COMMONWEALTH of VIRGINIA
DEPARTMENT OF SOCIAL SERVICES
Office of the Commissioner

S. Duke Storen
Commissioner

February 5, 2021

MEMORANDUM

TO: The Honorable Ralph S. Northam
Governor of Virginia

The Honorable Janet D. Howell, Chairperson
Senate Finance and Appropriations Committee

The Honorable Luke E. Torian, Chairperson
House Appropriations Committee

FROM: S. Duke Storen S. Duke Storen

SUBJECT: Report on Public Assistance Benefit Cliff

Pursuant to the 2020 Appropriation Act, Item 350 Q., attached is the report on the resource cliff faced by families receiving public assistance. Please contact me with any questions.

SDS:kc
Attachment

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The Public Assistance Benefit Cliff and A Study Proposal To Test The Effects of Eligibility Rules On Moving To Self-Sufficiency

1. Introduction

The 2020 Appropriations Act, Item 350. Q. states: "The Department of Social Services shall study the resource cliff faced by families receiving public assistance when income increases enough to reduce or terminate the family's eligibility for public assistance. The report shall address how the structure and terms of eligibility affect the ability of participants to move toward self-sufficiency. The report shall be submitted to the Governor and Chairmen of the House Appropriations and Senate Finance committees on or before August 1, 2021."

The resource cliff is commonly referred to as the "benefit cliff" and is a well-documented phenomenon where low-income families lose eligibility for public assistance as their earned income increases. The income threshold for most of these programs is set by federal law with the exception of the Temporary Assistance for Needy Families (TANF) which is set by states. Hence, the benefit cliff cannot be fully eliminated without changes in federal policy. However, there is demonstration authority in federal law that allows Virginia to test and evaluate policy changes using existing federal program funding that could eliminate the benefit cliff and help low-income Virginians earn a living wage.

The Department of Social Services proposes a pilot project to overcome the benefit cliff creating an earned income disregard across all the programs which replaces the benefit cliff with a benefit phase out at the point of a living wage. Families would not lose their supports until their earned income fully replaced a loss in benefits. The pilot could be financed in one of three ways: General Assembly support through an allocation of General Funds or TANF funds; General Assembly support through language directing the Department to seek demonstration authority and use existing federal program funds; or by seeking philanthropic funds.

2. Background

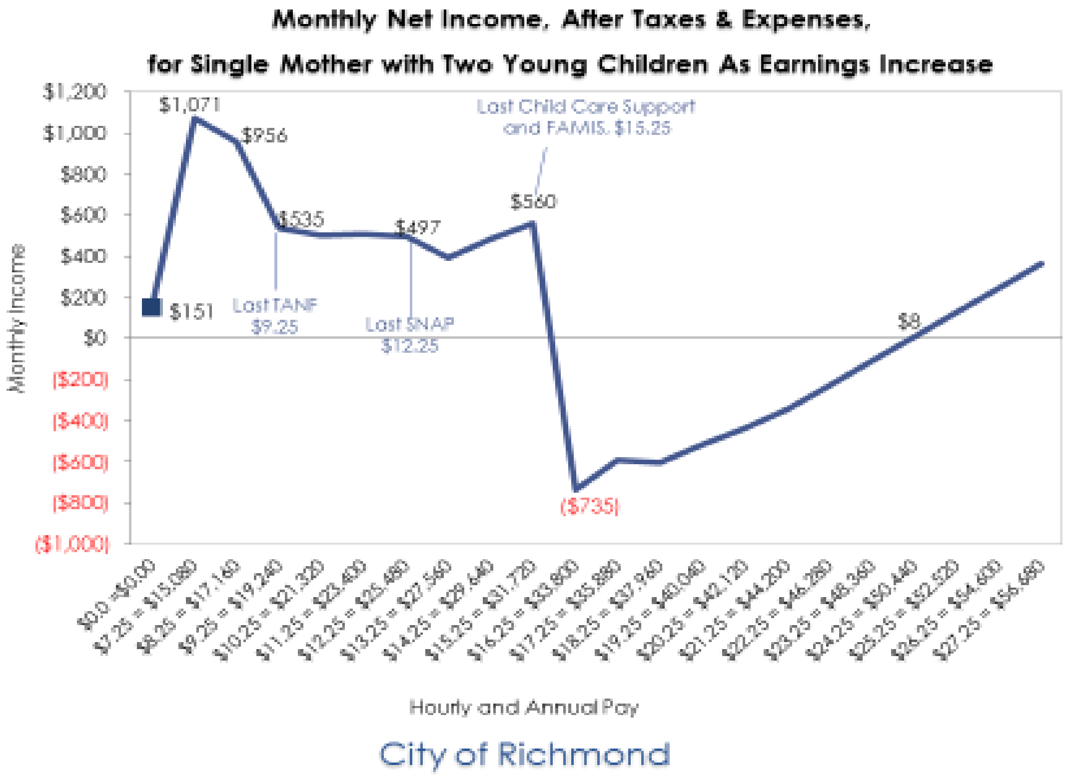
Public assistance programs are means-tested, anti-poverty programs meant to serve as both a safety net to severe deprivation and to provide stability to low-income households so they can develop their capacity for financial self-sufficiency. These programs include a variety of cash and in-kind benefits and services including education and training, housing, child care, medical assistance, utility assistance, and food assistance. The primary public assistance programs for which the Virginia Department of Social Services is responsible include TANF, Supplemental Nutrition Assistance Program (SNAP), the Child Care Assistance Subsidy Program, and Low Income Home

Energy Assistance Program (LIHEAP) as well as eligibility for Medicaid and the Children's Health Insurance Program (CHIP). Eligibility for these programs is based on economic need, unlike social security and unemployment, which require prior contributions.

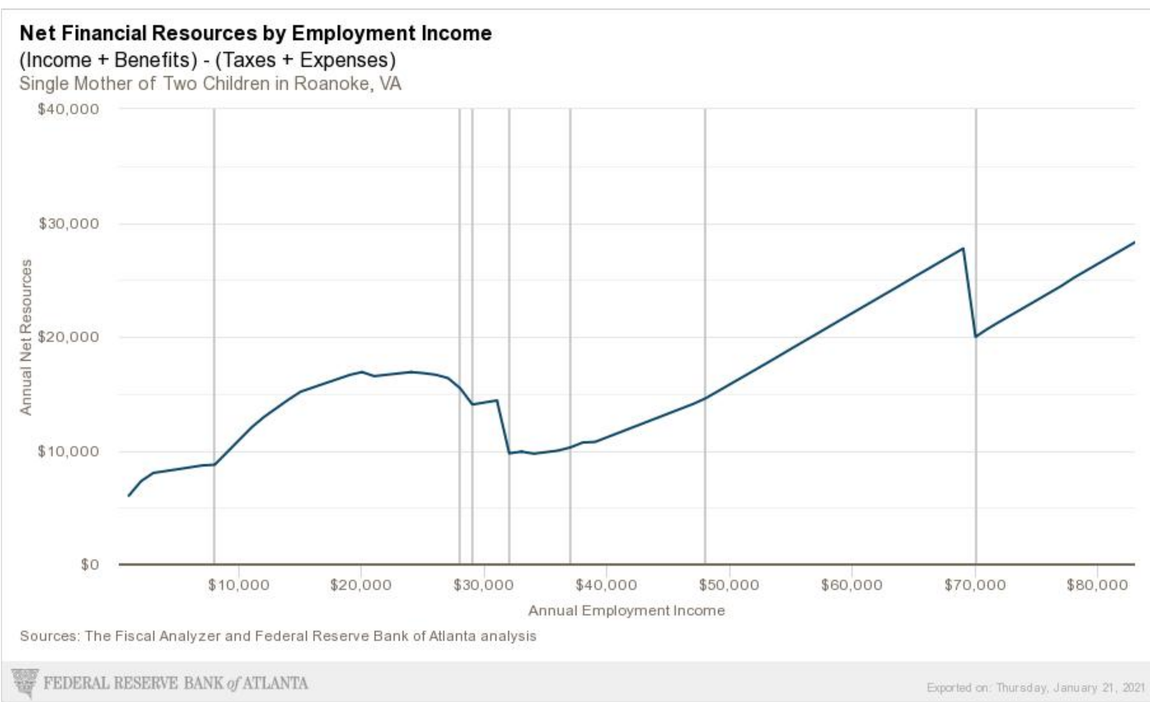
While the income threshold for each program is different, eligibility is determined by comparing household financial resources (earned and unearned income) to the Federal Poverty Level (FPL) to evaluate or "test" the extent to which the family has the "means" to provide for itself. For example, although federal rules only require that TANF cash assistance be means-tested with no specific threshold, in Virginia, families have to be below 46% of FPL to qualify. Eligibility for SNAP is limited to those below 130% FPL. Most of the income limits for Medicaid coverage across different Medicaid programs is limited to those below 185% FPL. Earning any amount above these limits results in the immediate loss of program benefits. Some programs, including the child care subsidy program, TANF, and SNAP, have "earned income disregard policies" that disregard a portion of earned income when calculating eligibility. However, ultimately, every program includes eligibility cutoffs creating a series of "benefit cliffs" in which earning one extra dollar results in losing benefits often worth several hundred dollars.

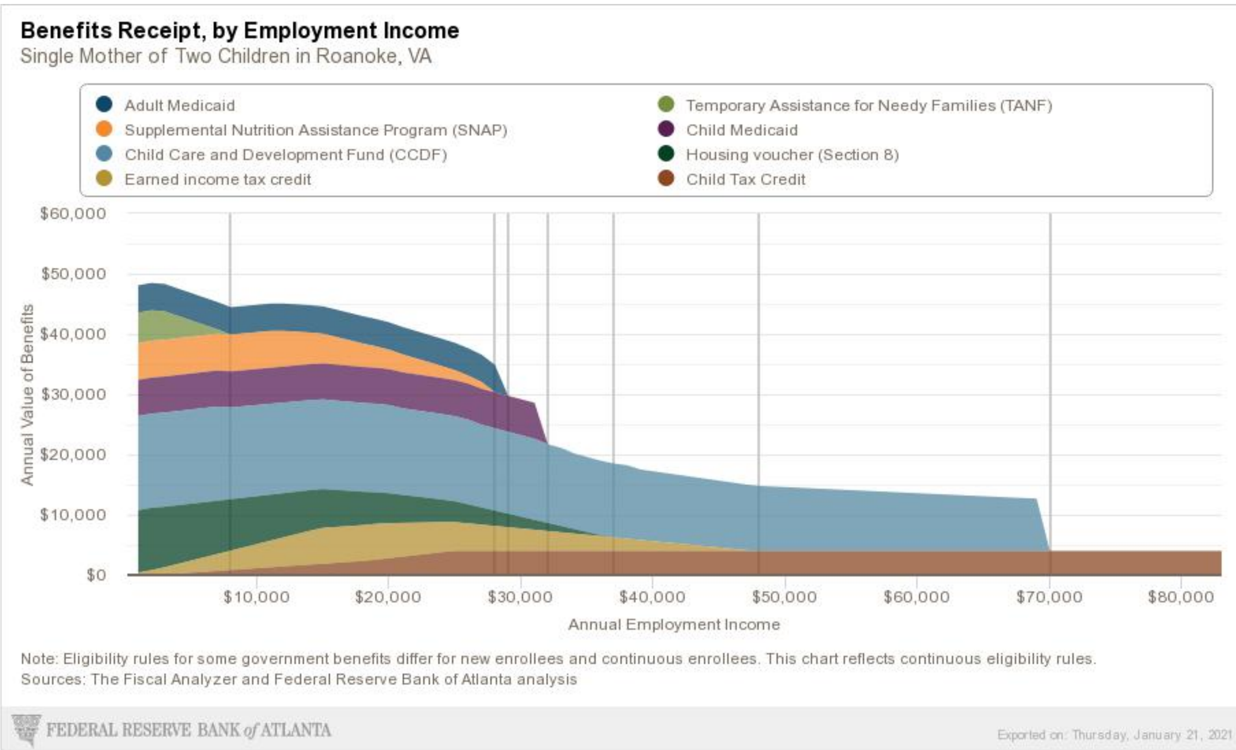
Because eligibility for means-tested assistance programs is set far lower than the actual cost of living, there is a wide gap between program income limits and the income needed to be financially self-sufficient. For example, based on analysis conducted by the VDSS Office of Research and Planning (2016) a single parent in the city of Richmond with two young children in child care needs to earn over $67,000 per year ($32 per hour at 40 hours/week) to be self-sufficient. However, they will lose eligibility for all means-tested programs if their income exceeds $30,500 per year ($15.25 per hour) (Figure 1).

The analysis used local costs (2015) for housing, food, transportation, child care, and health insurance, as well as benefit amounts the family would be eligible for based on household composition and income, taxes that would be owed on earnings, and benefits from the child tax credit and earned income tax credit. A small pay raise or extra work hours can actually make the family worse off financially because the increase in earnings is not enough to replace the loss of benefits. In particular, as shown in the diagram below, as income increases, eligibility for SNAP, Medicaid/FAMIS, child care assistance, and housing subsidies are lost. Child care and housing support are typically the last benefits to be lost and have the greatest impact on family finances. Households may not earn enough to replace the combined value of these lost benefits until they reach two to three times the poverty level. In the diagram below, the horizontal line represents the amount of income needed for a parent with two young children in the city of Richmond to be self-sufficient.



The Federal Reserve Bank of Atlanta has conducted extensive analysis on the benefit cliff and modeled the cliff for cities around the country including Roanoke.





The potential sudden net loss in family resources when program eligibility is lost can create a disincentive for program participants to increase their earnings. How much do program eligibility rules and benefit amounts affect decisions about labor force and program participation? Randomized controlled studies would help isolate and quantify the impact the benefit cliff has on labor force participation and the social cost of continuing to provide public assistance under the current policy structure versus alternative policies that would reduce or eliminate the benefit cliff and replace it with more effective incentives for low income working individuals to become financially self-sufficient.

The remainder of this report includes the following: a literature review, summary of State response to the benefit cliff, the opportunity for conducting a demonstration pilot, and an approach to finance the pilot and evaluation without the use of General Funds.

3. Literature Review on the Benefit Cliff

The “benefit cliff” is the product of longstanding federal policies authorizing safety net programs at different income eligibility thresholds that do not align with the actual cost of living for families. For some low-income families and individuals, the benefit cliff creates a disincentive to increase earnings as families make rational decisions about their total family income (inclusive of safety net program supports) and ability to meet their basic needs. While the existence of the benefit cliff is well documented in literature; there is little empirical evidence testing policy intervention to overcome the benefit cliff.

The negative consequences of the benefit cliff are well documented. The cliff effect is a significant barrier to moving from government support to self-sufficiency as government benefits constitute a sizable portion of the typical income package (Roll & East, 2014). More than 70 percent of public assistance recipients are not able to support their families or "make ends meet" after they leave the program (Livermore et al., 2011). Households may not earn enough income to replace lost benefits and become self-sufficient until they reach two to three times the poverty level, as shown by researchers who have developed measures reflecting the actual cost of housing, food, transportation, child care, etc., in each locality. In effect, the implicit marginal tax rate faced by program recipients at these cliffs exceeds 100 percent, creating strong disincentives to increase labor supply or accept a higher wage. By comparison, the top marginal tax rate in the federal tax code is around 40 percent.

A study examined the behavior of working mothers receiving the Colorado Child Care Assistance Program (CCCAP), a child care subsidy for low-income working parents. It found that families whose earnings were near the upper limit of the program's eligibility guidelines turned down extra work hours and raises in order to preserve their subsidy. The CCCAP participants were found to be 2.8 times more likely to reduce work hours or earnings in an attempt to mitigate the cliff effect if they had already been cut off from their child care subsidy once before (Goldfarb, 2019).

The benefit cliff de-incentivizes low-income working families from increasing their labor force participation by cutting off critical public benefits right when families are on the cusp of attaining greater economic security. The cliff effect has been found to have concrete adverse impacts on the health and well-being of low-income families, with disproportionate impact on minorities. The highest impacts are observed in single-female headed households and among African American and Hispanic or Latino children. A survey of 78 low-income women and 32 social service providers revealed that higher-earning participants (earning roughly $34,000 annually) fared worse than their lower-income peers because of the cumulative impact of managing the repeated loss of resources due to fluctuations in income. Coping strategies employed by the mothers surveyed included skipping meals or living without electricity for extended periods of time in an attempt to stretch limited resources after the loss of a benefit (Goldfarb, 2019).

Despite a recognition dating back to Friedman (1962) of the potential for income-based eligibility rules to discourage work, there is little rigorous evidence on interventions/policy changes to overcome the benefit cliff or consensus about the size of labor supply responses. Many studies have focused on smaller changes in benefit amounts (rather than the complete loss of benefits from the cliff), and estimated fairly small labor supply responses (Chan and Moffitt 2018). Some of these studies have used quasi-experimental variation in program rules across states or over time, which are potentially hindered by confounding effects of other policies or broader changes in the economy. Some studies also make a number of untestable assumptions about individual preferences and simulate responses according to an economic model of behavior. The most credible evidence may come from randomized experiments of the Negative Income Tax in the 1960s and 1970s, which obtained somewhat mixed results (Moffitt and Kehrer, 1981). In addition, the landscape of means-tested programs and the labor market are now quite different than they were 50 years ago.

4. State Policy Responses to the Benefit Cliff

While States possess some tools to moderate the benefit cliff, current federal rules prevent States from eliminating it. Moderating policies include creating a state-funded, refundable earned income tax credit; maximizing the earned income disregard policies for the child care subsidy program, SNAP, and TANF to enable participants to retain benefits after employment for a short period of time; 12 month authorization for subsidized child care; asset creation strategies like Individual Development Accounts; and subsidized employment policies that enable participants to be trained for positions with career ladders to increase earnings and the potential for wage growth. Additionally, states can help low-income families to overcome the benefit cliff by helping them achieve a living wage as quickly as possible and taking a whole family approach to service delivery. This approach requires a shift from a “work first” approach to a “career ladder” approach to helping individuals set goals and attain the necessary education, training, and credentials to succeed in a career that will pay a living wage without the assistance of safety net programs.

In Virginia, we have the following policies to mitigate the benefit cliff.

1. SNAP Standard Deduction: In SNAP, there is a standard deduction that varies by household and is indexed by inflation. Every household is entitled to the standard deduction as identified below:

   1-3 members $167
   4 members $181
   5 members $212
   +6 or more $243

   In addition to the standard deduction, there is an earned income deduction which is equal to twenty percent of the households earned income. The purpose of this deduction is to recognize taxes and work expenses.

2. TANF Earned Income Disregard: In TANF, the amount of earned income that is disregarded is dependent upon whether the recipient is participating in the TANF employment and training program, Virginia Initiative for Education and Work (VIEW). If a TANF recipient is participating in VIEW, their earned income is disregarded up to the federal poverty limit. If the recipient is not a VIEW participant, the income disregards are the same as those offered in SNAP, the standard deduction plus 20%. To assist participants in transitioning away from TANF, VIEW participants receive supportive services for one year after exiting the program, including case management, transportation assistance, child care, and $50 per month cash assistance for those employed for at least thirty hours per week.

3. Child Care Subsidy Earned Income Disregard: Statewide, participants in the child care subsidy program may continue their participation for 12 consecutive months in the program until they reach 85 percent of the state median income. Additionally, some local governments continue to pay a child care subsidy with local funds so that families have this support even after they exceed the federal income threshold.

Additionally, several General Assembly members have proposed budget amendments and legislation in the 2021 General Assembly that would further mitigate as well as test permanent solutions to the benefit cliff.

1. SNAP Broad Based Categorical Eligibility (BBCE): Governor Northam included funding for BBCE in his amendments to the Appropriations Act for FY22. This option allows a state to confer eligibility for the SNAP program based on the receipt of a TANF-funded service. The policy change enables states to eliminate the resource test for SNAP eligibility determination as well as increase the gross income threshold to 200 percent FPL from 130% FPL. These changes address the benefit cliff because households are not punished for savings (needed to address economic shocks, repair cars, pay for post-secondary education) and allow households to earn a higher wage before exiting the program. It should be noted that SNAP food benefits are 100 percent federally funded and the Governor's amendment provides state funding for additional staff and system changes needed to implement the policy change.

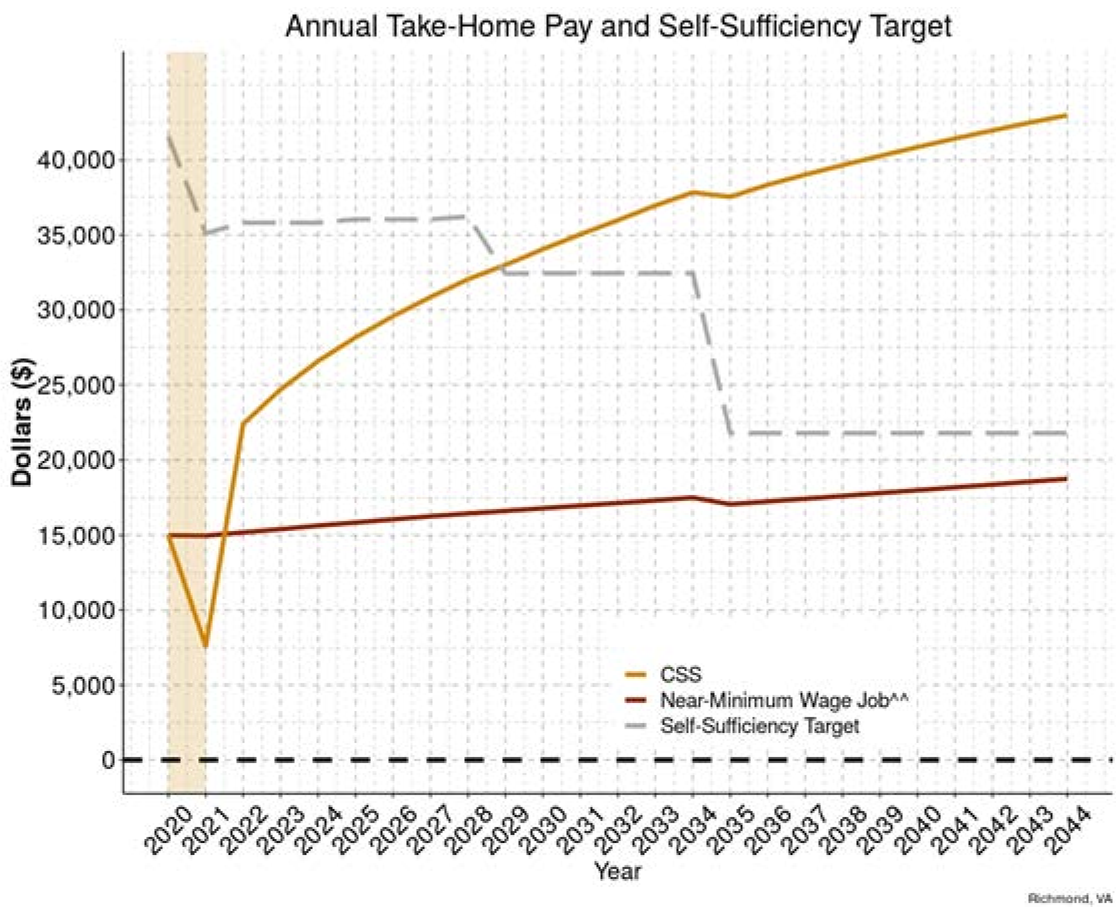
2. Revisions to the TANF Subsidized Employment Program: The Northam administration has also proposed changes to the TANF subsidized employment program, referred to as the Full Employment Program (FEP), increasing the amount of the subsidy to employers from $300 to $1,000. The proposed changes would also allow the TANF participant to keep their TANF benefit for up to 6 months. This change impacts the benefit cliff because TANF participants will have both earning from employment and their cash assistance benefit giving them an incentive to enter unsubsidized employment and giving the employer risk capital to hire an individual from the TANF program.

3. Increasing the TANF Earned Income Disregard: One budget amendment adjusts the income disregard to $250 plus 25 percent of the remainder of gross monthly income.

4. Budget Language Directing the Department of Social Services to use federal demonstration authority to test evidence-based initiatives to help families earn a living wage including a benefit cliff pilot. This language only amendment directs DSS to seek federal waiver authority to test, pay for, and evaluate strategies to end the benefit cliff.

In addition to policies that mitigate the benefit cliff, a number of interactive financial planning tools have been created for use by case managers and individuals to better understand the benefit cliff, and the Virginia social services system will be using these tools to assist in educating participants in their career planning. For example, the Federal Reserve Bank of Atlanta has provided a Career Ladder Identifier and Financial Forecaster (CLIFF). The CLIFF Planner provides analytical capabilities for workforce and human service professionals, employers, non-profits, and policymakers working to mitigate the benefit cliffs through changes in practices, policies, and system alignment. The CLIFF Planner helps workers and students identify the training programs that increase their earnings, improve their standard of living, and put their families on a path towards self-sufficiency. The figure below is an example of the output from the CLIFF Planner. It illustrates the changes in expected take-home pay for a single parent with two children who is considering becoming qualified as an Information Technology Customer

Service Specialist (CSS) (other family types and career choices are available). The Self-Suffiency target for the young adult changes over time as children are born, get older and no longer need child care, graduate high school, then college, and move on from their parent's support to start their own journey toward self-sufficiency.



While tools that help demonstrate the cliff as part of a career journey are helpful to manage expectations and set goals, they do not solve the underlying problem. Virginia has the opportunity to test strategies to eliminate the benefit cliff and help thousands of families achieve their dream of financial independence.

5. Testing Policy Changes to Overcome the Benefit Cliff

The Department of Social Services proposes a pilot project to overcome the benefit cliff. The first pilot is to create an earned income disregard across all the programs which replaces the benefit cliff with a benefit phase out at the point of a living wage. Families would not lose their supports until their earned income fully replaced a loss in benefits.

Replacing the benefit cliff with a benefit phase-out could produce fiscal gains both for families and for state government. If the phase-out increases labor supply by weakening the disincentive for recipients to work, income tax receipts would rise and spending on means-tested benefits would fall. In this way, combining expanded program eligibility with a phase-out can more than "pay for itself." The magnitudes of the increased revenues and reduced program spending will depend on the labor supply elasticities for those below the current eligibility cutoff.

This pilot project could be funded by the Department applying to conduct a demonstration project using existing authorities in the Social Security Act and the Food and Agriculture Act of 1977. If approved, the pilot would be funded using existing federal and state funds and require no additional General Funds.

Interest in such an intervention is high in the research and practitioner communities, and the Department has already secured a commitment from two prominent researchers from UVA and Harvard to evaluate the pilot. The Department and the research team would use a random control trial experimental design to ensure the rigor of the evaluation.

6. Conclusion

The “resource” or “benefit” cliff is well-documented. As low-income individuals advance in the labor market and earn higher wages, they face a difficult and terrible choice between advancement and economic decline caused by the benefit cliffs reached across various programs. These root causes of this problem lie with federal policies, and the solution must come with either federal policy reform or a waiver of federal policy in Virginia. To this end, the Department of Social Services is poised to implement a pilot project that changes the program rules and overcomes the benefit cliff as well as a rigorous evaluation to demonstrate the impact of this change for Virginia and the nation. The pilot could be financed in one of three ways: General Assembly support through an allocation of General Funds or TANF funds; General Assembly support through language directing the Department to seek demonstration authority and use existing federal program funds; or by seeking philanthropic funds.

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