Strengthening Pathways to the Middle Class: 
The Role of Work Supports

*The Cost of Living in Iowa 2014, Part 3*

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Authors and Acknowledgments

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The Iowa Policy Project

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Preface

This is the third and final report constituting the fourth edition of *The Cost of Living in Iowa*. The first report focused on basic needs budgets for families in Iowa’s 99 counties ([http://www.iowapolicyproject.org/2014Research/140226-COL.html](http://www.iowapolicyproject.org/2014Research/140226-COL.html)). The second report provided new estimates of the proportion of Iowa families whose income falls below the basic needs level [http://www.iowapolicyproject.org/2014Research/140409-COL-Part2.html](http://www.iowapolicyproject.org/2014Research/140409-COL-Part2.html). This report focuses on work supports and how they affect basic family budgets.

Since the last edition in 2012, we have greatly expanded the capabilities of the cost of living model by incorporating all of the major public supports available to low income families in Iowa: Child Care Assistance, Food Assistance (SNAP), public health insurance for adults and children (Medicaid and hawk-i), premium assistance and cost-sharing for health insurance plans under the Affordable Care Act, the Low-Income Home Energy Assistance Program (LIHEAP), the federal and state Earned Income Tax Credits (EITC), and Iowa’s child and dependent care tax credit (CDCC).

In this report we show how these programs help to close the gap between basic needs and the income received from work for many Iowa families, and the “cliff effects” that hinder the effectiveness of some programs. (A policy brief illustrating cliff effects in the Child Care Assistance program was released in March, 2014: [http://www.iowapolicyproject.org/2014docs/140313-CCA-cliffs.pdf](http://www.iowapolicyproject.org/2014docs/140313-CCA-cliffs.pdf).) We also illustrate the impact of selected policy changes on families and their ability to meet basic needs.
Strengthening Pathways to the Middle Class: The Role of Work Supports


By Peter S. Fisher and Lily French

Introduction

Working full time, year round is not enough to guarantee a middle-class standard of living. One in six working Iowa families, in fact, does not earn enough to meet basic needs. There are a number of things that could be done to help such families move into the middle class. Policies are needed to improve both the demand-side and the supply-side of the labor market. On the demand side, we need more middle-class jobs with decent wages and benefits. On the supply side, we need more workers with the education and skills needed to qualify for most good-paying jobs.

What we focus on here, however, is a set of policies called work supports that help low-wage working families survive and keep their children out of poverty, and that provide a stepping stone to a better education and a better job. We lay out a set of policies to strengthen these pathways to the middle class:

- Reform Iowa’s Child Care Assistance program to eliminate a huge disincentive called the cliff and to make it more effective as a help to parents trying to improve their skills and raise their wage level.
- Expand the Earned Income Tax Credit to provide even stronger support to low-wage workers, encourage more work effort, and keep children out of poverty.
- Expand the Child and Dependent Care Credit to cushion the loss of Child Care Assistance and to help those unable to use the Child Care Assistance program.

These reforms should be combined with education policies that ensure future generations of Iowans receive a quality and affordable education, from preschool through post-secondary institutions. This will require expansion of the universal preschool program, support of K-12 education through adequate funding of state foundation aid, and continued efforts to make post-secondary education more affordable by restraining tuition growth.

What Does it Take to Get By?

A family in Iowa with one wage earner and one or two children needs $35,000 to $48,000 a year just to pay for the basic costs of rent, utilities, food, transportation, child care and health care. These figures are based on basic needs budgets constructed for seven different family types for each of Iowa’s 99 counties, and can be found in Part 1 of The Cost of Living in Iowa,
2014 Edition. From these budgets, we calculate the hourly wage needed — full time, year round — to leave the family with after-tax income equal to the cost of basic needs. Meeting the basic family needs budget for a married couple with one wage earner, and either one or two children requires a job paying from $20 to $25 per hour. Most married couple families with children in Iowa have two wage earners, however. While working hours are doubled, expenses increase substantially because of the high cost of child care. For such families, each parent needs to earn between $12 and $17 an hour, as illustrated in Table 1, depending on whether there are one or two children under age 11 and whether one of the jobs includes family insurance coverage.¹

For a single parent, the budget math becomes more daunting, as child care costs must be paid out of a single paycheck. Now an hourly wage of $19 to $28 is needed, depending on whether the parent has one child or two, and whether the job includes health insurance, as shown in Table 2 at right.

These budgets include only basic expenses; there is nothing allowed for meals outside the home, trips or vacations, entertainment, or saving for college or retirement. Child care costs are for a licensed home; care in a licensed child care center would be higher. Health care includes the cost of a basic silver plan purchased on Iowa’s exchange, plus average out-of-pocket expenses. Food costs are based on the U.S. Department of Agriculture’s thrifty food plan. Thus families living on these basic needs budgets would be just getting by.

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<th>Table 1. Basic Family Budgets for Families with Two Working Parents</th>
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¹One child age 2 or 3  **One child age 2 or 3, one child age 6-10


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How Many Iowa Families Come up Short?

How many Iowa families with at least one full-time worker earn enough to meet basic needs without any help? If you are a married couple with no children, you very likely are getting by. If you are a single parent, you’re probably not. Take-home pay for almost three-fifths of the single parents in Iowa is insufficient to cover the basic needs budget. Overall, 16.7 percent of working families do not earn enough to get by (Figure 1).

For those with earnings below what is needed, the shortfall can be daunting. The average single parent family faces an annual deficit of $21,500, and for married couples with children under age 11, the average shortfall is about $16,800 a year.

An Economy of Low-Wage Jobs

The reasons that so many Iowans work full time, yet earn too little to support their families at a basic standard of living, is that there are simply too few jobs that pay a living wage. Over half the jobs in Iowa pay less than $16 per hour, yet most families need to earn more than that. Figure 2 shows that only single persons, and married couples with two wage earners but just one child (or none), can get by on earnings alone at the state’s median wage.

Wages of Iowa workers have stagnated in the past decade. As reported in The State of Working Iowa, 2014, this stagnation has occurred even while the productivity and educational attainment of Iowa workers has continued to rise. The first 30 years after World War II saw a steady increase in productivity, rising education levels fueled in
part by the GI bill and by large investments in public education, and wage levels that rose in concert. The gains from productivity were shared with workers, and a broadened and more prosperous middle class was the result.

Since 1980 productivity has continued to rise, in Iowa and in the nation, but the connection between productivity and wages has been broken, in large part because of the long decline in the bargaining power of workers. While productivity in Iowa rose 61 percent from 1979 to 2013, real median wages rose only 12 percent, and all of that increase came before 2000. Since then, Iowa workers have been treading water, even while productivity growth continued at its historic pace. Meanwhile, the minimum wage has failed to keep pace with a rising cost of living and remains well below a living wage.

**The Importance of Education**

Education is a key factor determining whether or not a worker earns a middle class wage. The median wage among states in our region for those with less than a high school education has fallen by more than 20 percent since 1979, while the wages of high school grads fell slightly. At the same time, the median wage for those with a college degree has risen about 20 percent. By 2000, the college grad was averaging $24.60 an hour vs. $10.97 for the worker without a high school diploma. But since that time, the wage premium for a college grad has risen very little. In fact, the reward for obtaining a college degree can no longer be taken for granted; while some do quite well in today’s economy, an increasing share of low-wage jobs have been filled by college grads. This occurs at the same time that public support of universities and community colleges has declined dramatically, with sharply rising tuition and student debt the result. Nonetheless, the economic return to an investment in a college education remains high; researchers at the Brookings Institution estimate that the return on a bachelor’s degree most recently is above 15 percent, down from its peak of 18 percent in the late 1990s, but still an extremely good investment.² The return on an investment in an associate’s degree is nearly 20 percent.

**Figure 3. Median Wage Higher by Educational Attainment (West North Central States)**

Source: *The State of Working Iowa, 2014*
Historically, education has been a key to growth in state prosperity. Research has shown that, over many decades, the best predictors of rising incomes have been the level of education of the state’s population, and the degree of innovation. Over the past 30 years, there has been a very strong and consistent relation between education level and the average wage in a state.

The education requirements of jobs will continue to rise. The latest occupational employment projections from the Bureau of Labor Statistics indicate that, from 2012 to 2022, overall employment will increase by 10.8 percent. Jobs requiring an advanced degree will increase 16.9 percent, however, while those requiring an associate’s degree or postsecondary certificate will increase 16.4 percent and those requiring a bachelor’s degree 12.1 percent. On the other hand, jobs requiring only a high school diploma or less will expand just 9.1 percent.

A child born into a poor family is unlikely to break into the middle class without a college education; about two-thirds will remain in the bottom 40 percent of families, most of those in the bottom fifth. A child born into a poor family who then obtains a college degree, on the other hand, has a 60 percent chance of making it into the top three quintiles of the income distribution. Clearly, any policy to strengthen pathways to the middle class for low-wage workers and their children must focus on supporting increased educational attainment.

At the other end of the education spectrum, universal preschool for 4-year-olds has been shown to be one of the most effective economic development strategies available to states. Iowa’s current system is a good start, but needs to be expanded to cover full-time preschool for a week rather than just 10 hours. This would benefit both the children, in the long run, and working parents. A child who attends quality preschool full time as a 4-year-old can be expected to have higher lifetime earnings as a result. These earnings will exceed five times the cost of the child’s preschool education.

Under the current system, the subsidized 10 hours are often of little help to working parents, who must still find alternative child care for the remainder of the week. A public preschool program that provides free care from 9 a.m. to 11:30 a.m. four days a week, for example, does not solve the child care needs for a parent who must work full time or even half time. In addition to the need to get the child to and from school during the parent’s work hours, licensed care centers and homes typically must charge the all-day rate for a child attending only from 11:30 a.m. to 5 p.m. because that child takes a space that could be filled by an all-day child. In such a situation, the free care provides no cost savings and adds transportation challenges.

While full-day preschool, as with elementary education generally, leaves the working parent to find alternatives during the summer, it does free up parents to pursue their own education during the school year if they are able to support themselves on student loans, a spouse’s earnings, a part-time job, or a combination of the three. Child care assistance can accomplish the same thing, but child care is not the same as preschool in terms of benefits to the child. Thus an expanded all-day preschool program could be funded in part by savings in the Child Care Assistance (CCA) program because it provides an alternative for parents working and/or going to school who are eligible for CCA, while at the same time ensuring that the child is receiving a quality education, with all the attendant lifetime benefits to the child, rather than simply going to day care. If it also enables more parents to further their education, the payoff to the family and to the state is that much greater.
Current Work Supports: An Overview

With half the jobs in Iowa paying less than what many families need to meet a basic needs budget, how do those families get by? Some do without health insurance, and then risk medical indigency or bankruptcy. Some rely on friends or relatives for child care. Some simply do without. But many families get help closing the gap from one or more work support programs:

- Food assistance (the Supplemental Nutrition Assistance Program, or SNAP, formerly known as Food Stamps)
- The Low Income Home Energy Assistance Program (LIHEAP)
- Child Care Assistance (CCA)
- Public health insurance: Medicaid and hawk-i (Iowa’s child health insurance program)
- Subsidies for the purchase of health insurance through the Affordable Care Act (ACA)
- Tax credits: state and federal Earned Income Tax Credits (EITC), the state Child and Dependent Care Credit (CDCC), and the federal Additional Child Tax Credit.

Not included in this list is TANF (Temporary Assistance for Needy Families) because it does not really function as a work support: any significant amount of earnings results in loss of eligibility. We also do not include public housing, because the coverage rate is so low (only about 25 percent of those income eligible actually receive public housing benefits) and waiting lists so long, it does not really function as an effective support.

Figure 4 shows the maximum value of available work supports for a single parent with two children at various hourly wages (assuming full-time work), starting at the current minimum wage and including the Iowa median wage (approximately $15.60). It should be stressed that it would be unusual for a family to actually benefit from all available supports; the scenarios below are the best possible. All these programs have participation rates (the percent of eligible families actually using the program) below 100 percent, and well below that for some, including one of the most important: Child Care Assistance.

Figure 4. How Work Supports Decline as the Hourly Wage Rises

Single parent working full time, two children

* Total family earnings, less: income taxes before refundable credits.
Benefits in some programs taper off as income increases: food assistance and the EITC are notable examples. This is clear in the shrinking value of these programs as the hourly wage increases. For the health care programs, Medicaid is replaced by ACA subsidies once wages approach the median, then they too disappear, while hawk-i benefits continue. Some refundable tax credits are actually highest at the middle wage levels.

**If we consider all work support programs except Child Care Assistance, it can be seen from Figure 4 that the family’s total resources are always higher the higher the wage. It always pays to get a better job, or to work more hours.** (Program eligibility is based on total earnings, not the hourly wage, so working more and earning a higher wage have the same effect on eligibility). The most striking effect, however, is the abrupt loss of the most valuable work support, CCA. For this family, CCA disappears at a wage of $13.65, at which point the family’s net resources — earnings plus program benefits — drop by a little over $9,000. This “cliff effect” will be explored in more detail below.

For a married couple with two children, both parents working full time, a similar cliff leaves the family with resources well below the basic needs level until the hourly wage reaches the $15.60 median (Figure 5). Food assistance and the EITC both disappear at a relatively low hourly wage.

**Figure 5. Work Supports Show Child Care Cliff for Married Couples**

_Both work full time, two children_

![Chart showing work supports and child care cliff]

A more realistic picture of the role of work supports in bridging the gap between earnings and the basic needs budget is shown below, where benefits are scaled back according to participation rates. We use the latest available Iowa-specific estimates of participation rates for the programs:

- SNAP: 88 percent
- EITC: 79 percent
- Medicaid and hawk-i: 88 percent
- CCA: 32 percent
- LIHEAP: 38 percent
Figure 6 shows the statistical average set of benefits for the single parent family with two children, including work supports — again scaled back for the participation rate. While no particular family would receive such a benefit package (each program being all-or-nothing), the graph provides a more realistic picture of the overall situation facing families in Iowa when all work supports together are considered. **Work supports in the aggregate leave the average such family with resources well below what is needed for basic needs until the hourly wage rises to around $25.**

Most work supports end well below the income needed to meet basic needs because they are tied to outdated definitions of poverty, not to a realistic measure of a living wage. Figure 7 shows the relation between a basic-needs income needed to support families vs. the official poverty line.

**Figure 6. Work Supports on Average Leave Iowa Households Below Basic Needs Budget**

*Single Parent with Two Children*

![Bar chart showing the difference between basic needs budget and total family earnings](chart)

**Figure 7. Official Poverty Level Is Well Below Income Needed to Meet Basic Needs**

*Total family earnings, less: income taxes before refundable credits.*

![Bar chart showing income levels for different family types](chart)
The family supporting income for families with children in Iowa ranges from 2.4 to 2.9 times the official poverty guideline for their family size (considering households with all adults working). Yet eligibility for most work support programs is tied to a ratio of income to the poverty level below the family supporting level. As shown in Table 3, this ratio is below 1.7 for several important work supports, and reaches a ratio consistent with basic needs only in the case of hawk-i and ACA subsidies. This means that families stop accessing essential work supports, such as assistance for food, utilities and child care, before they are able to meet their basic needs through employment alone.

Table 3. Most Programs Cut Off Eligibility Before Family Supporting Income Level is Reached

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<tr>
<th>Family Supporting Income: Ratio to FPG</th>
<th>Program Eligibility Ceiling: Ratio to FPG</th>
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<td></td>
<td>EITC</td>
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<tr>
<td>Married Couple, One Child</td>
<td>2.4 to 2.7</td>
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<tr>
<td>Married Couple, Two children</td>
<td>2.5 to 2.9</td>
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<tr>
<td>Single Parent, One Child</td>
<td>2.5 to 2.7</td>
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<tr>
<td>Single Parent, Two Children</td>
<td>2.6 to 2.9</td>
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Note: For all families, these figures are for the case where all adults work full time. The ratio of family supporting income to FPG (Federal Poverty Guidelines) ranges from a low that applies to a family with health insurance from the employer, to a high for a family purchasing health insurance on the private market. Eligibility ceilings for the EITC and for ACA premium subsidies were calculated from the authors’ cost of living policy model based on program rules. The program eligibility ceilings in all cases are not dependent on the work status of the parents, but the ratio of family supporting income to FPG is lower for married couples with only one working -- 1.6 to 2.1 (not shown here).

*The eligibility ceilings for ACA subsidies are deceptive; for example, for a single parent with two children, annual benefits drop from $761 to $315 at 200 percent of poverty and fall to zero at 250 percent of poverty; when the children lose hawk-i benefits, the family is once again eligible for premium subsidies, but the amount is less than $300 annually and disappears at 319 percent of poverty.

Food assistance is a vital support for Iowa working families. Although SNAP benefits disappear at 130 percent of poverty, they play an important role in helping to fill the basic needs gap for the lowest income households. As of August 2014, nearly 400,000 Iowans in 189,000 households received food assistance. The average benefit per recipient was $109 per month, or $230 per household.

Funding and eligibility for SNAP and LIHEAP are entirely federal. In the remainder of this report we focus on four work support programs where the state of Iowa plays a major role in determining eligibility and/or benefits: health insurance, child care assistance, the state earned income tax credit, and the state child and dependent care tax credit.

**Medicaid, Hawk-i, and the Affordable Care Act**

The Iowa version of Medicaid expansion (called the Iowa Marketplace Choice Plan) took effect in January 2014 and as of June had allowed over 105,000 Iowans to have comprehensive health insurance who previously were not eligible for Medicaid or who were enrolled only in the IowaCare program. The expansion raised the eligibility ceiling for adults from 100 percent to 138 percent of poverty, in effect pushing the cliff effect — sudden loss of Medicaid benefits — to an income level 38 percent higher than before. For children, eligibility now extends to 167 percent of poverty.

The Affordable Care Act provides two kinds of assistance for those not eligible for Medicaid. Premium assistance pays a share of the cost of qualifying insurance plans purchased on the
private market (most often through the new health insurance exchange), and is available for families with income up to 400 percent of poverty (though the formula results in a loss of benefits well below that income level, at least given the cost of health insurance in Iowa). Cost sharing pays part of out-of-pocket expenses (co-pays and deductibles) for those with income below 250 percent of poverty. Figures 4 and 5 above illustrate how Affordable Care Act subsidies kick in when adults lose Medicaid eligibility. For a single parent with two children, the parent loses Medicaid at an hourly wage of $13.00. But instead of facing a benefit cliff in the form of a $3,600 sudden loss of health benefits, the parent can now purchase insurance on the private market with subsidies and faces an additional expense of only about $1,100, the ACA subsidies covering the other $2,500 of the loss due to Medicaid ineligibility. Those ACA subsidies then taper off quite gradually. **The ACA in effect reduces a significant program cliff by 70 percent (Figure 8).**

![Figure 8. How Health Insurance Programs Interact in 2014 with Medicaid Expansion and Affordable Care Act subsidies](image)

While children lose Medicaid eligibility at 167 percent of poverty (for example, a single parent with two children earning $15.70 per hour), the hawk-i program immediately takes over with a similar level of benefits, and continues up to 302 percent of poverty. For single-parent families, ACA subsidies provide little or nothing beyond the point where eligibility for hawk-i is lost (see Figure 8). While premium subsidies are available for families earning up to 400 percent of poverty, for a single parent with two children the cost-sharing formula is such that the family’s expected contribution toward premiums (which is 9.5 percent of income once income exceeds 300 percent of poverty) exceeds the cost of health insurance in Iowa, so no subsidy is provided. While this leaves a significant cliff, amounting to about $4,000 for loss of hawk-i benefits for two children, it occurs at a high enough level of income — three times the poverty level — that families are better able to accommodate the loss.

**For married couples with children, the ACA subsidies help to cushion the loss of hawk-i benefits** because the premium subsidies continue beyond the eligibility ceiling for hawk-i (Figure 9). This is the case for couples with either one or two children living at home, and with either one or both parents working full time. For such families, the cost of health insurance in Iowa exceeds the required contribution under the ACA formula. That married couples receive ACA benefits beyond hawk-i eligibility while single parents do not reflects the substantially higher cost of insuring two adults; adults are considerably more expensive to insure than children.
The expansion of Medicaid has provided health insurance for thousands of Iowans and almost certainly has driven down the percentage of Iowans without insurance. Combined with premium subsidies under the Affordable Care Act, Iowa families no longer face the large Medicaid benefit cliffs that once acted as a significant disincentive to earning more.

Child Care Assistance

Iowa’s Child Care Assistance (CCA) program covers the cost of child care for working parents with incomes below 145 percent of poverty, with modest co-pays required for those with income between 100 percent and 145 percent. As the family budgets illustrate, child care costs are a major financial barrier for those who have children below the school age and who are working to support themselves. For low-wage workers, CCA can be the most significant work support available to them.

Why then do only about a third of those income-eligible for CCA actually take advantage of the program, according to one estimate? There are several reasons: Some may be able to rely on family members such as grandparents for child care, some may be unable to find a child care provider in the area who is willing to accept the state reimbursement rate, while others may simply not know that they are eligible for the program or are unwilling to accept public subsidies. While the state reimbursement rates have periodically been raised, they remain well below the actual cost charged by many child care providers, and in fact are now below the average cost of child care across the state. Providers are not allowed to collect the difference between the subsidy and their usual rate from the parents. Instead, they must either accept the child at the lower rate, or refuse to accept subsidized children. Nearly a quarter choose the latter.\footnote{In the 2014 session of the Iowa Legislature, a significant reform to CCA was enacted into law. In a report in late 2013, the Iowa Policy Project had recommended changing the eligibility rules for adults attending post-secondary education.\footnote{These rules made it difficult for parents who needed to work part time to attend school. Now, work hours and school hours are interchangeable, so a parent can choose the combination of work and school that is feasible for their situation.}}

Iowa has one of the lowest eligibility ceilings in the country. As of 2013, only seven states cut off eligibility for CCA at an income level below 145 percent of poverty. In 30 states, the threshold...
was 165 percent or more, including 16 states with a ceiling of 200 percent or higher. It is clear from the family basic needs budgets that Iowa eliminates child care assistance at an income well below what a family needs to get by, which is two to three times the poverty level.

The cliff effect in Iowa’s CCA program is severe. A parent deciding whether to find a job that pays more per hour or allows more hours per week could find herself facing a dilemma: The higher earnings could push her over the benefit cliff just as she is nearing a level of earnings sufficient to get by, so that getting the better job would make her family worse off.

The situation facing a single parent with two children is illustrated in Figure 10. Here we show the best-case scenario: the family participates in every program for which it is eligible. All other work supports gradually taper off, approaching zero as the family nears the level of resources needed to meet basic needs. But Child Care Assistance, while sufficient to bring the family up to the basic needs budget level of resource at low earnings levels, disappears completely when the hourly wage hits $13.65. The result is a sudden drop in family resources of $8,736. The family doesn’t reach the basic needs level again until the hourly wage hits almost $25.00.

Figure 10. How Work Supports Decline as Earnings Increase (Maximum Benefits Possible)
Single Parent with Two Children, Statewide Average

Figure 11. How Work Supports Decline as Earnings Increase (Maximum Benefits Possible)
Married Couple with Two Children, Both Parents Working, Statewide Average
The situation facing a married couple with both parents working and with two children is similar. Child care assistance is eliminated at the point where both parents are earning just $8.25 per hour, leaving the family almost $8,801 worse off, as illustrated in Figure 11 above.

Moderating the cliff effect in the CCA program is an important policy reform to ensure that working families in Iowa do not face a severe disincentive to getting a better job or working more hours. Parents earning just a dollar over minimum wage should not be faced with the prospect of making their family substantially worse off by bettering their work situation.

Figure 12. Eliminating the Cliff: Raising CCA Eligibility to 200 Percent of Poverty and Raising Co-Pay Schedule
Single Parent with Two Children, Statewide Average

$60,000
$50,000
$40,000
$30,000
$20,000
$10,000
$0

Basic Needs Budget: $47,875
CCA
Other Work Supports
Earnings

Resources: Earnings and Benefits

Hourly Wage
7.25 9 10.75 12.5 14.25 16 17.75 19.5 21.25 23 24.75

A detailed discussion of the alternatives for reducing the cliff is contained in an earlier report. Here we illustrate one reform option: raising Iowa’s low eligibility ceiling from 145 percent to 200 percent of federal poverty guidelines (FPG), while instituting a co-pay schedule that takes effect once income rises above the current 145 percent ceiling. The co-pay would rise as income rises, allowing benefits to taper off and substantially reduce the state cost of extending the eligibility ceiling. The effect for a single parent with two children is illustrated in Figure 12. Comparing this with Figure 10 shows that raising eligibility and instituting a higher co-pay replaces the cliff with a gradually declining benefit and greatly reduces the disincentive effect.

**Child and Dependent Care Credit**

At an hourly wage of $13.65, the single parent loses all child care assistance currently in Iowa. However, the federal and state child and dependent care tax credits make up for a small part of that loss. Federal law allows parents to deduct 20 percent of child care costs from their taxes; the credit begins to phase out at income levels above $75,000. The Iowa credit starts at 75 percent of the federal credit, and this percentage declines as income increases, and disappears when income exceeds $45,000. The total amount of the two credits for the case of the single parent with two children is $808 at the point where CCA is lost, and rises to a maximum of $1,161.

The credits do not eliminate the cliff effect. A family that increases earnings from $13.65 per hour to just over that amount will go from having 90 percent of child care costs covered by child care assistance and the credits, to having just 11 percent of the costs covered, as
shown in Figure 13. The federal and state credits increase to a maximum level of 20 percent of child care costs and hence the state credit.

Figure 13. Child and Dependent Care Credits Compensate Slightly for Loss of Child Care Assistance
Single Parent with Two Children, Statewide Average

Legislation signed into law in 2014 changes the way the Iowa CDCC is calculated. Instead of the Iowa credit being a percent of the federal credit after the limitation, starting in 2015 the Iowa credit will be a percent of the federal credit before the limitation. This makes sense; the federal credit is non-refundable, hence the cap equal to tax liability. The Iowa credit is refundable, so it did not make sense to apply the federal cap (designed to make it non-refundable) before calculating the state credit. Under the new legislation, the situation for the single parent depicted in Figure 13 would be changed to the picture in Figure 14. Now the Iowa credit is largest — $840 — at the point where CCA is lost, and then begins to taper off. Under current law,
the credit would be only $387 at that point, and then rises to a maximum of $750.

A bill that passed the Iowa Senate in 2014 (SF2337) would have gone further to raise the credit. In addition to the change in the base, the credit schedule would have been changed to provide an Iowa credit that is a larger percentage of the federal and that is phased out at $67,410 instead of $45,000. Figure 15 shows that this bill would have raised the percentage of child care costs covered by credits to 19 percent at the point where child care assistance is lost and would have extended benefits to those earning up to nearly $36 per hour.

Figure 15. Child and Dependent Care Credits (CDCC): Senate File 2337 as Passed by Senate in 2014
Single Parent with Two Children, Statewide Average

![Graph showing child care costs and credits](image)

**Earned Income Tax Credit**

The federal Earned Income Tax Credit (EITC) and its Iowa counterpart supplement the earnings of low-wage workers through the income tax. The federal credit is a fixed percentage of wages (and the percentage is higher the more children in the family) until earnings reach a certain level, at which point the credit begins to phase out. The gradual phase-out is shown in Figures 4 and 5; there is no cliff effect with the EITC as benefits eventually taper to zero. The state EITC was 14 percent of the federal credit for tax year 2013, and rises to 15 percent in 2014. Both the federal and state credits are refundable; if the family owes no income tax, they will still receive the full value of the EITC as a refund.

Many Iowa families with children pay state income tax even though they owe no federal tax; this includes many families with income below the federal poverty level. The EITC allows low income Iowans to earn more before owing any state tax. It also helps to fill the gap between earnings and the after-tax income required to meet basic needs. **The federal and state earned income credits together lifted out of poverty more than 62 percent of Iowa taxpayers in 2009 whose income fell between $15,000 and $24,999.** In 2010, about 206,000 Iowa households benefited from the EITC; they represented 15 percent of Iowa tax filers.
The EITC has proven to be an effective and efficient way to help low-wage workers make ends meet, particularly parents with dependent children. Recent research has shown that the EITC increases the work effort of recipients significantly by raising the rewards from work and making it more feasible for families with children to pay child care and other expenses necessitated by work. Furthermore, the beneficial effects last beyond the time when families actually receive the credit (which is only a year or two at a time for the majority of families). Women’s wages rose more in later years as a result of the EITC and they were less likely to rely on cash welfare assistance, while the children of EITC recipients are healthier as a result, have better school performance, and earn more as adults. These latter research findings are consistent with earlier research showing the lifetime benefits accruing to children who are lifted out of poverty.

The average Iowa taxpayer pays state income taxes equal to about 29 percent of his or her federal income tax. For the state EITC to be consistent with other features of the state tax code, the state EITC should be raised to 29 percent of the federal. This would also help to alleviate the problem of Iowa families with children who often start owing Iowa income tax well before they owe any federal tax.

1 Numbers in Tables 1 and 2 and in Figure 2 may differ slightly from those in The Cost of Living in Iowa — 2014 Edition, Part 1: Basic Family Budgets, due to recent minor corrections in the calculation of certain tax credits.
8 See Bartik, From Preschool to Prosperity.
9 The Urban Institute’s Safety Net Almanac, at http://www.urban.org/safety-net-almanac/snap/Graphic-Display.cfm?GraphicID=12
10 U.S. Internal Revenue Service, EITC Central, at http://www.irs.gov/EITC-Central/Participation-Rate
11 Participation rates of children in Medicaid and SCHIP are available from the Robert Wood Johnson Foundation, at http://www.rwjf.org/en/research-publications/find-rwjf-research/2013/09/medicaid-chip-participation-rates-among-children--an-update.html. Estimates of Medicaid take-up rates for adults vary widely, and are likely to be affected by the Medicaid expansions under ACA. State estimates range from 32 to 94 percent prior to ACA, with a similar range for additional eligible enrollees under ACA. See Ben Sommers, Rick Kronick, Kenneth Finegold, Rosa Po, Karyn Schwartz, and Sherry Glied, “Understanding Participation Rates in Medicaid: Implications for the Affordable Care Act,” March 2012, U.S. Dept. of Health and Human Services, at http://aspe.hhs.gov/health/reports/2012/medicaidtakeup/lib.shtml. For adult Medicaid, we use the Iowa rate for children, 88 percent, recognizing that this is probably high, as the efforts to enroll children in recent years have been very effective in raising rates.

13 FY2004 State LIHEAP Household Reports.

14 For ACA subsidies and for other refundable credits, we assume 100 percent participation, in the absence of data.

15 Center for Medicare and Medicaid Services (CMS), “Medicaid & CHIP: July 2014 Monthly Applications, Eligibility Determinations and Enrollment Report, September 22, 2014” at http://www.medicaid.gov / The figure includes enrollment in both Medicaid and CHIP (or hawk-i), but the increase can be assumed to be largely Medicaid recipients since eligibility for hawk-i did not change. The CMS did not include IowaCare participants in the 2013 baseline calculations, and those participants could have accounted for about 66,000 of the increase Tony Leys, “Has Obamacare expanded Iowa Medicaid rolls 7%? Or 20%?” Des Moines Register, July 14, 2014). IowaCare was terminated at the end of 2013 and would not have been extended even if Iowa had not adopted the Medicaid expansion. Under Iowa’s Medicaid expansion, adults between 100 and 138 percent of poverty receive premium assistance rather than traditional Medicaid, but the policies have similar coverage.

16 While premium subsidies are available for families earning up to 400 percent of poverty, for a single-parent with two children the cost-sharing formula is such that the family’s expected contribution, which is 9.5 percent of income once income exceeds 300 percent of poverty, exceeds the cost of health insurance in Iowa, so no subsidy is provided.

17 Reimbursement rates were last increased in July 2013 to just under the 75th percentile of the rates for child care that prevailed in 2006. Given the cost increases that have occurred in the eight years since 2006, reimbursement rates are well below the 75th percentile in 2014. Maximum rates allowed range from 86 percent to 97 percent of the state average cost of care, depending on the age of the child and the type of child care provider. The state average figures are based on data from the Iowa Child Care Resource and Referral web site http://www.iowacrr.org.


19 We recommended allowing all school hours to count towards the 28-hour work requirement. Thus the more hours of school, the fewer hours of work required. Peter Fisher and Lily French, “Child’s Play: Creating a Path to the Middle Class; Improving Child Care Assistance Can Facilitate Parent Education,” Iowa Fiscal Partnership, November 26, 2013. www.iowapolicyproject.org/2013/docs/131126-IFP-CCA.pdf


22 The policy simulation details are described in the appendix to the report noted above, with a modified formula for determining co-pays that is based on total hours of child care, and an 80 cent increment in the co-pay with each new income bracket.

23 The federal credit rises at first as the parent’s federal tax liability rises because the credit has a cap equal to tax liability (it is not refundable). Since the state credit is a percent of the federal, it follows that same pattern, but disappears much sooner.


27 Marr, Huang, and Sherman.