

The Cliff Effect

Introduction

Imagine working a low-wage job that barely provides for your family's needs. You are thrilled when you are offered a raise, an opportunity to take a new position with higher income, or more hours. Despite this positive step, your net income drops because you have lost significant work support benefits. This sudden reduction is known as the "cliff effect."

Low-wage jobs simply are not enough to meet a family's basic expenses. To help fill in the gaps, working parents can take advantage of work support benefits such as child care assistance or food stamps. These benefits are income-based so that as income increases, a family receives less of a benefit. Occasionally, benefit eligibility involves a sharp reduction. Because of this, a family moves from breaking even to sliding deeply in debt. Instead of benefiting from increased income, a working parent stands on a frightful cliff, where taking a positive jump results in negative consequences.

A Low-Wage Job Isn't Enough

The Family Budget Calculator, found on the Economic Policy Institute's (EPI) website, (www.epi.org/content/budget_calculator/) determines the annual cost of living in rural South Dakota with two parents and two children at \$37,534. In Sioux Falls, this cost is \$39,348; Rapid City is \$40,332. The figure includes the basics of rent, food, child care, transportation, and other necessities. The minimum wage in South Dakota is \$7.25 per hour, creating an annual income of just over \$15,000. Even if both parents work at minimum wage, a rural family will still be short \$7,000 in providing for basic necessities alone. A family in Rapid City would face a deficit of \$10,000. Parents then must make difficult choices such as deciding between buying groceries or needed medicine or sending children to cheaper, and potentially lower quality, childcare.

The National Center for Children in Poverty (NCCP) (2008) reports that over thirteen million American children live in families earning under the poverty level. Data presented by NCCP in their publication

South Dakota Family Economic Security Profile (2009) show that 36% of South Dakota's children live in families that are low-income (income below twice the federal poverty level). In South Dakota, the number of children living in poverty changed from 14% in 2000 (27,182 children) to 17% (32,511 children) in 2007, representing a 21% change for the worse. Over five thousand more South Dakotan children now live in poverty than they did at the beginning of the decade (Annie E. Casey Foundation 2009 KIDS COUNT Data Book).

Poverty Harms Children

Data show that official poverty rates are highest for vulnerable young children under age six. Living in poverty puts a child at risk for delays in cognitive, emotional, and social development. Early experiences actively shape a child's development; these experiences and relationships influence a child's ability to grow up healthy and ready to learn and succeed. The future depends upon children being successful participants in the American workforce and economy. Knudsen, Heckman, Cameron and Shonkoff (2006) explain, "*Cognitive, linguistic, social and emotional competencies are interdependent, all are shaped powerfully by the experiences of the developing child, and all contribute to success in the workplace.*"



Therefore, we can be certain of two facts:

- Working families may still be poor and live in poverty and consequently cannot fully provide for their families.
- Poverty is a risk factor that negatively affects the development of healthy children.

Work Supports

For the millions of working parents who still struggle to provide basic necessities for their families, work supports can help. Work support benefits include earned income tax credits (EITC), child care assistance, public

health insurance coverage, housing assistance and food stamps.

According to the EPI (2007), the Earned Income Tax Credit (EITC) reduces the amount of federal income tax low- to moderate-income working families pay.

For many working parents, childcare is the most costly work-related expense. A 2005 survey showed that the cost of childcare for two children is greater than the median cost of rent (Cauthen, 2007, p.8). There are two major childcare assistance programs: subsidies and federal and state tax credits. Subsidies pay providers directly and parents are required to make co-payments as their earnings increase. The federal Child and Dependent Care Tax Credit (CDCTC) reduces the amount of taxes a working family with childcare expenses must pay. Families are eligible for this tax credit at all income levels; however, no benefit is provided to families with incomes so low that they do not pay taxes.

Public health insurance includes Medicaid and the State Children's Health Insurance Program (SCHIP). SCHIP was created in 1997 to encourage states to cover children living in families with incomes above the Medicaid eligibility limits, resulting in a dramatic increase of children eligible for public health insurance coverage. South Dakota covers children living in families with income up to 200% of poverty.

Section 8 vouchers, or Federal Housing Choice Vouchers, and public housing units benefit low-income families. Housing vouchers are both federal and local – federal funding is distributed to local public housing authorities who manage the voucher programs. Residents typically pay rent determined by a percentage of household income.

The Food Stamp program is federally financed and administered by the state. Eligibility is determined by citizenship, income, and assets while benefit levels depend upon family size and income after deductions.

The Cliff Effect

Work supports make a tremendous difference in the lives of working families as they help parents cover the gap between income and expenses. By definition, work supports are income-based and means-tested: as a family's income rises, benefits typically phase out until the recipient reaches a certain level when the benefit is completely terminated.

Sometimes the means of determining eligibility can actually harm families. In some cases, a small increase in income can cause a severe reduction in benefits, leaving the family no better off than it was before. This

sudden reduction of benefits, leaving the family in a less secure financial situation despite earning more income, is known as the "cliff effect."

Because of the cliff effect, families receiving multiple work supports often find it difficult to get ahead. For example, NCCP's *Making Work Pay for Iowa's Families* (2008) details the net family resources of a single parent living in Des Moines with two children (ages 2 and 6) who works full time all year earning \$9 an hour. With work supports, the family is able to break even. When the parent begins earning more, however, he or she actually brings home less because of losing critical work benefits. Work supports begin phasing out between \$10 and \$12 an hour. A family loses eligibility for food stamps at \$11 an hour; this small increase results in a loss of over \$2,000 in annual food stamp assistance for this family. At \$12 an hour, the family is nearly \$4,000 short and will not recover its original resources until earning nearly \$19 an hour (see chart on next page).

Simply put, the cliff effect prevents a working parent from improving his or her family's lives by working more hours or earning more income. The cliff effect does not reward work.

Everyday families experience the cliff effect. Crittenton Women's Union investigated how women about to lose work supports or who have recently lost work supports manage their circumstances. A 35-year old mother of three who works full-time and earns \$32,000 a year said,

Every day there is a chokehold around me, you know, where sometimes it's really hard to breathe...because most days you feel this consistent choke because there is always a bill that needs to be paid. You can only pay a little on this bill, just to keep them off of your back about two weeks before you have to give them a little bit more money. And so it's this constant game of chess with these bills to just finagle the bills to keep everybody happy for the moment.

Another woman, a single mom, works two jobs and has four children. She recently lost her food stamps and public insurance because of increased earnings from her second job. She explained,

Even though you have a little, you're making a little bit more money, you're really not, you're still in the same category...I don't see how they think that they're making it better...it's not beneficial, actually...it feels like being punished for making more money...you contemplate whether you want to work more hours because

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you could be at home with your kids and still be in the same situation.

Other women were concerned because benefit application and re-certification processes do not take into account irregularities, such as varying work schedules or unpredictable child support payments. One month a woman may work overtime and net more pay, but the next month she may not have even half of those hours. A woman explained that she lost her Section 8 housing voucher because her teenage son began working and his pay was counted as part of the household income.

Crittenton Women's Union says, "*The participants with the highest average income (\$34,000/year) were doing worse in terms of their self-reported well-being than those with lower incomes.*"

Clearly, families are losing their work support benefits before they are able to live without them.

Conclusion

South Dakota is a state of hardworking men and women. Despite working full-time, parents in South Dakota may not be able to provide for their children. Poverty is among the greatest threats to children's wellbeing; as there is help for parents to succeed in the workforce, poverty's damaging influences can be alleviated. Work supports can help bridge the gap

between income and expenses through benefits such as childcare subsidies, food stamps, and tax credits. However, a working parent who earns an increase in pay may face a cliff and lose substantial benefits before the family's income is able to cover the lost benefit. Because of this cliff effect phenomenon, the family is no better off – despite earning a higher income. Work supports eligibility could be reviewed and amended to help working parents so that earning more always improves a family's financial bottom line.

Notes

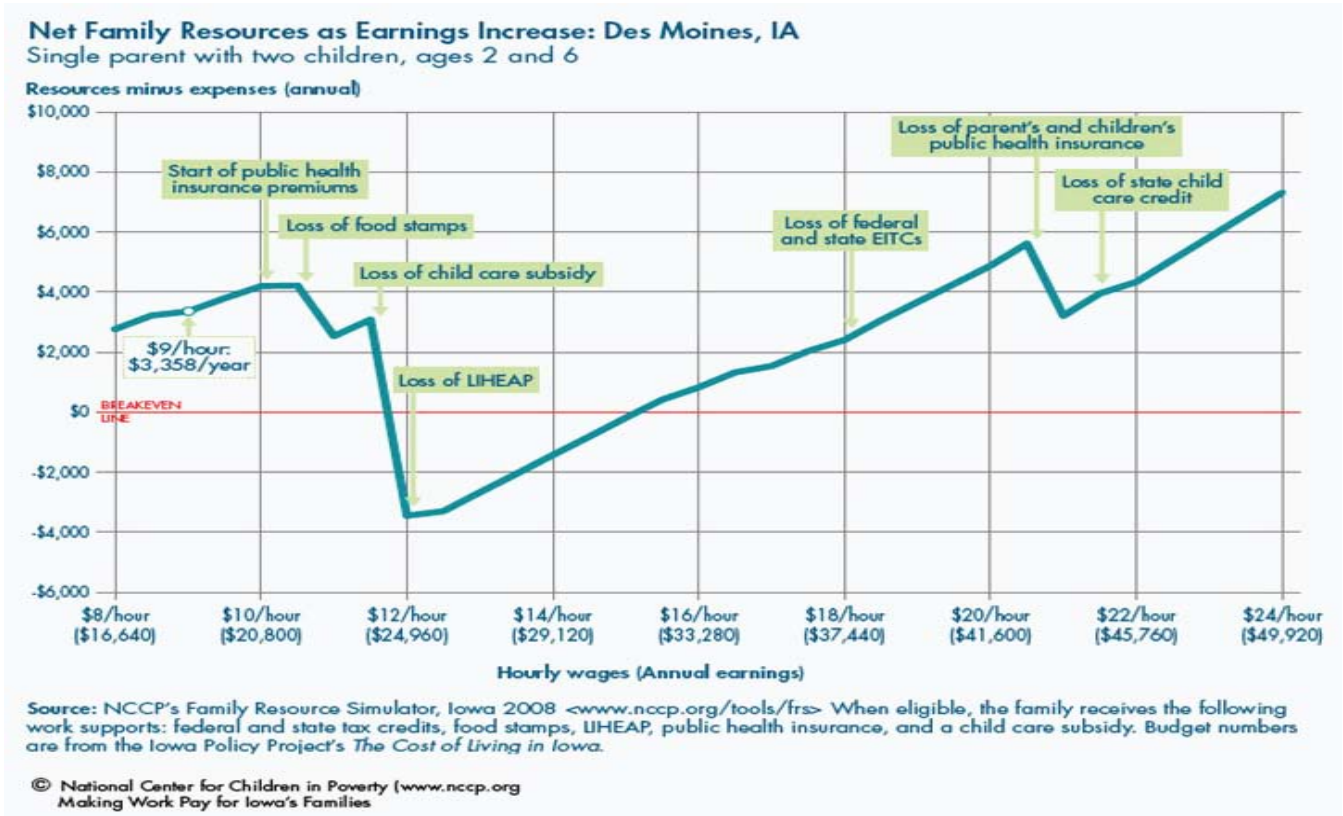
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Notes, continued...

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The South Dakota KIDS COUNT Project

(www.sdkidscount.org) is a national and state-by-state effort, sponsored by the Annie E. Casey Foundation, to track the status of children in the United States. By providing policymakers and citizens with benchmarks of child well-being, KIDS COUNT seeks to enrich local, state, and national discussions concerning ways to secure better futures for children and families. Additional funding for the state project comes from the South Dakota Departments of: Education & Human Services.

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