NATIONAL CENTER FOR POLICY ANALYSIS

# Liberating the Poor from Poverty

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*Poverty has exploded to record levels under President Obama. House Budget Committee Chairman Paul Ryan (R-Wisc.) and Senator Marco Rubio (R-Fla.) have offered plans that would sharply reduce poverty in America.*[1]

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**The War on Poverty.** This effort famously began in 1965. From then to 2008, nearly $16 trillion was spent on means-tested welfare, in 2008 dollars. That is more than twice what we spent on all military conflicts from the American Revolution to 2008.[2] From 1962 to 2011, federal spending on major means-tested programs increased from $516 to more than $13,000 per person in poverty.[3] What have we gotten in return? In 2012, the last year for which official data is available, the U.S. poverty rate stood at 15 percent, nearly back where it was when the War on Poverty began. And that number includes a record 46.5 million Americans in poverty and 20.4 million Americans, with incomes less than half the poverty level.

Ryan's House Budget Committee Report on the 50th anniversary of the War on Poverty identifies close to 100 federal anti-poverty programs costing $800 billion in fiscal 2012, more than was spent on national defense that year, or on Social Security, or on Medicare.[4] [See the table.] In fact, close to 200 federal programs now cost federal and state taxpayers well over $1 trillion annually.[5]

Bottom line: We fought the War on Poverty, and poverty won.

**Why We Lost the War on Poverty.** One reason we lost is that lower income populations predominantly stopped working.

- In 1960, nearly two-thirds of households in the lowest income quintile were headed by persons who worked.
- But by 1991, this work effort had declined by 50 percent, with only one-third of household heads in the bottom 20 percent working, and only 11 percent working full time, year round.

We hear much about inequality these days. But one primary reason the top 20 percent earn so much more than the bottom 20 percent is that they work so much more. There are nearly six times as many full-time workers in the top fifth as in the bottom fifth, according to the Census Bureau.

Ryan reports that only 2.7 percent of Americans who work full time, year round, are in poverty.[6] Robert Rector of the Heritage Foundation adds that the typical poor family with children is supported by only 800 hours of work during a year, which amounts to 16 hours of work per week. If work in each poor family increased to 2,000 hours per year — the equivalent of one adult working 40 hours per week — nearly 75 percent of poor children would be lifted out of poverty.[7]

**The Poverty Trap.** Under today's welfare system, taxpayers are basically paying the bottom 20 percent of the income ladder more than $1 trillion a year not to work. The seven-year Seattle/Denver Income Maintenance Experiment confirmed the impact of such substantial, unconditional welfare subsidies on work incentives.

Under that well-known experiment, the government provided special, generous packages of welfare benefits to poor individuals in Seattle and Denver. The dramatic bottom line result: for every $1 of extra welfare given to low-income persons, they reduced their labor and earnings by 80 cents. No wonder the War on Poverty failed!

Even worse, when those in poverty do go to work, they are effectively subject to extra, higher, marginal tax rates. Since welfare is phased out as income rises, the loss of benefits is economically the same as a tax on rising earnings.

Take the example of someone in poverty who receives $12,000 a year in welfare benefits and gets an offer for a job earning $16,000 a year.

- She will lose 50 cents in benefits for every dollar earned, an effective 50 percent tax that takes away $8,000 of her earnings.
- The payroll tax will take another 7.65 percent of earnings, federal income taxes another 10 percent at the margin, and state income taxes roughly another 5 percent at the margin, on the average.
- That leaves an effective marginal tax rate of 72.65 percent, leaving little incentive for the poor to work.

Art Laffer and Steve Moore call this "The Poverty Trap." Laffer examined the total effect of all needs tests and taxes affecting an inner-city family of four on welfare in Los Angeles. He found that the poor sometimes faced the highest marginal tax rates of all income groups. The family in his analysis, earning wages between zero and $1,300 per month, faced marginal tax rates ranging from 53 percent to a high of 314 percent. When the family's monthly wages increased from $1,000 to $1,100 per month, they lost $214 in spendable income.[8] A 1995 Urban Institute study by Linda Ginnarelli and Eugene Steuerle confirmed these results, finding that the poor faced effective marginal tax rates of 70 percent to 101 percent.[9] A more recent NCPA study by Laurence Kotlikoff and Jagadeesh Gokhale found that a low-income couple earning 1.5 times the minimum wage per hour moving from part-time to full-time work would lose an astonishing $1.06 for every extra dollar they earn.[10]

**Family Breakup.** Out-of-wedlock births to single mothers are the second key cause of poverty.

- The poverty rate for female-headed households with children is 44.5 percent, compared to 7.8 percent for married couples with children.
- The poverty rate for married black Americans is only 11.4 percent, while the rate for black female-headed households is 53.9 percent.
- The Heritage Foundation's Robert Rector explains, "If poor women who give birth outside of marriage were married to the fathers of their children, two-thirds would immediately be lifted out of poverty. Roughly 80 percent of all long-term poverty occurs in single-parent homes."[11]

Most welfare benefits are restricted to families with children. Thus, having a baby offers a gateway to a generous package of government benefits. But if the mother marries a man who earns a significant income, the benefits are lost. Indeed, if the mother marries a man who is not working, but the government requires him

**Spending on Federal Anti-Poverty Programs**
**Fiscal Year 2012**

| Program Area | # of Federal Programs | Cost in FY 2012 |
|---|---|---|
| Cash aid | 5 | $220 billion |
| Education and job training | 28 | $94.4 billion |
| Energy | 2 | $3.9 billion |
| Food aid | 17 | $105 billion |
| Health care | 8 | $291.3 billion |
| Housing | 22 | $49.6 billion |
| Social Services | 8 | $13 billion |
| Veterans | 2 | $21.8 billion |
| **Totals** | **92** | **$799 billion** |

Source: "The War on Poverty: 50 Years Later," House Budget Committee, March 3, 2014.

to take available work before benefits are paid, then the benefits will be lost in any event, whether he refuses to work, or if he works and earns an income that eliminates them.

Government is effectively paying women to have children out of wedlock.

**Welfare Reform That Worked.** The 1996 welfare reforms spearheaded by then House Speaker Newt Gingrich reformed the old New Deal-era Aid to Families with Dependent Children (AFDC) program.

Federal AFDC funding was based on a matching formula, with the federal government giving more to each state that spent more on the program, effectively paying states to spend more. The key to the 1996 reforms was that the new grants to each state were finite, not matching. The reform returned spending on the program to each state in the form of a fixed, finite "block grant" to be used in a welfare program redesigned by the state based on mandatory work for the able-bodied. Thus, federal funding did not vary with the amount the state spent. If a state's new program cost more, the state had to pay the extra costs itself. If the program cost less, the state could keep the savings. The reformed program was renamed Temporary Assistance to Needy Families (TANF).

The reform was shockingly successful, exceeding even the expectations of its most ardent supporters. The old AFDC rolls were reduced by two-thirds nationwide, even more in states that pushed work most aggressively, because the poor formerly on the program went to work or married someone working. Because of this renewed work effort, the total income of these low-income families formerly on welfare increased by about 25 percent over this period, according to Ron Haskins of the Brookings Institution.

As a result, Haskins further reports, child poverty declined every year. "[B]y 2000, the poverty rate of black children was the lowest it had ever been. The percentage of families in deep poverty, defined as half the poverty level…also declined until 2000, falling about 35 percent during the period."[12]

This decline in poverty "was widespread across demographic groups" and "was caused by increased employment and earnings of females heading families."[13] Based on total income, poverty among these female-headed households declined by one-third, which meant that nearly 4.2 million single mothers and children climbed out of poverty.

At the same time, by 2006, total federal and state spending on TANF fell 31 percent from AFDC spending in 1995 and by more than half of what it would have been under prior trends. Consequently, not only did poverty decline sharply, but taxpayers saved 50 percent of the cost of the program.

**Reality-Based Reform.** The 1996 reforms restructured only one federal program. The federal government sponsors close to 200 additional means-tested welfare programs, including Medicaid, Food Stamps (formally, the Supplemental Nutrition Assistance Program, or SNAP), 27 low-income housing programs, and 30 employment and training programs, among others.

All of these programs can and should be block-granted back to the states. Such extended reform could save taxpayers trillions. The best estimate of the total cost of these welfare programs for the period 2009 to 2018 is $10.3 trillion.

States could experiment with this new control over funding by replacing the counterproductive welfare system with a work safety net for the able-bodied, providing public assistance only in return for work.

Americans reporting to their local welfare offices in the morning could be guaranteed a minimum-wage work assignment for a full day's work. Organizing local employers to offer private jobs would be a function for charitable efforts, local business groups, churches and welfare administrators. States could contract out their welfare offices to private temp companies.

The current minimum wage, plus the current Earned Income Tax Credit, plus the current child tax credit adds up to more than the poverty line for every possible family combination. Consequently, this work safety net would completely eliminate poverty in America. (The disabled would be provided assistance under separate programs.)

This new system would eliminate the poverty trap. Earning more would not reduce benefits. People would be incentivized to take whatever job is available because they have to work to support themselves. That private employment will lead to permanent employment, pulling the worker out of public assistance with wage gains due to experience, learned skills, promotions and the new

opportunities to which work leads over time.

Incentives for family breakup would be replaced by incentives for family unification, reducing the dependency burden on taxpayers.

In January, Rubio proposed extending the 1996 block grants to all means-tested welfare programs through consolidation into one federal agency, which would then distribute "Flex Funds" to the states to carry out their own programs to address poverty. In the last several Republican budgets passed by the House, Ryan has included extension of the 1996 AFDC/TANF block grants to Medicaid, the largest federal program to aid the poor.

But neither Rubio nor Ryan have proposed a policy of using the extended block grant, or Flex Funds, to provide all aid to the able-bodied solely through a work safety net. Such extended reforms could eliminate poverty in America, while saving taxpayers trillions of dollars.

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## Endnotes


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