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Making Work Pay Enough

A Decent Standard of Living for Working Families

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New Safety Net Paper 1

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MAKING WORK PAY ENOUGH

A Decent Standard of Living for Working Families

What does it mean to "make work pay" for working families? For years, researchers and commentators, concerned by the fact that some people stayed on welfare for long periods, argued that public assistance programs actually discouraged work. During the 1990s, major changes in public assistance programs and the tax code helped "make work pay" for families that had not previously been working. In other words, "make work pay" meant "make work pay more than welfare."

Since then, the number of families relying on cash assistance and not working at all has plummeted by more than 60 percent nationwide. But now, although work pays more than welfare, work alone is not paying *enough* for many families: not enough to consistently meet family expenses (especially in communities with high housing costs), not enough to be prepared for emergencies, and not enough to secure a foothold on the path to long-term self-sufficiency. "Making work pay" for *working* families should mean that they can consistently afford the basics—housing, health care, food, and child care—and see real benefits to continuing and increasing their work effort.

Ironically, some of the policy and program changes that have helped make work pay more than welfare have created a catch-22 for low-income working families. Once families have at least one part-time worker, working more hours, adding a second worker, or earning a higher wage does not substantially increase their disposable income because all the public supports the families qualify for when they start entry-level jobs phase out rapidly as earned income rises. Although these families often do not earn enough to cover the costs of basic needs, working more does not markedly improve their well-being because they face extremely high combined marginal tax rates.

In fact, even full-time work may not pay enough to provide a decent standard of living for many families. In particular, housing costs have been rising faster than wages for a growing segment of the workforce. Consequently, a growing share of lower-income families spend more than 30 percent (and in higher-cost markets, more than 50 percent) of their incomes for housing, cost burdens deemed "unaffordable" by federal standards (Katz and Turner 2008). In Baltimore, Maryland, for example, a parent would have to work full

time for at least $20.07 an hour to afford the average rent for a modest, two-bedroom house or apartment (NLIHC 2006).

Making work pay for working families requires tackling both the income side and the expenditure side of working family budgets. We propose a package of program reforms and policy initiatives that increase purchasing power, reduce "taxes" on incremental earnings of entry-level workers, and cut the costs of big-ticket necessities like health insurance, child care, and—our focus here—housing.

Understanding the Needs of Low-Income Working Families

By definition, a low-income working family has at least one member who regularly works at least part time. Most such families have incomes above the official poverty level. In fact, most earn too much to quality for cash welfare through the TANF (Temporary Assistance for Needy Families) program.[1] Those with sufficiently low incomes may receive food stamps and, if they have children under age 5, WIC.[2] Their children are eligible for health insurance coverage either through Medicaid or SCHIP (the State Children's Health Insurance Program).[3] And some may get help with housing or child care, although the need for assistance far exceeds available slots. Finally, low-income working families can receive fully refundable tax credits through the EITC (earned income tax credit), and some may receive additional tax credits through the CTC (child tax credit).[4]

Why then should policymakers be concerned about these families? First, the budgets of low-income working families are perilously tight. Consider the example of a single mother with two young children living in Philadelphia, Pennsylvania. To meet her estimated expenses for housing, utilities, food, child care, health care, transportation, and other necessities like clothing, school supplies, and household and personal care items, she would need after-tax resources of over $34,500 in 2005 (Cauthen 2006). If this single mother worked full time at $8 an hour (well above the minimum wage in 2005 and higher than the $7.25 an hour the minimum wage will be in 2009), her income would still fall short, even with the help of food stamps and federal income tax credits.[5]

Public programs designed to help supplement the earnings of low-income working families fall short, in part because not all families take full advantage of benefits to which they are entitled, but also because housing and child care assistance serve only a fraction of those in need. Indeed, among low-income families with at least one full-time, full-year worker, less than one in five receives food stamps, less than one in ten receives child care help, and only half receive public health insurance coverage through Medicaid or SCHIP for at least one family member (Zedlewski et al. 2006).[6] Further, federal housing assistance serves only about one-third of all low-income renters and virtually no low-income homeowners.[7]

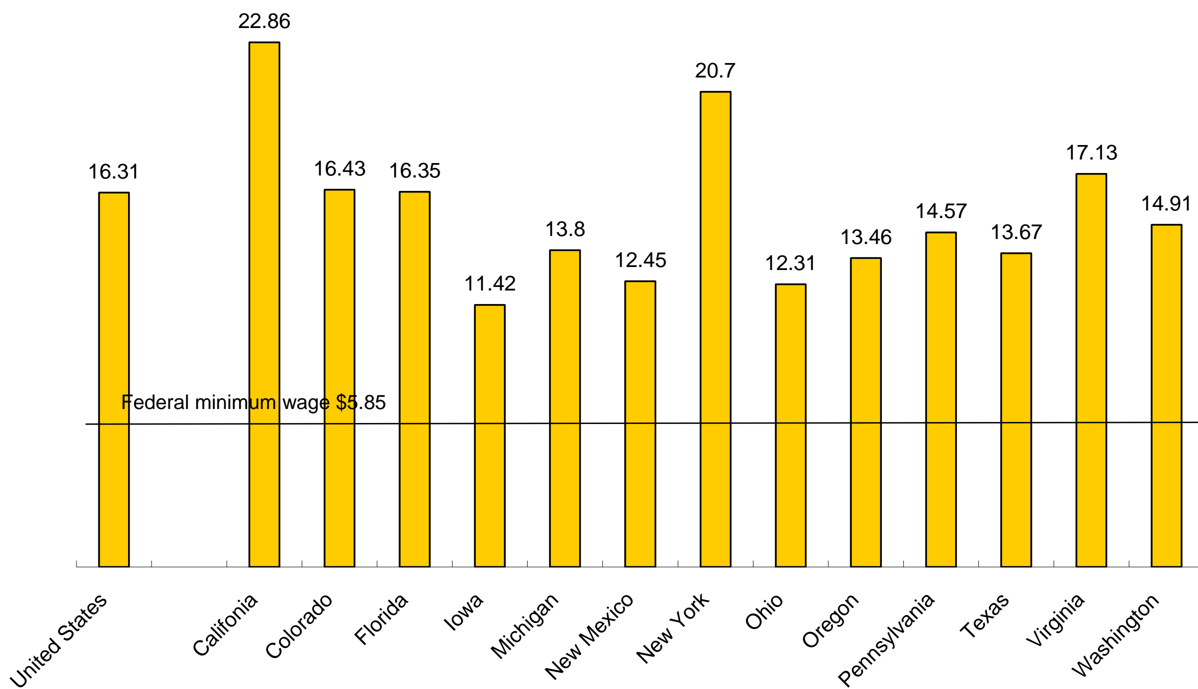
Not only are earnings low for these families, but the costs of big-ticket essentials—including housing, health care, and child care—are high and rising. We focus here on housing. Average rents nationwide have been growing faster than inflation, while the median renter's monthly income has dropped 7.3 percent since 2000 (Katz and Turner 2008). Half of all working households with incomes between $19,000 and $37,500 spend more than 30 percent of their monthly incomes for housing, and 15 percent spend more than 50 percent (Dreier 2007). When housing consumes such a large share of families' monthly income, they have little left for other essentials like food, health care, and child care. And they risk eviction and possible homelessness if they miss rent or mortgage payments.

But housing costs (and hence the severity of affordability problems) vary widely across markets. The mismatch between wages and housing costs is greatest in the nation's most prosperous metropolitan areas, where growth in the housing supply is not keeping pace with growth in jobs and population. Specifically, local zoning laws, land-use controls, and other regulatory barriers limit total housing production, raise the costs of new units, and often prevent the construction of low-cost houses and apartments. As population expands in a

market with constrained supply, the increased competition for units drives prices up, even for those who do not typically live in new homes or apartment buildings (Glaeser and Gyourko 2002; Glaeser, Gyourko, and Saks 2005). As figure 1 shows, a parent would need to work full time at wages up to 3.9 times the current federal minimum wage (and up to 3.2 times the new, higher minimum wage for 2009) to afford housing in markets like San Francisco and New York (NLIHC 2007).[8]

When families cannot make ends meet, they face difficult choices about whether to compromise on the quality of their housing or child care, forgo medical care or health insurance, or skip or cut the size of meals. Not surprisingly, therefore, low-income working families suffer high rates of deprivation and hardship. One of every four low-income working families with at least one full-time, full-year worker reports having to cut or skip meals because they are unable to pay for enough food, and one of every four reports missing at least one rent, mortgage, or utility payment over the course of the year (Acs and Loprest 2005). Despite their substantial commitment to work, low-income working families are, at best, far from economically secure and, at worst, living on the edge of poverty, suffering material hardship, juggling to keep up with bills, and racking up debt just to get by. Public policy can and should do more to help low-income working families make ends meet and to better reward their work effort.

Figure 1. Hourly Wage Needed to Afford a Two-Bedroom Home at Fair-Market Rent



Source: NLIHC 2007.

How Do Public Programs Reward and Penalize Low-Income Working Families?

Today's public assistance programs mainly channel aid to families with little or no income, so benefits decline fairly quickly as family income rises. Table 1 and figure 2 summarize eligibility ceilings and benefit levels for the major entitlement assistance programs (Zedlewski et al. 2006).[9] Although all these programs can help working families make ends meet by supplementing their incomes, the benefits are not clearly or consistently linked to work. TANF recipients must meet certain work requirements, but even low-wage, part-time work raises a family's income above the eligibility threshold. Other programs do not require work, and because benefits phase out as income rises, low-income working families receive relatively little assistance.

Low-income working families can also qualify for federal rent subsidies. The most generous of these programs pays the difference between the families' rent contribution—set at 30 percent of monthly income—and the actual rent for a house or apartment. [10] Families can receive this kind of "gap-filling" subsidy if they live in public housing (owned and managed by a local public housing agency) or in a privately owned development that has a long-term subsidy contract with the federal government. Gap-filling subsidies are also available as federal housing vouchers (also known as Section 8), which allow families to rent homes and apartments on the private market and cover the difference between 30 percent of family income and the market rent, up to a locally determined maximum.[11]

Although families with incomes up to 80 percent of their local area median can quality for federal housing assistance, help is available for only about a third of all who are eligible. Waiting lists for assistance are so long that, in most communities, housing agencies open them to new applicants only once every year or two. And because many housing agencies understandably target assistance to families with the lowest incomes (below 30 percent of the local area median) or the most severe housing needs, the average incomes of households receiving federal housing assistance fell below $10,000 in 2000; less than a third of these households received most of their income from wages.[12] Most low-income working families receive no housing assistance, even if they live in high-cost markets where homes and apartments they could reasonably afford are in short supply.

Other federal assistance programs directly link benefits to work. Most notably, the earned income tax credit provides benefits only to families with earned income and is the benefit low-income working families are most likely to receive. About 22 million families—75 to 85 percent of eligible tax filers—benefited from it in 2005, and the total amount of the credit (or forgone taxes) was $41.5 billion. The biggest benefits go to families with the least earnings, providing as much as a 40 percent supplement to the earnings of a full-time minimum-wage worker with two children. Married-parent families earning between $11,340 and $16,810 in 2006 received the maximum credit of $4,536 if they had two children or $2,747 if they had only one child. The credit then phases out, so a married-parent family with two children no longer qualifies for the EITC once its earnings exceed $38,348 (Maag 2006). Eighteen states and the District of Columbia (and some localities) also offered state earned income tax credits as of January 2006, largely modeled on the federal EITC (Nagle and Johnson 2006).

Low-income working families can also benefit from the child tax credit. Unlike the EITC, however, it is only partially refundable, so low-income families without tax liabilities receive less benefit than other families.[13] Although the CTC is the largest tax benefit to families with children, costing $45 billion in 2007, it is not targeted at low-income families. In fact, only 1 percent of total benefits go to families in the bottom income quintile, while 60 percent go to families in the top two income quintiles (TPC http://www.taxpolicycenter.org/briefing-book/key-elements/family/ctc.cfm).

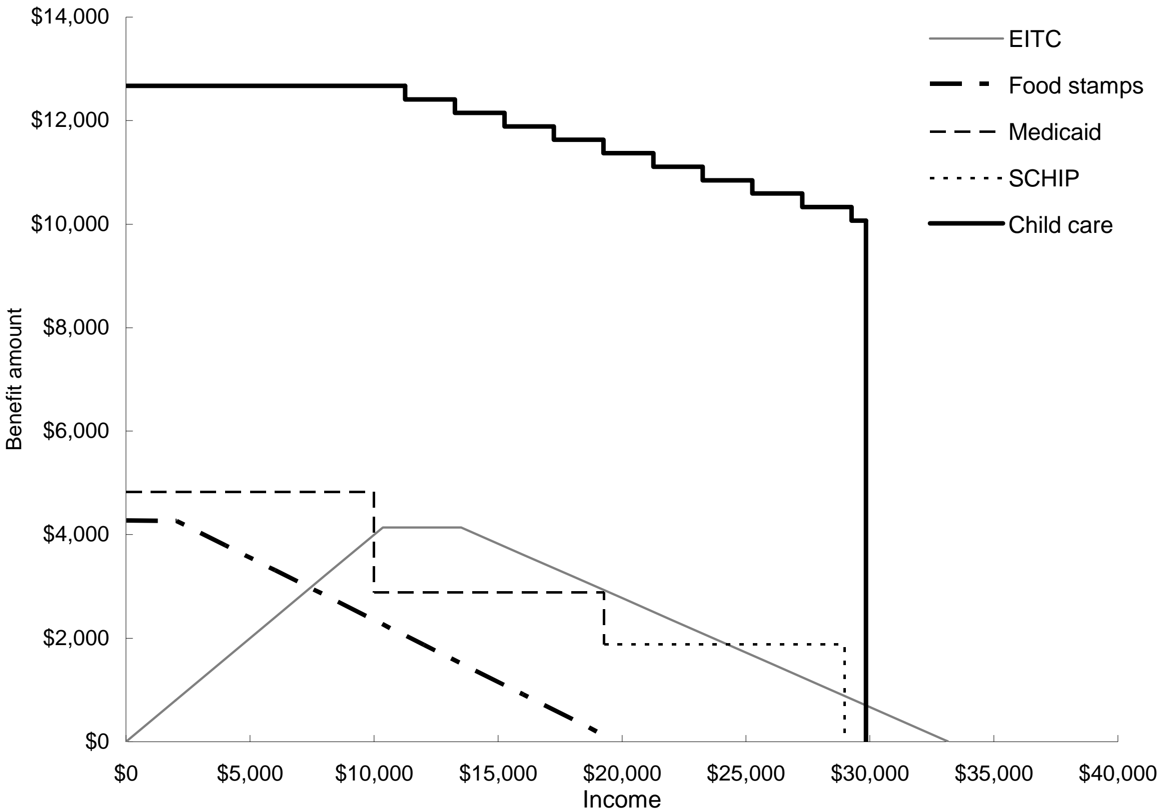
Table 1. Eligibility Requirements That Affect Access for Working Families

Feature	*Medicaid*	*SCHIP*	*Food stamps*	*Child care*	*EITC*
Categorical eligibility	Low-income families, children, and, with a waiver, single adults.	Children and, with a waiver, parents.	None.	Parents must be working, in TANF work-related activities, or in education or training (varies by state) unless child is in protective services. Children must be under age 13 unless they have special needs.	Families with earnings and children. Child must be under age 19, under age 24 and a full-time student, or disabled and must live with the taxpayer for more than half of year and receive half of care from taxpayer.
Immigrant eligibility	Legal immigrants in U.S. for 5+ years; emergency Medicaid for other immigrants.	Legal immigrants in U.S. for 5+ years.	Legal adult immigrants in U.S. for 5+ years, all children under 18.	All immigrants.	Aliens authorized to work in U.S.
Income eligibility	Limits vary by eligibility category and state. On average, below 133% of FPL if children under 6, 100% of FPL if children over 6, and 67% of FPL if working parent.	Varies by state. Ranges from 133% to 350% of FPL.	Below 130% of FPL.	Limits vary across states: the “official” median limit was 194% of FPL in 2003. Limits range from 103% to over 240% of FPL (2003 state plans).	Credit phases to zero at AGI below 226% of FPL if single with two children and below 185% of FPL if married with two children. Phaseout begins at 92% and 79% of FPL, respectively (2004).
Income disregards	Varies by state. Can use gross income, standard (and higher) earned income, and/or child care deductions.	Varies by state. Can use gross income, earned income, and/or child care deductions.	Standard and earned income deductions, shelter and child care expenses.	Not required in federal law, and most states have not adopted earnings disregards.	None.
Asset tests	State option, varies by eligibility group; 5 states apply for children and 29 states for parents (Kaiser 2004).	State option, but rare.	Financial assets limited to $2,000 and car value limited (in some states).	Not required in federal law; only 2 states had limits in FY 2004.	Income from assets cannot exceed $2,650 (2004).
Maximum annual benefit for parent and two children	Average spending per family $4,827 if below 69% of FPL and $2,888 if 70%–133% of FPL (2002), reflecting differences between full and partial family coverage.	Average annual benefit per family $1,876 (2002).	Maximum annual allotment for three people in household $4,272 (2002).	Maximum benefit varies by state, ages of children, number of hours of care, location of the care, and copay charged in the state.	Maximum credit $4,140 (2002).
Copay/premium requirement	Limited ability to require copayments and/or premiums without waiver.	Varies by state and limited to 5% of income; 33 states required premium in 2004.	None.	Copays typically increase with income and vary across states; 32 states use flat rate formula that increases copay by income bracket.	None.

Sources: For Medicaid and SCHIP, http://www.statehealthfacts.org; for food stamps, http://www.usda.gov/fsp and FNS (2003); for child care, Giannarelli (2005), HHS (n.d.), and Schulman and Blank (2004); for EITC, IRS (2005) and “EITC Parameters 2002,” http://www.taxpolicycenter.org/TaxFacts/Tfdb/TFTemplate.cfm?DocID=35&Topic2id=40&Topic3id=42.

AGI = adjusted gross income; FPL = federal poverty level; FY = fiscal year.

Figure 2. Annual Benefits That Could Be Paid to a Single Parent with Two Preschool-Age Children, FFY 2002



Sources: For EITC, authors' estimates calculated with 2002 parameters reported by the Urban-Brookings Tax Policy Center; for food stamps, Food and Nutrition Service (2003); for Medicaid, Holahan and Bruen (2003); for SCHIP, authors' estimates using program expenditure information from statehealthfacts.org and the number of enrollees (children and adults) from CMS; for child care benefits, authors' estimates based on Schulman (2000).

Notes: Food stamp benefits are for a three-person household. EITC is calcuated for an adult with two qualifying children. SCHIP calculations assume benefits for three under Medicaid up to 69% of the poverty level; benefits for two children under Medicaid between 69% and 133% of the poverty level; and, benefits for two children under SCHIP between 133% and 200% of the poverty level. For child care benefits, reimbursement rates to providers, average costs of care, copay requirements, and income eligibility levels for benefits vary across states. Most states use a flat rate copayment formula that increases with income to determine family contributions to care and benefit amounts. Pennsylvania is fairly representative of a state with a flat rate copayment formula. Using information from the 2003 Child Care state plans, we used the copay scale and corresponding income limits for a parent with two preschool age children in full-time center care in Pennsylvania to estimate the potential benefit level for child care. As for cost of child care, most states will reimburse providers for costs up to the 75th percentile of market rates. Unable to locate a distribution of costs, the cost estimate used is the average cost of center-based care for a 4-year-old child in Pittsburgh in 2000, made available in Schulman (2000). Using the Consumer Price Index (CPI-U) to inflate the estimate to a 2002 value, we approximate that the annual cost of care for two preschool-age children is just under $13,000. From this cost, we subtact the copay requirement by income for a family of three and show the net cost ($12,740) as the value of the potential child care benefit. The income eligibility for a family of three in Pennsylvania is from the 2003 Child Care state plans and is $30,516 a year in 2003 ($29,836 in 2002 using CPI).

Some low-income working families that pay for child care can also receive tax credits that cover up to 35 percent of their expenses through the child and dependent care tax credit (CDCTC). The maximum credit is $3,000 for one child and $6,000 for two children. The non-refundable CDCTC can only be used to offset taxes owed and in 2005, families had to earn at least $23,700 (and pay for child care) to receive any benefit from the CDCTC, leaving out the lowest income working families. The cost of the CDCTC exceeded $3 billion in 2007 (TPC http://www.taxpolicycenter.org/briefing-book/key-elements/family/child-care-subsidies.cfm).[14] Finally, child care assistance is available to some working families, though only about one in five low-income working families receives help paying for care from any source (Golden 2005). In 2005, about 1.78 million children, out of an estimated population of 17 million children under age 13, were in subsidized care each month.[15]

Taken together, these public assistance programs and tax credits form a complex web of supports for low-income working families. Depending on a family's income, these supports can provide substantial aid to struggling families and encourage work, but they can also substantially erode the rewards to increased work and advancement. Consider, for example, a single mother with two children under the age of 5 in Detroit, Michigan.[16] If she has no private means of support and applies for and receives benefits from the TANF, Food Stamp, and WIC programs, her annual net income would be $10,800 and she and her children would have public health insurance (Medicaid/SCHIP) (see table 2). Given fair-market rents in Detroit, she would likely pay $9,252 a year in rent—over 85 percent of her net income—for adequate housing. If she took a part-time job (20 hours a week) at $10 an hour, she would lose her TANF benefits, but she would receive substantial tax credits and retain most of her food stamps and WIC benefits. In addition, child care subsidies would largely offset her child care costs,[17] and she and her children would still be covered under public health insurance programs. Overall, her effective income (after taxes and child care expenses and including benefits) would now exceed $18,000 and her housing cost burden would drop to 51 percent of her monthly income. By starting to work, this single mother of two would see her effective income rise by almost 70 percent. In this way, public assistance programs reward work.

Table 2. Income for a Single Mother of Two in Detroit, Michigan, 2003

	no work	*20 hours @ $10*	*40 hours @ $10*	*40 hours @ $15*
Earnings	$-	$10,404	$20,796	$31,200
Federal tax	$ -	$ -	$1,032	$1,176
EITC	$ -	$4,164	$2,712	$528
Payroll	$ -	$(792)	$(1,596)	$(2,388)
State	$ -	$(48)	$(456)	$(876)
Total tax	$ -	$3,324	$1,692	$(1,560)
TANF	$5,508	$ -	$ -	$ -
Food stamps	$4,392	$3,744	$ -	$ -
WIC	$900	$900	$900	$ -
Net child care		$(144)	$(144)	$(3,600)
Available income	$10,800	$18,228	$23,244	$26,040
% change		69%	28%	12%
Effective tax rate		29%	52%	73%

Source: Urban Institute tabulations based 2003 program and tax rules.

Notes: Assumes two children under age 5 with child care costs of $250 a month before subsidy. The family has no assets.

But what happens if this mother starts working full time? Her earnings double, reaching $20,800 a year. But now she earns too much to qualify for food stamps, and although she now receives the CTC, the value of her EITC falls and her payroll and state tax liabilities rise, reducing her net tax subsidy. Despite doubling her work effort, her effective income only rises by about 28 percent—to $23,244. Put another way, she only keeps about $5,000 of the $10,400 she earned by working an extra 20 hours a week—an effective tax rate of over 50 percent. Her housing costs now consume 40 percent of monthly income, still unaffordable by federal standards. And to make matters worse, she might no longer be covered under Medicaid, although her children would still be eligible for public health insurance. In this regard, current tax and transfer programs fail to reward the efforts of working families as they try to move up the economic ladder.

The situation is even more troubling if she moves up to earn $15 an hour. Her EITC benefits fall by over $2,000, and she loses all her child care assistance. Although her earnings rise by $10,400, her net income rises by less than $3,000. Overall she only sees about 25 cents of every extra dollar she makes. And her housing expenses still consume 36 percent of her net income.

The story is similar for married couples. It is similar in other states and for wage rates above and below those used in this example. And in markets with higher housing costs, parents working full time at hourly wages considerably above $15 still face unaffordable rent burdens. By and large, work pays more than not working. But for most low-income working families, work does not pay enough to consistently meet expenses, and working *more* barely pays at all.

Proposed Approach—Making Work Pay *Enough*

Proposals aimed at making work pay enough for a reasonably decent and secure quality of life must increase the disposable incomes of low-income working families while preserving the incentive to move up the economic ladder. One approach would be to phase out program benefits and tax credits more gradually as income rises, effectively giving working families a tax cut by allowing them to keep more of their earnings and rewarding them for advancing in their jobs and careers. Numerous politicians, advocates, and researchers have called for an expansion of the EITC for just this reason.[18]

There are real limits to this approach. If EITC benefits increase, phaseout points rise, or phaseout rates fall, the eligibility ceilings for assistance and tax credits will also rise. So, families already receiving benefits receive more, and additional families—with higher incomes—become eligible for help. For example, if the maximum EITC benefit were raised by $2,000, families earning about $48,000 could claim benefits.[19] Although this would provide substantial help to low-income working families, the benefits would not be particularly well targeted to the neediest low-income working families; some of the benefits would go to families with incomes over 200 percent of the poverty level. Further, the high effective marginal tax rates would remain, unless benefits were phased out more slowly. And an across-the-board expansion in EITC benefits would fail to reflect the substantial variations in housing costs across markets—providing more help than necessary to families living in low-cost markets while leaving those in high-cost markets still struggling with unaffordable housing cost burdens (Dreier 2007).

We propose a package of reforms that provides more support to the lowest income working families, modest tax relief for the average low-income working family, and a targeted boost for low-income families with particularly high expenses. We focus on housing expenses because other papers in this series address child care (http://www.urban.org/url.cfm?ID=411718) and health care (http://www.urban.org/url.cfm?ID=411714). Our proposed approach consists of three basic components: (1) "scale up" existing benefits to reduce the "tax rates" of working families, thereby increasing their purchasing power; (2) provide an additional income boost targeted to families facing high housing costs; and (3) increase the supply of modestly priced houses and apartments in the marketplace, thereby reducing a major drain on the budgets of low-income working families. This approach rewards work by supplementing the earnings of low-wage workers and by ensuring

that working *more* pays off with more disposable income. And it moves toward the goal of ensuring that people who work full time can afford the basic necessities and achieve some degree of financial security. The purchasing power components of our strategy should be implemented consistently nationwide (and targeted to low-wage workers), while the expanded supply components should vary in response to local market conditions (and could serve a wider band of incomes).

Increase Family Purchasing Power

The first and most basic way to expand low-wage workers' purchasing power is simply to supplement their earnings so they have more disposable income that they can use for any purpose. Increasing the minimum wage accomplishes this purpose, strengthening incentives for people to work at all and to work more hours. In 2007, Congress upped the federal minimum wage from $5.15 an hour to $7.25 an hour (by July 2009), raising the annual earnings of a full-time, minimum-wage worker from $10,712 to $15,080. Thirty-one states and the District of Columbia mandate even higher minimum wages, and a growing number of localities are debating "living wage" policies, requiring employers that receive public funding to pay wages that cover living costs. However, critics of higher minimum wages argue that (at some level) they discourage job creation and may even reduce employment opportunities for the lowest skilled workers. It is probably unrealistic to expect additional hikes in the federal minimum wage anytime soon, but periodic adjustments to keep pace with inflation would ensure that the purchasing power of a minimum wage income does not steadily erode relative to the cost of living.

Combined with reasonable minimum wage requirements, tax credits increase workers' disposable income. Phasing the EITC out more slowly as earnings increase offers an administratively efficient way to boost the after-tax incomes of low-income working families. Our proposed adjustment is modest but straightforward: reduce the phaseout rate for families with two or more children from 21.06 percent to 15.98 percent. Aligning the phaseout rate for families with two or more children with the rate for one-child families in this way would translate into about $360 more a year for the typical low-income working family earning $24,000 a year. The cost of this change is estimated at $3.7 billion annually.

Complementary gains could be achieved by making the federal child tax credit refundable starting with the first dollar of earnings, instead of requiring a family to have at least $11,300 in income before it sees any benefit from the credit (Maag 2006). A 10 percent phase-in rate would allow families earning $10,000 to receive the full credit, and the phase-in of the CTC would partially offset the phase-outs of other program benefits. Finally, because families with incomes below $110,000 receive the full credit already, no working low-income family would lose any of their benefits as their income increased (at least not until they were no longer low income). The total annual cost of this expansion is about $6.4 billion a year.

Boost Families' Housing Purchasing Power

In addition to policies that supplement workers' disposable incomes for any purpose, the federal government has long provided demand-side assistance to help people pay for specific goods and services. Food stamps, vouchers for housing and child care, and publicly provided health insurance all enhance purchasing power for specific needs. Our proposal to help low-income working families pay for housing is intended to complement current, HUD-administered housing assistance programs, which primarily serve the poorest and most vulnerable families.[20]

For low-income working families that are *not* receiving federal housing subsidies, we propose a refundable housing tax credit, calculated to help cover the cost of decent housing in the communities where they live. This credit would be available for working families with children—both renters and homeowners—with annual earnings that exceed the earnings level at which the EITC is fully phased in ($12,060 in 2008).[21] The credit's value would rise as annual earnings increase to $17,060 (just above full-time minimum-wage work).[22] The maximum amount of the credit would vary with local housing costs and is calibrated to substantially

narrow the gap between what a full-time, low-wage worker can afford to spend on housing and the actual cost of housing in the local market.[23]

More specifically, the credit would equal half the difference between $4,524 and the family's annual rent or mortgage payment, up to a maximum—the fair-market rent (adjusted for family size) where the family lives. The $4,524 represents an "affordable" housing expenditure for a family supported by one full-time worker earning the minimum wage as of June 2009.[24] And fair-market rents (which HUD calculates for all metropolitan areas and nonmetropolitan counties nationwide) reflect the cost of modest, decent-quality housing available on the market.[25] At the average FMR nationwide, the maximum refundable tax credit would total $1,980. Larger families and families living in high-cost housing markets would receive a larger credit, while those living in low-cost housing markets or paying less than FMR for their housing would receive a smaller credit.[26]

To encourage and reward work, the credit's value would be greatest for families with earnings at or above the full-time minimum wage level. The credit would increase from zero for families earning less than the amount required to receive full EITC benefits ($12,060 for a family with two children in 2008) to the full amount for families earning $17,060. The amount would then remain the same (regardless of earnings increases) until earned income topped $40,000, holding families' effective housing expenditures down as their incomes increased. In effect, a low-income working family's *housing cost burden* would decline steadily.

Once a family's earnings surpassed $40,000, this credit would phase down from its maximum value by $20 for every additional $100 in earnings. Thus, for a family living in a moderate-cost housing market that qualified for a maximum credit of $1,980, the credit would decline to zero once earnings reached $49,900. But a family living in a very high cost housing market that qualified for a credit of $4,000 would still qualify for some credit up to earnings of $60,000. This smoothes the transition for families living in very high cost housing markets and avoids an abrupt "benefit cliff."

This new tax credit would serve about 12 million families and cost approximately $27 billion a year (in current dollars).[27] Although this represents a substantial new tax expenditure, it amounts to less than half the cost of the current mortgage interest deduction, which mainly benefits higher-income homeowners (that own high-priced homes and face high marginal tax rates).[28] The mortgage interest deduction totaled $72 billion in 2006 (Gale, Gruber, and Stephens-Davidowitz), and 82 percent of these benefits went to taxpayers in the highest income quintile (Carasso, Steuerle, and Bell 2005).

Expand the Supply of Modest Housing

Raising the purchasing power of low-income working parents—and providing an extra boost to cover high housing costs—is clearly a critical first step. But if moderately priced houses and apartments are unavailable, severely dilapidated, or unsafe in the communities where low-income working families live and work, more purchasing power alone will fall short. Economic theory suggests that enhanced purchasing power will induce increased supply, but in many circumstances, regulatory and market barriers impede construction of modest housing (Glaeser et al. 2005). In these circumstances, more purchasing power might increase upward pressure on housing prices and rents, making housing even more expensive.

To address this problem, the third component of our proposal offers subsidies and other incentives to make more moderately priced housing available *where it is currently in short supply*. Primary responsibility for this initiative should fall at the state and local level, where land use and zoning regulations and building codes are enacted and enforced. In fact, only policymakers at the state and local level can accurately determine *where* more housing is needed. In many metropolitan areas, affordable housing is abundant in distressed central-city neighborhoods but scarce where job opportunities are expanding. Historically, both jobs and affordable rental housing were concentrated in central cities. But in recent decades, employment growth has become increasingly dispersed, while exclusionary zoning laws have limited development of rental housing in many

suburban communities.[29] In short, central cities are still where most affordable rental housing is but not where most jobs are.

Although states and localities are best suited to take the lead in determining where and how to expand affordable housing, the federal government can create incentives for them to do so. Federal incentives could encourage state and local governments to adopt land use regulations that are "affordable housing friendly" to catalyze the production of substantially more affordable housing in communities that offer access to quality jobs, not in distressed communities where subsidized housing is already overly concentrated.

The federal government already provides considerable funding to state and local governments to promote affordable housing development. The federal Low Income Housing Tax Credit (LIHTC) program works through the states to provide tax credits to investors in housing development deals, thereby increasing their effective return and allowing properties to charge lower rents. And the federal HOME Program provides block grants to cities and urban counties for many affordable housing purposes, including new rental construction. These two programs have subsidized the production (or substantial rehabilitation) of roughly 100,000 homes and apartments annually that charge rents affordable for households whose incomes are 60 percent of their local area median.[30]

Two specific adjustments to these programs could strengthen their effectiveness. First, the LIHTC should be expanded and retargeted. Specifically, we recommend a 20 percent increase in the program's size—at an estimated cost of about $1 billion annually—in conjunction with revised targeting formulas that direct more tax credits to states where rental housing is in short supply (and fewer to states where the supply of rental housing is adequate) and to locations within these states where moderately priced rental housing is scarce.[31] Second, to spur more affordable rental production in suburban communities, we propose a new federal incentive fund. Jurisdictions would be eligible to receive awards from this fund (to use for any housing or community development purpose) if they reduced regulatory barriers to affordable housing production and demonstrably expanded the supply of moderately priced rental housing within their borders. An annual incentive fund of $1 billion would support awards of $10 million each to the 100 top-performing jurisdictions across the country. At this point, it is not possible to estimate how many affordable housing units might be produced as a consequence of such an incentive fund. But systematic monitoring over time could identify the most effective local strategies, disseminate this information nationally, and focus incentive awards to communities adopting proven approaches.

Summary and Potential Benefits

Over the past decade, reforms to social safety net programs have created strong incentives for people to work, rather than relying primarily on welfare. But current systems still fall short on the principles of "rewarding work" or "making work pay enough." Many parents who work full time cannot earn enough to afford a basic standard of living for their families, especially where housing costs are high. And working more hours or advancing to a higher paying job does not pay off with meaningful gains in economic security or well-being, because benefits are scaled back as incomes increase.

Our strategy for tackling this problem addresses both sides of the family budget ledger; it supplements the income side with enhanced purchasing power (including an income boost specifically targeted to cover housing costs) and reduces some costs by making more moderately priced housing available in the marketplace. Specifically, we propose a three-part solution.

- Increase effective earnings among low-income working families:
  - Phase out the value of the EITC more slowly as earnings increase. At a cost of $3.7 billion annually, this will benefit families with two children making between $16,000 and $45,000 a year.

- Make the federal child tax credit (CTC) refundable starting with the first dollar of earnings. For $6.4 billion annually, this change benefits the lowest earning working families—with incomes up to $24,000 a year.

- Help cover high housing costs among low-income working families:
  - Create a new, refundable tax credit that help fills the gap between the cost of decent housing and what low-wage workers can reasonably afford to spend. At a cost of $27 billion annually, this initiative targets help to low-income working families facing high housing costs.

- Expand the availability of moderately priced housing in the marketplace:
  - Expand and retarget the federal Low Income Housing Tax Credit. This would cost $1 billion annually.
  - Create an incentive fund for state and local jurisdictions that increase production of moderately priced housing, at a cost of $1 billion annually.

In combination, these reforms would substantially increase the net incomes of working families with earnings up to and beyond $40,000 a year, with the largest benefits going to full-time working families with low wages. Table 3 shows how these changes would help the single mother of two in Detroit, Michigan, we described earlier. If she works full time at $10 an hour, her net income rises from $23,244 under current law to $27,173, and her housing cost burden falls from 40 to 34 percent. Our proposal also substantially reduces effective tax rates for families leaving welfare for part-time work as well as for those moving from part-time to full-time work. The effective tax rate for starting a part-time job at $10 an hour falls from 29 percent to 19 percent. And the effective tax rate for moving up to full-time work at $10 is 24 percent, down from 52 percent.

Table 3. Income for a Single Mother of Two in Detroit, Michigan, 2003

Baseline law versus reform proposal

	Part Time at $10/Hour		*Full Time at $10/Hour*		*Full Time at $15/Hour*		*Full Time at $20/Hour*	
	Baseline	*Reform*	*Baseline*	*Reform*	*Baseline*	*Reform*	*Baseline*	*Reform*
Earnings	$10,400	$10,400	$20,800	$20,800	$31,200	$31,200	$41,600	$41,600
Net income	$18,228	$19,268	$23,244	$27,173	$26,040	$29,522	$32,964	$35,241
FMR/net income	51%	48%	40%	34%	36%	31%	28%	26%
Effective tax rate	29%	19%	52%	24%	73%	77%	33%	45%

Source: Urban Institute tabulations based on 2003 program and tax rules.

Notes: Assumes two children under age 5 with child care costs of $250 a month before subsidy. The family has no assets.

As families move from full-time work at low wages to full-time work at moderate wages, they still face extremely high effective tax rates under our proposed plan (about 75 percent), but their net incomes are substantially higher, and their housing costs are much more affordable. Finally, as families move into middle-income status, the phaseout of the proposed housing credit creates higher effective tax rates than exist under current law, but these families are relatively secure economically and can increasingly take advantage of the home mortgage interest deduction.

This approach would improve the standard of living for families taking their first steps up the economic ladder. Clearly, however, a trade-off remains between higher effective incomes for lower-wage parents and the higher marginal tax rates for families just above them on the earnings ladder. Tweaking our proposal by starting to phase in the housing credit at the point where the EITC starts to phase out or slowing the rate at which this new credit phases in would reduce the effective tax rates families face as they advance from earning around $20,000 to $30,000 a year (currently around 75 percent) but at the expense of providing less help to those earning $20,000 a year.

Our proposed approach offers other advantages as well. If more decent-quality affordable housing is built, families at a range of income levels benefit. And by allowing low- and moderate-income working families to make their own choices about where to live, whether to rent or own, and how much to spend for housing (rather than relegating them to a subset of rental housing projects earmarked for occupancy by the needy) it integrates them into the conventional marketplace and the social mainstream. Finally, our proposal both responds to the heterogeneity of markets and neighborhood conditions and respects federalism—giving states and localities the resources and the flexibility to invest in ways that make sense locally.

The same principles could be applied to other big-ticket essentials that burden the budgets of low-income working families, by both enhancing purchasing power through targeted subsidies or tax benefits and simultaneously subsidizing the "production" of quality child care, community health facilities, and full-scale grocery stores in locations where these amenities are in short supply or overpriced. This approach is simultaneously "people based" and "placed based." And because access to these expanded amenities would not be strictly limited to low-income families, this approach helps address the financial pressures facing moderate- and middle-income families, garnering wider political support for a more generous and effective safety net.

NOTES

[1] TANF income-eligibility thresholds vary considerably by state and differ for new applicants versus those already receiving benefits. Qualifying incomes for single-mother applicants with two children range from $269 a month in Alabama (after six months of TANF receipt) to $1,431 a month in Virginia (for those enrolled in the VIEW program, which is open to most applicants who do not receive work exemptions). See the Welfare Rules Database. http://www.acf.hhs.gov/programs/opre/welfare_employ/state_tanf/index.html.

[2] Families with incomes (after deductions for a portion of allowable expenses) below 130 percent of the federal poverty level are eligible for food stamps; those with children age 5 and younger and with incomes below 185 percent of the federal poverty level are eligible for WIC.

[3] SCHIP eligibility varies by state, but for the most part, children in families with incomes below 200 percent of the federal poverty levelare eligible.

[4] Those paying for child care may also receive the child and dependent care tax credit (CDCTC).

[5] The family budget approach may be criticized because value judgments are required to determine a family's needs. However, using actual data on family income and expenditures, Acs and Nichols (2005) demonstrate that the average low-income family (income below 200 percent of the poverty level) with a full-time, full-year worker must make do on very tight budgets. Poor families with full-time, full-year workers and low-income families with only part-time workers typically have even more difficulties making ends meet.

[6] Almost 80 percent of these families qualify for the EITC (Zedlewski et al. 2006) and more than 80 percent of those eligible receive it (Tax Policy Center, http://www.taxpolicycenter.org/briefing-book/key-elements/family/eitc.cfm).

[7] Technically, households with incomes up to 80 percent of their local area median can qualify for federal rental housing assistance, but these programs have never been funded at a scale commensurate with needs.

[8] Several states have minimum wages higher than the federal minimum wage; further, nine states and the District of Columbia have or will have state minimum wages that exceed the $7.25 federal minimum wage by July 2009 (http://www.dol.gov/esa/minwage/printpage.asp?REF=america.htm).

[9] Table 1 and figure 2 are not comprehensive pictures of all the tax and transfer programs affecting low-income working families. The exhibits serve to illustrate the complex interactions in a select sample of programs; additional programs add to this complexity.

[10] Some local housing agencies are now experimenting with work requirements, time limits, and alternative subsidy formulas, but the impacts of these experiments have not been rigorously assessed.

[11] Besides these gap-filling housing subsidies described above, the federal Low Income Housing Tax Credit (LIHTC) program subsidizes the production of moderately priced rental housing by offering tax credits to investors in housing development deals, thereby increasing their effective return in exchange for lower rents. Specifically, rents must be "affordable" (30 percent of monthly income at most) for households earning 60 percent of their area median, and the assisted units are earmarked for households at or below this income level. But the rent charged does not vary with tenant income, so households with lower earnings end up paying more than 30 percent of their monthly income to live in these subsidized properties.

[12] Data tabulations from HUD's *A Picture of Subsidized Households 2000* show average household incomes between $8,300 and $10,600, depending on the specific program. The percentage of households with the majority of income from wages ranges from 15 to 34 percent.

[13] Families with earnings below $11,300 receive no benefit from the child tax credit. Working low-income families with one child can receive the full $1,000 per child credit once their earnings reach $17,970; families with two or more children can receive the full $2,000 maximum credit once their earnings reach $24,180 (Maag 2006).

[14] In addition, some workers have access to dependent care spending accounts through their employers. The cost of this tax benefit was about $1 billion in 2007 (TPC http://www.taxpolicycenter.org/briefing-book/key-elements/family/child-care-subsidies.cfm).

[15] This total includes both CCDF state and federal expenditures, and TANF funds spent on subsidies. HHS CCDF expenditure data: http://www.acf.hhs.gov/programs/ccb/data/index.htm.

[16] This example is computed using the U.S. Department of Health and Human Services' Marriage Calculator (http://marriagecalculator.acf.hhs.gov/marriage/index.php) and reflects program and tax rules from 2003.

[17] We assume her child care costs are $3,600 a year, which is slightly less than the expenses reported by families using child care (Acs and Nichols 2005). Her annual child care subsidy would be $3,456 based on program rules in 2003.

[18] For examples of political and researcher perspectives on expanding the EITC, see *Pathways* magazine Winter 2008 issue: http://www.stanford.edu/group/scspi/pdfs/pathways/winter_2008/winter_2008.pdf. Some (e.g., Berlin 2007) have suggested expanding the EITC to childless adults to encourage more work particularly among less-skilled single men who might then better marriage partners. Such an expansion would only indirectly help the low-income families with children that are the subject of this essay. Further, nearly four in five low-income families with a full-time, full-year worker are two-adult families (Acs and Nichols 2005).

[19] This simple example assumes that the phase-in rate is accelerated so maximum benefits are reached at $11,340, that benefits start to phase out at $16,810, and that they phase out at 20.96 percent as they do under current law.

[20] In particular, we would recommend targeting scarce federal housing vouchers to very low income families (at or below 30 percent of the area median income), while serving low-income working families with the shallower purchasing power boost outlined here.

[21] In 2003, the year for which we simulate policy changes, the EITC fully phased in once earnings reached $10,510.

[22] Families that have no housing costs (because they live with relatives or pay no cash rent or mortgage), those receiving federal housing subsidies, and homeowners that claim the mortgage interest and property tax deduction would be ineligible for this refundable tax credit.

[23] Peter Dreier (2007) similarly recommends adding a "housing component" to the EITC, which (like the credit proposed here) would vary based on local housing costs.

[24] $7.25 (minimum wage) × 1,040 hours × 30% (federal housing affordability standard). For our simulations based on 2003 program rules, we deflate $7.25 to its value in 2003: $6.50. Hence, our affordability standard is $4,056.

[25] FMRs vary widely, from $382 a month ($4,584 a year) to $1,642 a month ($19,704 a year) for a two-bedroom unit as of 2007. The average for the nation is $707 a month ($8,484 a year) for a two-bedroom unit.

[26] In the lowest cost housing markets, the value of the credit is essentially zero.

[27] Computation from the TRIM3 microsimulation model using program and tax rules from 2003; dollar thresholds for our proposal have been deflated to 2003 levels for the simulation.

[28] Many lower-income homeowners are better off taking the standard deduction and consequently obtain no tax savings despite the fact that they make mortgage interest and property-tax payments.

[29] See Pendall, Puentes, and Martin (2006).

[30] See "Statistical Overview of the LIHTC Program, 1987 to 2005" (http://www.danter.com/taxcredit/stats.htm) and *FY2005 Performance and Accountability Report*, HUD (http://www.whitehouse.gov/omb/budget/fy2005/hud.html).

[31] For an excellent review of the strengths and weaknesses of the LIHTC program and recommendations for reforms, see Khadduri and Wilkins (2006).

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