Table: The Effect of Transfer Benefits and Taxes on the Incentive of an Indiana Mother of Two to Earn Income

Annual Gross Earnings	Transfer Benefits[1]	Income & Employment Taxes[2]	Spendable Income	Implicit Marginal Tax Rate
$0	$8,952	$0	$8,952	
$2,000	$9,311	$164	$11,147	-9.8%
$4,000	$9,659	$317	$13,342	-9.8%
$6,000	$10,007	$470	$15,537	-9.8%
$8,000	$10,174	$690	$17,484	2.7%
$10,000	$10,187	$912	$19,275	10.5%
$12,000	$9,920	$1,017	$20,903	18.6%
$14,000	$8,972	$938	$22,034	43.5%
$16,000	$8,173	$844	$23,328	35.3%
$18,000	$7,007	$766	$24,241	54.4%
$20,000	$6,032	$687	$25,345	44.8%

1. Includes Temporary Aid for Needy Families, Food Stamps, and the Earned Income Tax Credit.
2. Includes FICA, as well as state and federal payroll and income taxes. Computed by Fatima Carson and Justin Ross with full description of calculation process found here: http://jross08.googlepages.com/BenefitCalculationProcess.pdf

When Welfare Punishes the Working Poor

By Justin M. Ross
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Unfortunately, it is sometimes the case that well intentioned public policy is part of the problem for those it is intended to help. In many states, social safety nets designed to help disadvantaged families move out of poverty, like welfare benefits and tax credits, instead play the role of captivity nets for families struggling to break out.

How could this be the case? Is it not obvious that welfare benefits and tax credits help these families? Well, that depends on what you mean by help. Since welfare benefits and tax credits are decreased as income rises, one of the tricky problems created by this system is that it can create a disincentive for individuals to improve their situation when they want to. To modify a timeless but wise phrase, the problem is not always that the system does not teach them how to fish, but that it taxes them for trying to learn in the first place.

To demonstrate this disincentive effect in Indiana, we calculated the levels of benefits and taxes that would exist for a single mother of two children for different annual incomes. When our hypothetical single mother sets out to earn income for her family, the welfare and tax system can combine in surprising ways that significantly punish her for working to earn additional income. In other words, the reduction in benefits and increase in taxes create an "implicit tax" for each additional dollar earned.

To illustrate, suppose our Indiana working mother of two is on track to earn $16,000 in annual gross earnings (about 36 hours of work per week at $9 per hour) and is considering increasing her work load by four hours a week to earn an additional $2,000 annually. However, because of the reduction in benefits and increase in taxes, her actual spendable income would only increase by $913, as if she were in a 54%

income tax bracket! In fact, over the range from earning $10,000 to earning $20,000 this single mother of two would be paying an average of almost 40% in implicit income taxes. For comparison, taxpayers earning over $357,000 annually pay a 35% marginal income tax rate.

While critics of progressive taxation are right to point out that the percentage of the population that actually pay taxes is becoming smaller and smaller, it neglects this hidden "implicit" tax rate facing the "working while on welfare" poor. A person in a situation like this would have to ask her or himself "is it worth the additional child care hours, gas money, and other expenses when half of what I earn will disappear?"

Most of us have probably turned down a job opportunity at one time or another that we would have undertaken had it paid twice as much. This disincentive to work in the welfare system can have long-term consequences on future promotions and pay raises for this employee, not to mention the fact that society at large loses the production she would have contributed to her employer.

With the election season finally over and as the new political regimes take seat at all levels of government, it is important for those new officials to return the focus from ad hominem campaigning to identifying and addressing current public policy problems. While in these campaigns we see frequent appeals to the middle class, it is important for these policy makers to address those who have not yet achieved their defined "middle class" status.

The problems we demonstrated here that are inherent in the current welfare system, have been pointed to by many others before us. Possible solutions like greater coordination between state and federal welfare systems, a negative income tax, or lump sum payments are often quickly dismissed as not being as politically feasible. However, since most of them campaigned on their leadership skills, it is time policy makers show those who need help the most that they care about whether or not their good intentions achieve good outcomes.

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