The Reward of Work, Incentives, and Upward Mobility

December 1, 2016

Lower participation and slower growth in the labor force will constrain the U.S. economy's capacity to expand, barring a pickup in productivity growth. That could limit gains in living standards, the government's ability to pay its bills and the economy's staying power in the face of unexpected shocks.[1]

Introduction

Since the turn of the century, the United States has witnessed slower growth in population, labor force participation, and hours worked. The economy has also experienced slower growth in the years following the most recent recession. While technological and demographic factors have a considerable role, and could have both positive and negative implications, there are a number of government policy factors that have negatively altered the incentives to work, thereby reducing the capacity of a more prolific economy. The incentive to work is intrinsic—we are naturally driven to create—but extrinsic factors can weigh into the decision of how much and how often to work.

Today, an unfortunate nexus of policies and their structures cumulatively chip away at the rewards that encourage work, or the monetary rewards that one receives for work effort in the place of other activity. Over the last half-century, many programs intended to improve the well-being of citizens, particularly the most vulnerable populations, in many cases effectively hinder upward economic mobility by diminishing work incentives. These policy developments have occurred in both tax and spending provisions, as well as through regulations. It is important to understand the parameters of the problem—the cumulative negative effects of policies on the financial "reward of work,"[2] as termed by economist Casey Mulligan, Professor of Economics at the University of Chicago—given the problem's broad scope and pervasiveness. It is also important to aim for reforms that would reduce labor market distortions that have accumulated not only since the "War on Poverty," but since the most recent recession as well.

The current low-growth environment portends troubled times for the United States and the global economy at large. According to the Congressional Budget Office (CBO), growth of the potential labor force is less than previous estimates,[3] and the Bureau of Labor Statistics (BLS) notes that it has been slowing over more than a decade.[4] As was discussed at great length at the JEC hearing, "What Lower Labor Force Participation Rates Tell Us about Work Opportunities and Incentives,"[5] while many believe that America has entered a "new normal" characterized by lower economic growth and workforce participation, it is perhaps too soon to claim that these trends are permanent features of the American economy.

Whither Work?

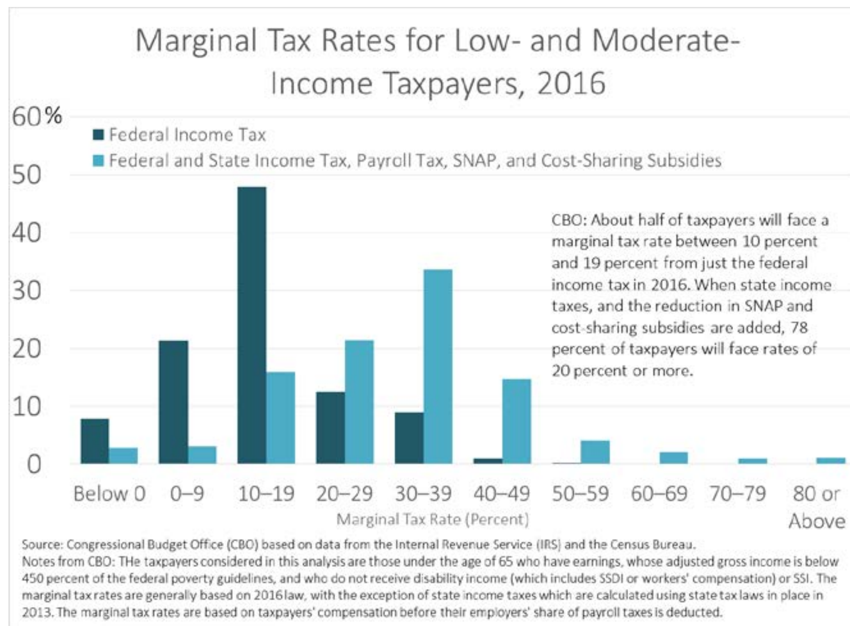
Work matters. Extensive research and ample evidence show that meaningful work is inextricably tied to purpose, is associated with a number of positive effects on worker psyche and well-being, and beyond strong and healthy families, is among the better predictors of upward economic mobility.[6] Unfortunately, for many Americans work is out of reach, and they continue to suffer from an "opportunity gap" that favors the highly skilled and well-educated over those with fewer skills, long-term unemployed workers, and individuals caught in "poverty traps" that

discourage upward mobility. An earlier JEC analysis of economic mobility in the United States suggested that refocusing policy on the "opportunity gap" requires, among other considerations, analyzing how policies affect incentives and identifying policies that fail to provide long-term solutions to increase well-being.[7]

The best place to start, of course, is with the existing mesh of spending programs, tax structure, and regulations that cumulatively serve to diminish the benefits of a hard day's work. As the *Wall Street Journal* notes, "Nearly 1 in 5 Americans in their prime working years aren't employed or looking for a job, and the right mix of tax and benefit policies might draw many of them into the labor force."[8] The benefits of reforms with work in mind serve to help many potential workers out of poverty, and more broadly, up the proverbial economic ladder. After all, work is the most effective solution to poverty and upward mobility: "...employment is central to the well-being of families and the economy. The fact that so few Americans are holding or actively seeking a job is a serious problem, especially for those at the bottom."[9] However, current federal policies tend to effectively distort equality of opportunity rather than support it, making upward mobility and economic well-being more difficult to achieve:

- For those at the bottom of the economic ladder, a number of government policies undermine virtually any incremental work effort. This is commonly known as the "poverty trap," the interaction between taxes and the phase-outs of social welfare benefits as income increases, frequently imposing an excessively high effective marginal tax on earning additional income. Americans struggling with economic immobility are not liabilities, but government programs often inadvertently treat them as such by making it less advantageous for people to find and keep employment. Government programs targeted at the impoverished, especially in their current structure, lack the flexibility in the quick execution and variety of solutions that the private sector provides to families looking to move out of the poverty trap and improve their financial well-being.
- For those living above the poverty line, many policies effectively punish working additional hours or days, or working near certain income thresholds. This could essentially be termed as the "opportunity gap," an unintentional confluence of policy impediments that ultimately discourage additional work that could lead to better opportunities in one's income, benefits, skill acquisition, experiences, and career. Broadly, government regulations, taxes and other policies cumulatively reduce the rewards associated with work and offering work opportunities, negatively altering many Americans' relationship with the workforce. At a time when economic opportunity and mobility are increasingly important, reforms that restore the reward of work are essential.

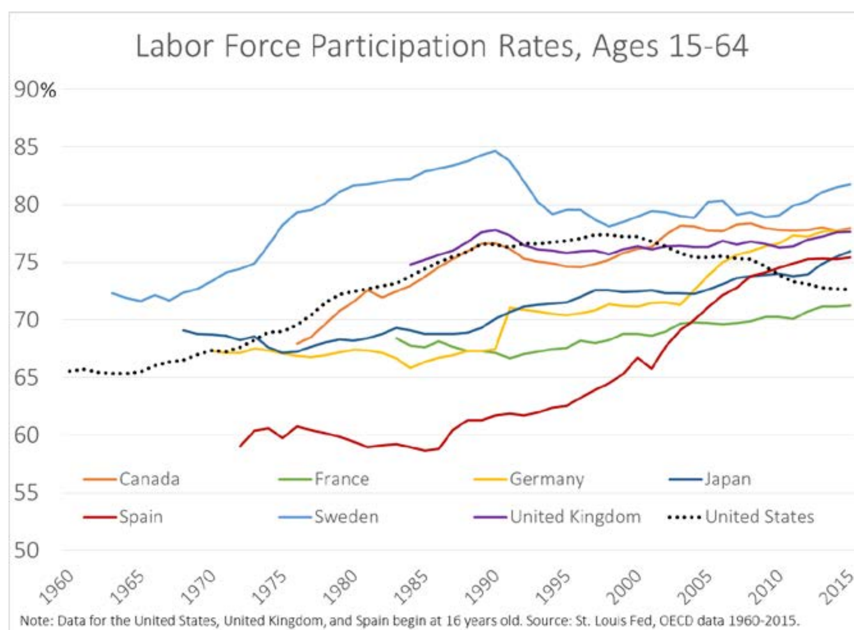
The poverty trap remains a significant hurdle for those wishing to move out of poverty. A phrase popularized by economists Art Laffer and Stephen Moore,[10] the poverty trap refers to the notion that the loss of welfare benefits is economically the same as an exorbitant tax on higher earnings, financially constraining economic mobility and providing powerful incentives to avoid work. Furthermore, the parameters for these programs have gradually expanded to make eligible an increasingly broader swath of Americans. However, the "poverty trap" is merely a narrower version of the "opportunity gap" playing out at the lower end of the income scale, where individual decisions to work and even to wed can have significantly higher costs attached to them as a share of the resources potentially lost than how broader policy impediments affect those above the poverty line. As the figure below from CBO shows, although half of non-elderly low- to moderate-income taxpayers pay a federal marginal income tax rate between 10 and 19 percent, once state income taxes, federal payroll taxes, and the loss or reduction of benefits and subsidies are also considered, nearly four-fifths of these taxpayers face rates of 20 percent or more—in some cases, as high as 80 percent or more.[11]



Source: Congressional Budget Office (CBO) based on data from the Internal Revenue Service (IRS) and the Census Bureau.
Notes from CBO: THe taxpayers considered in this analysis are those under the age of 65 who have earnings, whose adjusted gross income is below 450 percent of the federal poverty guidelines, and who do not receive disability income (which includes SSDI or workers' compensation) or SSI. The marginal tax rates are generally based on 2016 law, with the exception of state income taxes which are calculated using state tax laws in place in 2013. The marginal tax rates are based on taxpayers' compensation before their employers' share of payroll taxes is deducted.

The consequences of remaining trapped have large costs as well. The longer an individual is out of work, the more difficult it is to obtain subsequent employment. More than seven years into the current recovery, the share of jobless Americans that are unemployed long term (27 weeks or longer) is still elevated at more than a fourth of all the unemployed, compared to the long-term average of about one in seven unemployed. Broader measures of unemployment, including the U-6 unemployment rate, which includes discouraged workers (normally considered out of the labor force because they have given up looking for work) and involuntary part-time workers that would like full-time work, are also elevated since the recession. This jeopardizes the well-being of millions of Americans who would prefer a hand up in the form of a job, and a hands-off approach from government policy rather than a handout.

How much the recent recession and financial crisis fundamentally changed to the labor market remains to be seen, and is a frequent subject of debate. Other countries have not seen the same rapid decline in labor force participation in the aftermath of the 2007-09 recession and global financial crisis that the United States has endured.[12]



Note: Data for the United States, United Kingdom, and Spain begin at 16 years old. Source: St. Louis Fed, OECD data 1960-2015.

American men in their prime working years with relatively less formal education in particular suffered the greatest declines among demographic groups. Despite the considerable downward revisions to the trajectories of the economy and labor force growth going forward, we can't be entirely certain how much demographic forces will come into play going forward. The confluence of government policies has regrettably created a path toward a vicious cycle of involuntary dependence on growing federal spending obligations. Given this, in light of the dire fiscal circumstances the United States faces in the not-too-distant future, policymakers should turn to every structural policy reform at their disposal to unshackle the greater potential in the U.S. economy. As aforementioned, work is the most effective solution to poverty and upward mobility. Therefore, to the extent that it is feasible, work should be promoted where possible in fiscal policy and regulation design.

Fiscal Policy

Decades of tax and spending policies that comprise fiscal policy have slowly eroded the reward of work. As economist Laurence Kotlikoff and co-author Alan Auerbach note in a recent study of the mismeasurement of inequality, U.S. fiscal policy has a very significant impact on work incentives:

> *Our system's plethora of taxes and benefits—designed with a multitude of income and asset tests and with little regard to how they work as a whole—have left many households facing high to super high net marginal tax rates.*[13]

Taxes like the Affordable Care Act's (ACA) individual mandate are designed to reduce particular behaviors, such as forgoing health insurance, while tax deductions like the deduction for higher education tuition and fees, and tax credits like the earned income tax credit (EITC) are meant to encourage other behaviors, such as skill acquisition and work. Similarly, targeted spending programs like the Supplemental Nutrition Assistance Program (SNAP) are meant to prevent hardships among the most vulnerable Americans. Further complicating the matter, some spending occurs through the tax code, like the refundable portion of the EITC. Most of these taxes and spending programs are means tested, formulated to end or phase out as income and asset accumulation rises, thereby designed to prevent cost overruns and misuse.

These programs have succeeded in sustaining millions of individuals and their families through the most difficult of times. However, by virtue of the flawed design in many of these programs, even one additional dollar earned beyond a test threshold could be sufficient to disqualify an individual from receiving thousands of dollars' worth of benefits. These steep thresholds are more commonly known as "benefits cliffs." Benefit cliffs prevent families from improving their economic well-being because the resulting loss of benefits can often constitute a greater hardship than remaining at the status quo.

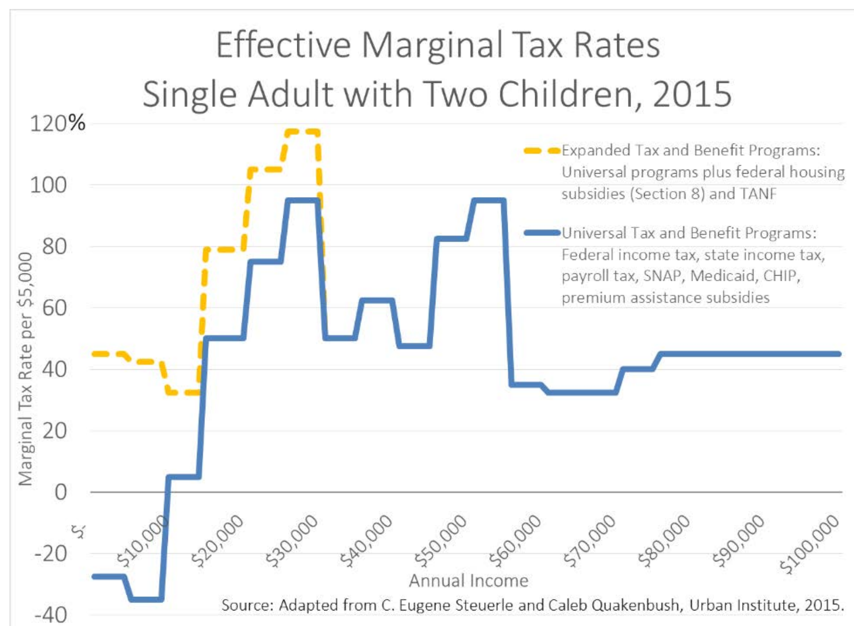
This phenomenon is not unique to the tax and benefit structure of the United States. Indeed, the Organization for Economic and Co-ordinated Development (OECD) notes that many OECD countries possess a tax and benefit system structure that reduces incentives to work, particularly for single parents and one-earner families with children on welfare:

> *...these groups tend to face reduced incentives upon their return to work after a period of unemployment or inactivity. In addition, for those low-income individuals who have a job, working longer hours or earning higher wages often entails little additional net income. Disincentives are also particularly strong for unemployed individuals with low potential earnings, especially if they face the prospect of returning to work at a salary lower than the one earned in their previous job*.[14]

As economist Casey Mulligan testified at a JEC hearing on the employment effects of the Affordable Care Act and explained in previous writing, when it comes to the sacrifice of work, many of the programs intended to help people get back on their feet have inadvertently been designed to make work more costly as Americans strive to

improve the livelihoods of themselves and their families. He noted: "Another way of putting it is that taking away benefits has the same effect as a direct tax, so lower-income workers are discouraged from climbing the income ladder by working harder, logging extra hours, taking a promotion or investing in their future earnings through job training or education."[15] As highlighted in recent JEC analysis, it is a mistake to assume that individuals don't consider the combined effects of taxes and the loss of benefits. Mulligan points to anecdotal evidence of potential workers estimating the change in their net benefits based on taking a job, and choosing not to work. In Mulligan's analysis of these benefits and their effect on reducing work, he estimates that they were responsible for roughly half the drop in work hours since 2007, and possibly more.[16]

Urban Institute scholar Eugene Steuerle found that a household with two children can face a combined effective marginal tax rate of 70 percent to 101 percent.[17] Steuerle's analysis includes the interactions of federal, state, local, and employee payroll combined, in addition to the effects of lost benefits. Rates rise sharply particularly around the $15,000 to $30,000 annual income range, as shown in the figure below.



In an earlier *National Tax Journal* issue, Steuerle and his colleagues looked at the variations in the effective marginal tax rates across states and found some interesting differences, dependent upon family composition and location. For example, if a single parent of two children increased his or her income from $26,025 to $34,700, he or she would keep less than 20 cents per additional dollar earned in more than half of states, and a mere 5 cents in 20 of those states. In seven states, he or she would effectively lose money by working more.[18]

In light of the substantial evidence demonstrating the positive impact marriage has on children, particularly children from low-income families, it is important that public policy not discourage the practice. Yet, many public policies can create a financial disincentive for low-income, single parents to marry. Research has found that the structure of federal welfare programs includes a marriage penalty where "many low-income couples with children face substantial penalties for marrying that can amount to almost one-third of their total household income."[19] Steuerle noted in separate analysis on the subject, "In aggregate, couples today face hundreds of billions of dollars in increased taxes or reduced benefits if they marry. Cohabitating or not getting married has become the tax shelter of the poor."[20] This can occur on the tax side and the spending side of fiscal policy—affecting EITC eligibility and often in federal income tax in moving from single to filing jointly in the former, while affecting benefits received on the spending side.

Spending Policies

Much ink has been spilled on the current welfare system's dismal state of affairs. It often relies on the wrong measures and outcomes, and it remains cost ineffective by operating in separate "silos" rather than linked to better address recipient needs. More than $1 trillion annually is poured into the welfare system, but the prevalence of poverty remains fairly constant. There are more than 80 federal means-tested welfare programs, including low-income housing programs, employment and training programs, social service programs, food and nutrition programs, low-income health programs, and low-income child care programs among them.[21] Despite significant and successful reform to the Aid to Families with Dependent Children Program (AFDC, replaced by Temporary Assistance for Needy Families, or TANF) twenty years ago, which pulled many individuals back into the workforce and lifted millions of children out of poverty, many of the work requirements implemented have been weakened in the years since.[22] The 1996 reform to AFDC illustrates what can work to improve outcomes for impoverished groups, provided that workforce attachment for able-bodied Americans remains a mandate connected to the benefits.

Many changes during and in the aftermath of the recent recession increased redistribution, relaxed work requirements, and reduced work incentives with benefit increases, effectively increasing the implicit tax on work.[23] SNAP is now the largest of the 18 separate food assistance programs[24] and accounted for over $74 billion of the more than $100 billion spent on these programs in 2014.[25] As noted in the *2016 Joint Economic Report*, since 2009, the national unemployment rate has been cut in half to 4.9 percent,[26] while the number of SNAP enrollees has actually increased by more than 12 million people.[27] SNAP is largely countercyclical; therefore, it's expected that enrollment will increase as the unemployment rate rises. The fact that the opposite occurred shows that the SNAP program is not achieving its goal of bringing people out of poverty.

Spending policies alone, even before any potential tax interactions, can often reduce the reward of work. In fact, existing spending programs that serve to alleviate the effects of poverty can, in some cases, exceed income earned from an entry-level job. Cato Institute's Michael D. Tanner and Charles Hughes found that the value of welfare benefits can greatly exceed the poverty level, but because welfare benefits are tax-free, their dollar value can be greater than the amount of take-home pay a worker might receive from an entry-level job.[28] In the most recent edition of their white paper, Tanner and Hughes find: "Welfare benefits continue to outpace the income that most recipients can expect to earn from an entry-level job, and the balance between welfare and work may actually have grown worse in recent years."[29]

In other cases, spending programs incentivize workers to remain in low-income jobs. As highlighted in the *2016 Joint Economic Report*,[30] the Illinois Policy Institute demonstrated this fact using the example of a single mother of two in Cook County, Illinois, earning $12.00 per hour, or approximately $22,100 annually. The value of the welfare benefits the mother receives is $41,476 annually, bringing her total take-home (benefits plus salary) to about $64,000. Should this mother be offered a job that pays twice as much per hour, she would lose over $39,000 in benefits. In part because welfare benefits are not taxed as income,[31] this mother would have to earn $38.00 per hour, which is the equivalent of $80,000 annually, in order to make up for the loss of benefits she received making only $12.00 per hour.[32] Rather than providing an opportunity to gradually increase her earnings and advance her career over time, the welfare benefit structure incentivizes her to remain in a low-paying job.

Tax Policies

Income taxes, by their nature, reduce the reward of work. In extreme cases, or in combination with the incentives of other taxes and spending programs, they can discourage individuals from working at all. In other cases, they can induce workers to work fewer hours, or substitute other activities in place of work. Given that the United States

has a relatively progressive income tax system, the higher an income earned, the greater the reduction in the reward of additional work.

The current U.S. individual income tax system is broken, complex, and harms earners and small businesses. Though the top statutory individual income tax rate is 39.6 percent, as noted in last year's *Joint Economic Report*, in combination with taxes in the ACA, the top rate paid by small businesses that file under the individual income tax is now 44.6 percent.[33] While Americans rely on small businesses to provide of new jobs, high marginal tax rates reduce resources that could be used to create jobs Furthermore, the U.S. corporate tax rate is the highest in the developed world, making it difficult for American businesses to compete on a global scale, create American jobs, or increase worker pay.

The OECD notes that corporate income taxes are the most harmful type of tax for economic growth, with personal income taxes following second, then consumption taxes, and finding property taxes the least harmful. The OECD identifies "growth-oriented tax systems" as those which minimize the obstacles to investment, innovation, entrepreneurship, and other factors of economic growth.[34] Rather than targeting tax relief, the OECD suggests a broader tax base with lower rates, particularly for the most harmful types of taxes, proves the most conducive to economic growth.

The ACA imposes new taxes on individual income that reduce the incentives to work, save, and invest, thereby reducing employment. Wages and self-employment income over $200,000 (single) or $250,000 (married) are now subject to an additional 0.9 percent Medicare payroll tax. Investment income, such as rent, interest, dividends, and capital gains, for this same group of earners is subject to an additional 3.8 percent tax. According to a Tax Foundation study, these taxes will reduce the number of full-time equivalent jobs by 0.3 percent.[35]

On the employer side, compliance with the ACA means that many businesses will have less resources available to provide productive employment opportunities. Small and medium-sized employers with 50 or more full-time equivalent employees are mandated to offer health insurance coverage or face a tax, prorated monthly, per each full-time employee over the first 30 employees. The tax is indexed each calendar year to the growth in insurance premiums, and in 2016 the annual tax rose to $2,160. As noted in the *2016 Joint Economic Report*, this year, larger employers offering health insurance could face a $3,240 tax for each full-time employee receiving a subsidy to purchase health insurance coverage through the federal health insurance marketplace. The employer mandate creates an incentive for employers to hire fewer full-time employees and shift some existing full-time employees to part-time employment. Employers may also choose instead to reduce wages as an offset to the cost of the tax. However, in light of the relatively recent imposition of this tax, it remains to be seen exactly how employers will alter their structure and compensation to manage its full costs.[36]

As discussed later, the ACA has more pervasive effects on the reward of work than just the explicit taxes levied. In fact, the very structure it imposes on employers and their employees pose an additional set of perverse incentives that effectively tax work efforts.

Regulatory Policies

Federal regulations continue to increase in volume and in scope. Many policies more recently pursued by the Obama Administration are estimated to negatively affect employment. Examples include the President's proposed minimum wage increase, the ACA's 30-hour full-time work threshold,[37] and the pending increase in the Department of Labor's income threshold for overtime pay eligibility.[38]

Labor Requirements

Over time, the number of requirements associated with employing additional workers grows increasingly burdensome for private businesses[1] that seek to offer a basic employee benefits package. Payroll requirements and contributions, unemployment compensation, retirement benefits, safety and health standards, the *Fair Labor Standards Act* (FLSA), which includes regulations on overtime pay and the minimum wage, collectively require compliance beginning with just one employee. While ensuring the safety and well-being of workers with minimum standards is a laudable goal, employees may have different preferences than what the law requires employers to provide, or in some cases, an employer may be unintentionally subject to a particular regulation that ultimately proves ineffectual to its intended goal.[39] Such rigidities serve to reduce both working and opportunities for work.

CBO projected that a proposed Federal minimum wage to $10.10 per hour could amount to an employment reduction of as many as one million workers.[40] Yet increasing the minimum wage has another unintentionally insidious effect: as the minimum wage increases, many workers may actually prefer to work fewer hours in order to prevent the loss of federal benefits by going over a “benefits cliff” as their incomes rise. Sometimes even a minor increase in income can be enough to make one marginal financial step forward feel like two significant and costly steps back. As an example, the Indiana Institute for Working Families points out that for a working parent in Indianapolis with a preschooler and a school-age child, simply moving from $15 per hour to $15.50 per hour would result in a benefit loss of nearly $9,000 in annual childcare subsidies.[41]

These regulations and others effectively reduce economic productivity and thwart job growth for the most vulnerable workers. Over time, the minimum wage gives employers added incentive to automate, which reduces job opportunities for those with limited skills. Yet one cannot easily distinguish the advances in technology that are motivated by artificially increased wage cost from those that occur independently. Consequently, the detrimental effect of the minimum wage on employment likely is greater than what can be definitively attributed to it.[42]

As a business expands, so do the requirements, with many regulations adding taxes associated with labor. A recent study found that based on tax alone, employers should expect to pay an additional 10 percent or more of an employee’s earnings to cover payroll taxes, unemployment taxes, and workers’ compensation insurance. In addition, because of the way these taxes phase out, employers pay a relatively higher percentage for lower-earning employees than for higher-earning employees.[43]

Even a small firm offering a basic employee benefits package that has a mere 25 employees must also devote resources toward paperwork and compliance associated with regulations that pertain to immigration, veterans, medical benefits upon termination, benefits for and antidiscrimination against older workers, disabilities, record keeping, and others depending on specific state and industry requirements.[44] For example, a 2014 National Association of Manufacturers study found that the average regulatory compliance cost in the United States amounts to $9,991 per employee per year. For manufacturers, the compliance costs were higher, amounting to $19,654 per worker. However, manufacturing firms with fewer than 50 employees bore the larger burden at $34, 671 per worker.[45] The cumulative burden of growing regulations over the past several decades has served to slow business growth, make hiring costlier, and dry up many work opportunities.[46]

[1] Specifically, private businesses that are non-union, non-government contractor firms which have their own particular requirements.

Occupational Licensing

Occupational licensing laws at the state level, if misused to benefit incumbent businesses rather than protect consumers, serve as an additional encumbrance for many would-be entrepreneurs and workers. Such laws typically require fees, training, exams and other qualifications for certain professions, but there is a severe inconsistency in licensing for many professions from one state to the next. As noted in previous JEC staff commentary, some occupations require a license in all states (e.g., emergency medical technicians), whiles others are only required in particular states (e.g., florists, interior designers). The commentary noted: “Licensing has the effect of restricting market entry, stifling innovation, constraining labor mobility, increasing the costs of services, and limiting choices, hurting both workers and consumers.”[47] Indeed, the time and cost required to obtain a license may be out of reach for many potential workers.[48] Among the improvements that states could consider include a review of the effectiveness of existing licensing laws, voluntary certification alternatives where appropriate, as well as cross-state licensing reciprocity.

Health Care Policies

Generally, health insurance, when offered as an employee benefit, tends to increase attachment to the labor force. However, as aforementioned, the ACA’s existing structure dramatically changes the incentive to work more hours or more days for many individuals that are affected by the law. CBO’s most recent projections indicate that the ACA will reduce the labor supply by 0.86 percent by 2025, translating to 2 million fewer full-time equivalent workers in the labor force than if the ACA had never become law.[49] This projected labor supply reduction is due to various disincentives to work created by provisions of the ACA designed to subsidize health insurance coverage, mandate the purchase or provision of health insurance coverage, and raise revenue through different taxes and penalties.

As noted in the *2016 Joint Economic Report*,[50] half of the total labor supply reduction projected by CBO (0.43 percent) is attributable to the health insurance premium and cost-sharing subsidies available through the ACA marketplace.[51] Premium subsidies are available to individuals with incomes between 100 and 400 percent of the Federal Poverty Level (FPL) who lack access to employer-sponsored or other qualified health insurance. Because premium subsidies in the marketplace decrease as income rises, the result is an increased effective marginal tax on work.[52] This disincentive to work is compounded for individuals with incomes between 100 and 250 percent of FPL who obtain health coverage through the marketplace because the effective marginal tax on work is more pronounced due to the sharp phase-out “cliffs” built into the ACA’s cost-sharing subsidy formula.

Subsidized health coverage is also available to individuals with incomes below an effective 138 percent of FPL in states that have either expanded traditional Medicaid as originally envisioned by the ACA or have expanded coverage through an alternative model incorporating waivers from Medicaid’s rules. Because state Medicaid programs generally provide more heavily subsidized coverage compared to subsidies gained through the ACA marketplace, individuals whose incomes rise above the Medicaid eligibility threshold are therefore subject to a subsidy cliff and increased effective marginal tax on work. Individuals with incomes just above the eligibility threshold also have an incentive to work less in order to land on the more advantageous side of the Medicaid eligibility threshold, thereby gaining access to lower-cost health insurance.[53]

Economist Casey Mulligan estimates that the ACA’s explicit and implicit taxes will affect nearly half of the working population, reducing average wages by $1,000 per year, or about four percent for low-income families and nearly two percent for higher-income families.[54] Mulligan also estimates that, by 2017, the ACA’s labor effects will translate to roughly three percent less in weekly employment, three percent fewer total hours worked, two percent less in labor income, and two percent less GDP compared to the economy in absence of the ACA.[55] CBO notes that, when factoring in labor supply elasticities, it will take some time for workers to fully adjust to the harmful

incentive structures created by the ACA, meaning that the overall impact of the ACA on the supply of labor will become progressively worse as time goes by.[56] This also means that there is still time for Congress to thwart the bulk of the labor market damage projected to occur as a result of the ACA's existence.

Disability Policies

In many ways, government policies meant to prevent individuals with disabilities from falling into poverty inadvertently affect their ability to work. Two of the better-known assistance programs available to individuals with disabilities are Social Security Disability Insurance (SSDI) and Supplemental Security Income (SSI), designed as means-tested programs to prevent fraud and abuse. Given their purpose, these programs are understandably relatively generous compared to other public assistance programs, but their strict income requirements severely restrict work opportunities. If beneficiaries of SSDI earn more than $750 per month, they lose eligibility, which is sometimes difficult obtain and often delayed in payment—sometimes taking a year to process.

In fact, as economist David Autor points out, the SSDI program effectively prohibits workers with disabilities from having a job while applying for disability benefits rather than keeping them attached to the workforce.[57] Further, many cannot earn more than $85 per month, thanks to the arbitrarily low income threshold for SSI benefits. A person with a disability cannot exceed the "nine-month rule" for SSDI and SSI, which is the maximum number of allowable months that a beneficiary may receive more than $85 in monthly income for SSI and more than $750 in monthly income for SSDI in a five-year period. Doing so would mean getting dropped from the programs and losing their disability status and benefits entirely.[58]

Workforce attachment for people with disabilities proves difficult even when they may not be a recipient of disability benefits. Section 14(c) of the FLSA, a contested policy designed to keep individuals with disabilities employed and attached to the workforce, allows authorized employers to pay persons with disabilities "special minimum wages" that amount to less than the federal minimum wage. Only four types of employers are eligible: work centers, hospital or residential care facilities, businesses that receive a certificate from the Wage and Hour Division of the Department of Labor, and School Work Exportation Programs. An employee for one of those employers may only be paid the special minimum wage if his or her disabilities impair productive capacity in the job performed.[59]

Disagreement between groups of individuals with disabilities over the policy rests upon whether it is equitable to pay a person with disabilities less than the regular minimum wage. In many cases, individuals with disabilities who are paid special minimum wages would find themselves without employment if the policy was repealed, as many authorized employers have indicated that they could no longer afford to hire persons with disabilities at the Federal minimum wage nor offer additional training and support services to help those employees. In the best cases, some individuals with disabilities may be better off finding gainful employment for skills that may have been undervalued while working for an employer authorized under Section 14(c). In the worst cases, many of these individuals would have no other alternative than to receive home or hospice care in the absence of a special minimum wage job.[60]

Even the programs intended to keep in or return persons with disabilities to the workforce often face perverse incentives. Programs like Vocational Rehabilitation Agencies and Employment Networks exist to place individuals with disabilities into a stable job that pays more than the "Substantial Gainful Activity" level of $13,000 annually, the income cap for receiving SSDI benefits. However, such programs lack the incentives to place these individuals in jobs that pay much more than that threshold. In many cases, the benefits potentially lost by a person with disabilities can exceed a value of $17,000 to $20,000 annually, overwhelming the value of a job that pays at or near

the $13,000 threshold. The security, stability and value of disability benefits prove better in many cases than seeking and obtaining work, despite the strong preference to be working and making one's own way.

The Social Security Administration (SSA) has gone to great lengths to offer programs that encourage work among individuals with disabilities, including extended health care benefits for up to eight years, a moratorium of the automatic medical review if an individual decides to work, and a trial work period with "expedited reinstatement" after losing a job within three years of coming off disability. However, less than five percent of beneficiaries of SSDI or SSI are reported to have participated in SSA's work programs.[61] Following the broader trends, labor force participation for both men and women ages 16 to 64 with a disability has steadily declined since the data series began in July 2008. Since then, women with a disability have seen participation fall from over one-third to just over one-quarter, while men with a disability have seen participation fall from over two-fifths to just over one-third.[62] The underlying reasons for this declining trend, despite these efforts, are not fully understood.

Manhattan Institute scholar Scott Winship found that the roughly 70 percent of surveyed men between the ages of 25 and 54 who indicate that they do not want a job accounts for virtually all of the decline in men's prime working-age labor force participation between 1979 and 2006. However, the rise in disability claims runs counter to broader physical and mental health indicators among this group. In short, policy changes have made it much easier to qualify for federal disability benefits. In total, Winship estimates that more than a third of the decline in labor force participation of men is due to the rise in disability claims.[63] Winship further testified that:

> *…receipt of federal disability benefits has increased significantly since the 1980s. Roughly half of the increase since 1989 may be attributed to policy changes that have made it easier to receive disability benefits (and made them more attractive). Federal disability benefits increasingly serve as a shadow long-term unemployment program for a group of able-bodied men with low skill levels.*[64]

In fact, the reasons why men have responded more to the disability policy changes than women could have to do with the incentives specific to the demand for work within their skills sets. In response to the decline in middle-skill jobs over the past three decades, the Kansas City Fed notes that women have obtained more education and moved disproportionately toward high-skill jobs, while men shifted into high- and low-skill jobs in roughly equal numbers. This could partially explain why prime-age men have seen a larger decline in participation as well as a significant increase in disability claims as eligibility standards have been relaxed.[65]

Solutions

> *Happiness stems from work, and in the United States the pursuit of happiness is an inalienable right.*[66]

The specter of generational poverty remains a significant concern for those who currently struggle to find work, even as many continue to experience the effects of living in or near poverty throughout their lives and the lives of their children. Indeed, children raised in poverty are 32 times as likely to be impoverished as adults.[67] However, current longstanding federal policies and programs focus more towards alleviating short-term symptoms rather than offering sustainable pathways toward earned success. Unfortunately, federal anti-poverty programs have so far failed to achieve their original goals, mostly because they too often contain perverse incentives that effectively penalize low-income individuals for finding or maintaining employment.[68]

As noted in the *2016 Joint Economic Report*, it will take a multifaceted approach to create a smarter system that promotes achievement and helps Americans fulfill their desires of employment. Solutions should span the breadth of tax, spending, and regulatory policies—there is no shortage of potential improvements. States play a crucial role in creating a smarter system. They are in a better position than the federal government to assess their residents' needs, and should therefore be afforded greater flexibility in administering welfare and job training programs.

The most straightforward policy solutions involve putting a greater emphasis on letting people earn. For example, helping individuals with disabilities remain attached the workforce in some capacity means addressing the benefit cliffs that erase the reward of work, as well as connecting individuals to work settings that can accommodate a particular disability. Reducing fraudulent payments in the EITC and adjusting its pay structure to scale better with hours worked among parents and legal guardians can help improve workforce attachment for recipients.[69] In other examples, entrepreneurial endeavors should not be subject to byzantine licensing rules that serve incumbent businesses rather than to protect consumers. In yet other cases, onerous regulations at the federal level, including provisions in Dodd-Frank, ACA, and those handed down by OSHA and the EPA dry up work opportunities and financial choices as businesses divert precious resources towards compliance instead of expansion.

Metrics Matter for Agency and Beneficiary Incentives

The measure of success for most aid programs has traditionally relied on the amount of government money spent and the number of people receiving those funds. Metrics for public aid programs rarely, if ever, go beyond those basic statistics to determine how long individuals are on the programs, whether they return to the program, or generally any other indication that individuals are successfully transitioning off the program. Some programs proactively recruit individuals that meet the program's eligibility requirements. In fact, declining program participation rates may be misinterpreted as a negative outcome rather than a good one, particularly when states and programs risk losing funding when individuals move off programs. In other cases, states have an incentive to enroll individuals in programs that are federally funded even though they may be largely state-administered.

House Speaker Ryan's Poverty, Opportunity, and Upward Mobility Task Force issued the *Better Opportunity for Growth* with a focus on opportunity as the best means of improving American lives, and part of that means properly measuring the desired outcomes. In addition to creating an expectation among work-capable adults to look for and obtain work while on benefits, the plan also notes that the incentives matter not only for beneficiaries, but for the program executors as well. Getting incentives right, measuring the results, and focusing support on those in greatest need are among the principles guiding the plan.[70]

As such, there is clearly room for improvement in the current structure of spending programs. As noted in Speaker Ryan's plan, incentives must be realigned. For example, states may be required to help their adult residents move into the workforce, but a number of factors have enabled many states to evade emphasizing work as a benefit requirement. The plan suggests that additional flexibilities granted to states, like waivers in lieu of the existing unemployment insurance system and portable housing vouchers beyond local jurisdictions and across state lines, would help return the unemployed to the workforce.

In addition, the Census Bureau reports that current welfare spending is four times what would be necessary to give the poor cash to meet the poverty line,[71] suggesting that overhead costs are high compared to the value of benefits received, and leaving much room for improvement in delivering benefits targeted to the most vulnerable Americans. Furthermore, reducing bureaucratic-focused overhead costs associated with running government benefit programs could free up spending for more effective ventures, such as helping chronically unemployed workers move to stronger job markets.

A 21st Century Approach: Portability of Benefits

Given the tide of changes in the labor market over the past several decades, many federal policies resemble an archaic remnant of a time past. In fact, the rise of worker benefits as an attachment to traditional full-time work is somewhat of a fluke that stuck since tax policy treated health benefits as nontaxable for employees and a write-off business expense for employers.[72] While this worked in an economy where workers generally expected to stay with one company for the majority of their careers, it is less useful and likely counterproductive in today's more dynamic economy.

Many public policy leaders now advocate portability of benefits that enable workers to access their own safety net if they get sick, injured, lose a job, or retire. As stated in the *Wall Street Journal*, "Many workers who perform tasks and jobs via apps don't fit neatly into a regulatory landscape that recognizes only two types of worker: employees in traditional work relationships and independent contractors."[73] Given the increasing prevalence of the sharing economy, a territory increasingly fraught with labor protection battles pertaining to the categorization of its workers, portable benefits offer a potential solution that puts both the added stability and responsibility of benefits in the hands of the worker rather than the employer.

Indeed, a recent Hamilton Project paper suggests allowing independent workers to qualify for many—but not all—of the benefits and legal protections that traditional employees receive, including the freedom to organize and bargain collectively, as well as access to civil rights protections, tax withholding, and employer contributions to payroll taxes. Overtime and minimum wage requirements would not apply. Intermediary businesses could also be permitted to pool independent workers for unemployment insurance, health insurance and other benefits, like retirement options.[74] Current law allows only certain businesses under particular circumstances to collectively provide retirement plans for their employees, preventing many small businesses from pooling together resources that offer better retirement options for their workers.[75] In the age of the sharing economy, giving businesses and the independent workers greater flexibility would improve mobility opportunities for the increasing number of Americans that earn money online and through other platforms, including mobile applications.

The Flexibility of Private-Sector Solutions

Ultimately, the capabilities of the government, at the federal level and to certain extents at the state and local levels, are relatively rigid, immobile, and uniform in the handling of every case. While that consistency proves useful in many government functions, it fails to provide the best and most effective means to move individuals out of poverty and into opportunity to improve economic well-being for their families. The incredibly flexible and innovative role that private-sector firms and nonprofits possess is often forgotten in the discussion of making work pay.

As noted in Speaker Ryan's plan: "Often local non-profits and other business partners have a better perspective and greater flexibility to address the needs of the communities they serve, as well as the ability to connect individuals entering and advancing in the workforce with needed services."[76] A number of privately funded programs are scattered across the United States, serving uniquely separate needs and populations, working together over both formal and informal networks to achieve long-term, sustainable solutions for the individuals they serve. Examples abound, including Salvation Army's Pathway of Hope, enabling families on the brink of poverty and crisis to move beyond that state onto stable paths to success, thereby breaking the cycle of intergenerational poverty.[77] In addition to helping families with one-on-one counseling, life-skills training, and providing resources like emergency financial assistance, Pathway of Hope matches families with existing private and public programs that specialize in addressing particular needs. Another successful non-profit known as the Doe Fund gives homeless men, often struggling with addiction or other strife, the opportunity to live and earn with the provision of living quarters and job assignments improving city streets and greenspaces, building skills for success beyond their program while working in their Community Improvement Project and through other social enterprises.[78]

Many of these non-profit programs have a common purpose and are uniquely advantaged compared to government programs: they are programs built on trust, not only of the individuals they serve, but in building intrinsic trust, self-worth and self-reliance within the individuals themselves. They also teach "soft skills" associated with emotional acuity, including effective communication, self-management, networking, adaptability and critical thinking—the likes of which many have never had the opportunity to develop or demonstrate.

Furthermore, in the increasing demand for "hard skills" associated with specified task capability, like statistics, programming, and accounting, "soft skills" are indeed oft-forgotten necessities of the working world today.

The private sector offers a number of opportunities to expand apprenticeships. Many individuals that have fallen into poverty or suffered through long-term unemployment lack the skills in greatest demand by employers. Apprenticeship programs provide a work-based learning approach that combines study with on-the-job training.[79] As employers typically know best the kinds of skills workers should possess, apprenticeship opportunities provide a more effective approach than most job training programs administered by government.

However, few employers have the capacity to offer apprenticeship programs on their own. Many states have youth apprenticeship programs in operation, while others have broadened focus beyond young adults. According to Urban Institute scholar Robert Lerman, a study of ten states revealed that apprenticeship programs boosted participant earnings by $6,000 to $6,500 annually compared to similar non-participants. Though still relatively rare, apprenticeship programs are nonetheless making a comeback, and bringing new skill sets to the table. In Wisconsin, employers train 10,000 registered apprentices in roughly 200 occupations through the Registered Apprenticeship Program. The Wisconsin Department of Workforce Development received a $5 million grant from the federal government to register apprenticeships in twelve occupations deemed "high-growth," including advanced manufacturing, healthcare and information technology.[80]

A less disaggregated, more streamlined welfare system that promotes work would help more Americans in poverty transition to self-sufficiency through their own efforts. Smarter policies can support workers' pursuit of better employment opportunities and skill refinement, thereby helping to close the opportunity gap and improving upward mobility. As always, there are no silver bullets. Congress should continue to look to pro-growth policy reforms to increase the incentives for potential workers to find jobs and for businesses to hire and train them.[81]

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