ▶ Decline of the Middle Class
- ▶ Job Quality is Uneven

A blue-tinted photograph of a classical dome with a statue of a woman holding a bundle of wheat on top. The text is overlaid on the image.

Low Unemployment Rate:
New England – 3.1%
Connecticut – 3.6%
**Yields a Very Tight Labor
Market**

And a job isn't enough anymore

Official poverty among working age
adults in the US:

12.3%

...among those with at least one job

7.2%

Share of workers with more than one job in the US:

4.9%

Source: FRBB Analysis of Current Population Survey – ASEC 2019 Data, downloaded from IPUMS.org ; Bureau of Labor Statistics U.S. Department of Labor, *The Economics Daily*. Retrieved from <https://www.bls.gov/opub/ted/2018/4-point-9-percent-of-workers-held-more-than-one-job-at-the-same-time-in-2017.htm>

And poverty is a relatively low bar

- ▶ MIT calculations suggests it takes much much more for a family to meet its basic needs.
 - ▶ In Connecticut, a single mom with 2 kids would need to earn \$32.96
 - ▶ This decreases to \$17.84 with 2 adults, both working.
 - ▶ In no case is the current state minimum wage (\$10.10/hour) enough to sustain families with children
- ▶ Trying to balance necessary living expenses with low wages requires calculations that may include staying a job rather than advance, take more hours, and so forth.
- ▶ Why?

What are “Cliff Effects?”

▶ Context: Inadequate Provision of Public Goods

- ▶ Used to Describe a Variety of Ways Program Benefit Dollars Decrease with Increased Earnings

- ▶ Some use them for thresholds when entire program benefits disappear

 - ▶ Child Care Subsidies

 - ▶ WIC

- ▶ Others Use them to talk about any increases in Marginal Tax Rates

 - ▶ Marginal Tax rates describe the tax incurred on an additional dollar of income

 - ▶ In addition to true taxes, many think about these inclusive of lost benefits

 - ▶ Many social programs phase-out with additional earnings

 - ▷ Housing

 - ▷ EITC

 - ▷ SNAP

- ▶ US HHS ASPE

 - ▶ Marginal Tax Rate > 100%

 - ▷ The total resources available to a family actually decrease with additional dollars earned

 - ▷ Rare

Who Experiences “Cliff Effects”?

- ▶ Working, and low income
 - ▶ Not generally working poor
- ▶ Families with Children
 - ▶ Targeted by most social benefit programs
- ▶ Families with a Benefit Profile that puts them at risk
 - ▶ Social programs are administered by multiple agencies
 - ▶ Different rules, different eligibility, different phase-outs
 - ▶ Not all families get the benefits they are eligible for
 - ▶ Availability
 - ▶ Information
 - ▶ Stigma
- ▶ Estimating actual “cliffs” is very difficult. Simulations are complex but do give information on hypothetical cliffs.

- ✓ *Among households with children just above poverty, the median marginal tax rate is high (51 percent); rates remain high (never dipping below 42 percent) as incomes approach 200 percent of poverty.*

What Happens When People Increase Their Earnings? Effective Marginal Tax Rates for Low-Income Households

Brief #2 in the ASPE Marginal Tax Rate Series

March 2019

By Nina Chien and Suzanne Macartney

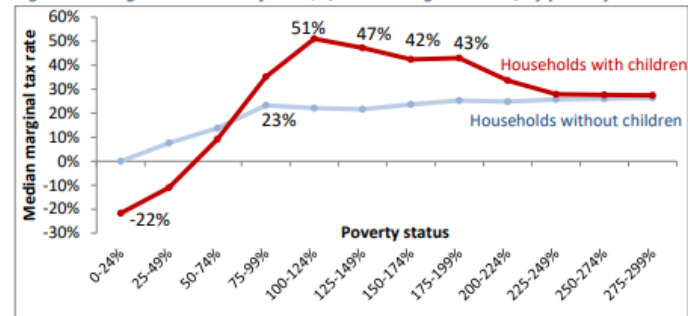
Highlights

- ✓ This is one of the first analyses to use nationally representative data to estimate marginal tax rates faced by different kinds of households.
- ✓ Among households with children just above poverty, the median marginal tax rate is high (51 percent); rates remain high (never dipping below 42 percent) as incomes approach 200 percent of poverty.
- ✓ Households with children are more likely to face high marginal tax rates than households without children.
- ✓ Among households with children below 200 percent of poverty, the most common combination of benefits is **SNAP + EITC + Child Tax Credits (CTC) + Medicaid/Children's Health Insurance Program (CHIP)**, and these three million households experience a median marginal tax rate of 42 percent.

Households with Children: Marginal Tax Rates Are Highest Just above the Poverty Line

Among households with children, when earnings increase by \$2,000 (see Figure 1, dark red line), median marginal tax rates rise precipitously from *negative* 22 percent¹ (when family income is 24 percent of poverty or less) to 51 percent (when family income is just above poverty). Marginal tax rates then stay fairly high, with median families netting between \$980 to \$1,160 after the \$2,000 earnings increase (reflecting marginal tax rates between 51 and 42 percent), until families exceed twice the poverty threshold.

Figure 1: Marginal tax rates after a \$2,000 earnings increase, by poverty status



Source: ASPE tabulation of microdata from the TRIM3 model, Current Population Survey, ASEC 2015.

What are marginal tax rates?

“Effective” marginal tax rates refer to how much of *new* earnings are effectively reduced by income tax, payroll tax, and especially, a reduction in government benefits. If a hypothetical family earns an additional \$1,000 from extra work hours over the course of a year, the added earnings are taxed (-\$200) and SNAP benefits are reduced (-\$200). Altogether, the bite taken out of new earnings by taxes and reduced benefits yields a marginal tax rate of 40 percent. Extra earnings of \$1,000 amounts to a resource increase of \$600.

Some level of marginal tax rate is a natural and inevitable consequence of benefit programs targeting low-income households. Program benefits are designed to decline as earnings rise, yet marginal tax rates set too high may discourage work. The median U.S. household faces a marginal tax rate of 34 percent after a \$2,000 earnings increase. We refer readers to the ASPE brief “Marginal Tax Rates: A Quick Overview” (<https://aspe.hhs.gov/system/files/aspe-files/260661/brief1-intromtrs.pdf>)

“Cliff Effects” and Employment

- ▶ Some evidence of “parking” at cliffs to avoid loss of benefits
- ▶ Fear of “cliffs” that may or may not be relevant may impact individual labor force behavior.
- ▶ Short term benefits may preclude long term mobility.
 - ▶ Foregone Wage Increases
 - ▶ Limited Hours
 - ▶ Declined Promotions

Underlying Concerns

- ▶ For those interested in addressing cliff effects, there is often an underlying desire to improve the income situation of working families.
- ▶ In a context of income insufficiency and income volatility, many strive to preserve benefits so that families can meet their basic needs.
- ▶ Two things to fix
 - ▶ Information gap: Narrative and Advice
 - ▶ Benefit Solutions
- ▶ Benefit “Fixes can come from policy solutions or labor force solutions.
 - ▶ High enough wages would make cliffs irrelevant
 - ▶ Policies can smooth cliffs and reduce the risk
 - ▶ Difficult
 - ▶ Costly
 - ▶ Trade-offs
- ▶ Solving cliff effects will benefit some but won’t solve poverty.
 - ▶ Structural problems
 - ▶ Embedded challenges



Thank You!
Responses, Comments, Questions.

Beth.Mattingly@bos.frb.org

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