**Mapping and Addressing "Benefits Cliffs" in Michigan**

Lessons learned from a benefits cliff working group coordinated by Michigan Future, Inc.

In early 2023, Senator Kristen McDonald-Rivet established a working group to explore the so-called "benefits cliff," and its impact on Michigan families. Most public benefits (SNAP benefits, housing assistance, cash assistance) are "means tested," meaning as employment income increases, the level of public assistance they receive declines. A "cliff" occurs when the next dollar of income earned by a household actually *reduces* a household's overall resources after reductions in public assistance are accounted for. In the case of a true cliff, a household is made worse off through increased income from work. If cliffs are present in the benefits schedule, they could serve to disincentivize work and lead to greater household financial instability. The goal of the workgroup was to identify these cliffs, as well as policies to mitigate them.

In analyzing how Michigan's benefit system interacts with household income, we looked at most major public benefits programs: food assistance (FAP in Michigan; SNAP nationally); cash assistance (FIP in Michigan; TANF nationally); health insurance (Healthy Michigan, Medicaid); housing assistance (public housing; section 8 vouchers); childcare assistance; the earned income tax credit and state earned income tax credit; and the child tax credit. It should be noted that of these programs, the only ones that reach a high percentage of low-income Michigan households are SNAP, Medicaid, and refundable tax credits (EITC and child tax credit). Housing vouchers reach only a quarter of eligible families; only 11% of poor families in Michigan receive cash assistance; and just an estimated six percent of children eligible for a childcare subsidy receive one. So in thinking about how employment income interacts with the public benefits system, we did not include these programs with low utilization rates, and instead focused on only those programs that reach the vast majority of low- and moderate-income Michigan households.

Through biweekly meetings over six months, and several analyses conducted by Michigan Future (MFI eventually took over coordination of the working group), we arrived at six central findings, outlined below, that can guide our response to the problem of benefit cliffs going forward. These findings are outlined in brief below, and in more detail in the pages that follow.

1. **True "cliffs" largely don't exist, but households do experience a steep marginal tax on benefits.** A true cliff is when a decline in public assistance resulting from additional employment earnings leads to a net decline in household resources. By and large, this kind of cliff does not exist. Indeed, most public assistance programs are specifically designed so that households do not experience a decline in total resources from additional employment earnings.

   However, many households receiving public benefits still experience a steep "marginal tax" on their net resources resulting from additional employment income, which can lead to financial instability and, potentially, a disincentive to earn more income. In particular, we found that households earning between $20,000 and $40,000 from work have relatively static net household resources (income from work plus public assistance) over that entire income range.

2. **The rules for the largest means-tested programs are set federally, so most of the meaningful levers for alleviating this high tax on benefits would need to be pursued in Washington, not**

**Lansing.** States have little control over the structure of most public benefit programs. For example, benefit levels and income eligibility determinations for the largest public benefit program, SNAP (formerly food stamps), are determined by federal policy, and monitored by federal agencies. There are some small changes states can make around the edges to make benefits easier to access, but by and large the state's role is in administering federally designed programs. The two major exceptions are TANF (cash assistance) and state tax credits, which are discussed later in the brief. For most other programs, Michigan has already implemented many of the common reforms that are available to states to ease high benefit taxes.

3. **The strongest lever available to states to combat high benefit taxes is to expand their state EITC.** The most important thing states can do to boost the incomes of households hit by high benefit taxes is to implement or expand a state earned income tax credit, which Michigan recently did. Michigan's expansion of its state EITC, from 6% to 30% of the federal credit, places Michigan near the top of all states in the size of its state EITC. A further expansion of the state EITC – either across the board or specifically targeted to households with children, who face the steepest benefits tax – remains the most powerful lever for reform at the state level.

4. **State leaders should also push for federal reforms to ease high benefit taxes.** As noted, because the structures of our benefits systems are largely set at the federal level, the most impactful solutions lie there as well. In particular, an expansion and/or redesign of the federal Earned Income Tax Credit or SNAP program could reduce the benefit tax faced by low-income households.

5. **Improving access to public benefits is part of the solution.** The workgroup eventually held a series of meetings on ways to improve access to public benefits in Michigan. While reforms to improve access would not alter the means-tested design of the system, they would help achieve the goal of enhancing the financial stability of Michigan households, by ensuring greater access to those households eligible for benefits. We heard presentations from Civilla, the non-profit design studio that partnered with MDHHS on a number of human-centered design initiatives to remove obstacles from the benefits system; from Secretary of State Jocelyn Benson about the work she has led to dramatically improve customer service in her department; and from Propel, an organization that builds technology tools to help families manage their safety-net benefits. Much can be learned from these and other efforts around how we make interacting with our public benefits systems as seamless as possible.

6. **The one true "cliff" in our public benefits system is in the state's childcare subsidy program.** We chose not to tackle Michigan's childcare subsidy system through this workgroup because we felt the complexities inherent to the system required a dedicated effort. However, the state's childcare subsidy system is ripe for reform. As currently structured, it is the one place within Michigan's public benefits system where something like a true cliff exists.

**Finding #1: True "cliffs" largely don't exist, but households do experience a steep marginal tax on benefits**

To get a sense for how public benefits interact with household income, we can start with a case example of a single adult with two children. Here, we track how this family's net household resources change as income from work grows, and public benefits decline. At each income level we compile the household's resources (income from work, SNAP benefits, and refundable tax credits) and subtract costs (income and payroll taxes and health care costs). Not included here, because of variability by household and the relatively small reach of the programs, is cash assistance, housing assistance, childcare subsidies, or Supplemental Security Income (SSI). On the cost side, we do not provide estimates of housing, transportation, food, or other household costs, again due to variability by household.

The top line of the table below shows income from work, increasing in $5,000 increments, on an annual basis. The second line shows a household's net resources, after the addition of public benefits and refundable tax credits, and subtraction of income and payroll taxes and any health care costs. The third line shows the net gain in household resources from each additional $5,000 in employment income, and the final line shows this as the net gain in household resources from each dollar earned from work.

| | Income from work | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **$15,000** | **$20,000** | **$25,000** | **$30,000** | **$35,000** | **$40,000** | **$45,000** | **$50,000** |
| Net resources | $33,173 | $36,496 | $38,159 | $39,335 | $40,052 | $41,061 | $43,113 | $45,085 |
| Net gain from $5,000 raise | - | $3,323 | $1,663 | $1,176 | $717 | $1,008 | $2,052 | $1,972 |
| ___ of each dollar | - | $0.66 | $0.33 | $0.24 | $0.14 | $0.20 | $0.41 | $0.39 |

What we see here is that as employment income increases from $20,000 to $40,000, this household's net resources only increase by $4,500. This is what we mean by a steep marginal tax. There is no point at which an additional dollar earned results in a *decline* in household resources, but there are places within this income schedule when the return in net resources on the next dollar earned is vanishingly small. For example, as employment income rises from $30,000 to $35,000, the household's net resources only increase by $717, or roughly $0.14 for each additional dollar earned from work. This is because as this household head earns more from work, she simultaneously faces increasing state and federal income taxes, as well as reductions in SNAP benefits and a smaller Earned Income Tax Credit. This small gain in net resources from each additional dollar earned at work may dampen a worker's motivation to take on a new job for more hours or higher pay and may undermine her pursuit of household financial stability.

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**Finding #2: The rules for the largest means-tested programs are set federally, so most of the meaningful levers for alleviating this high tax on benefits would need to be pursued in Washington, not Lansing.**

For most social safety-net programs, eligibility rules and benefit amounts are set and monitored by the federal government, leaving states with few levers to alleviate high benefit taxes. For instance, the Supplemental Nutrition Assistance Program (SNAP), known here in Michigan as the Food Assistance Program (FAP), is one of the largest safety-net programs, providing thousands of dollars of food assistance to millions of families every year. As households earn more income, their SNAP benefits are reduced by approximately $0.36 for every additional dollar of income. Because of SNAP's outsize contributions to the resources of low-income households, a powerful lever for easing the overall benefit tax would be to reduce this "tax" on SNAP benefits. If households only lost $0.15 for every additional dollar of income, for example, the overall benefit tax rate becomes much less steep. However, states are unable to reduce this tax – policy change in this area would have to occur at the federal level.

A similar story can be told with housing assistance. Housing vouchers are woefully underfunded (only about a quarter of low-income households receive housing assistance), but for families that do receive a voucher, the voucher enables them to pay no more than 30% of their monthly income towards rent. While this support goes a long way towards easing housing cost burdens, the structure of the program also fixes a 30% "tax" on each additional dollar earned, potentially leaving voucher recipients to feel like they can't get ahead. This structure is also federally determined.

States can make small changes in how they administer these programs, which can make a difference at the margin. Michigan has already implemented many available reforms, including raising the asset limit for SNAP recipients; adopting a program known as broad-based categorical eligibility, which streamlines the application process for benefits; and adopting simplified reporting, which reduces the frequency with which SNAP beneficiaries need to report changes to their incomes. Though these programs are important, and can streamline access to benefits to support families, they do not alter the high benefit tax rate built into the structure of these programs.

*Where do states have control?*
Two areas where states do have some control – and where potentially powerful levers exist – are in the TANF program (cash assistance) and through a state Earned Income Tax Credit. States have considerable autonomy in how they structure their TANF programs – funded through a federal block-grant – and many states have used this autonomy to provide relatively generous cash assistance to a relatively large share of low- and moderate-income families. Michigan, however, has moved the other way, using the autonomy afforded under TANF rules to dramatically restrict cash assistance and use TANF dollars to fill gaps elsewhere in the state budget. In theory, given the flexibility of TANF block grant dollars, Michigan could use these dollars to structure programs that provide cash to households experiencing benefit taxes in other programs, though this would be a dramatic departure from current uses.

The state Earned Income Tax Credit, which we'll discuss in the next section, is another area where the state has control, and, indeed, is the most powerful lever we have at our disposal for combating benefit taxes in other areas.

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**Finding #3: The strongest lever available to states to combat high benefit taxes is to expand their state EITC**

Given the limited control states have over the design of safety-net programs, the most critical thing they can do to support households experiencing high benefit taxes is to introduce or expand a state earned income tax credit. Thirty-one states have a state EITC, with most of them pegged to some percentage of the federal EITC.

Michigan Future recently led a successful push to expand Michigan's state EITC from 6% to 30% of the federal credit. If our case household – a single parent with two kids – was earning $35,000, this would boost their state EITC from $226 to $1,132 – welcome cash as other benefits are reduced.

As we look ahead for ways to further reduce the burden of high benefit tax rates, we are proposing a second expansion of the state's EITC, this time focused on households with children (discussed briefly at the close of this document). Because the majority of safety-net benefits are targeted towards households with children, these households also face the steepest benefit tax rate as they earn more employment income. Adding some form of child supplement to the state EITC would be one way to lessen this burden.

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**Finding #4: State leaders should also push for federal reforms to ease high benefit taxes.**

Because the majority of reform levers exist at the federal rather than state level, state leaders can and should develop a federal reform agenda for dealing with high benefit taxes. Potential reform ideas include:

- **Expanding the federal EITC.** Outside of adjustments for inflation, the federal EITC has not been meaningfully expanded for households of all sizes since the early 1990s. Expanding the size of the EITC, and altering its structure, would be the single most impactful thing the federal government could do to reduce high benefit taxes as earnings rise, and to enhance the financial stability of low- and moderate-income households. A larger credit would boost incomes across the board; a shift to its structure, for example by implementing a more gradual phaseout of the credit, would reduce the benefit tax as earnings rise.

- **Expanding and/or lessening the benefit tax on SNAP benefits.** Because SNAP is one of the largest safety-net programs, reaching the greatest number of households, reforms to SNAP would have broad impact. Base SNAP allotments were recently expanded due to a reassessment of USDA food budgets; further expansions would deliver more resources to households facing benefit taxes.

  But in addition to the size of the base amount, reducing the rate at which benefits are reduced as employment income increases would go a long way towards boosting household financial stability. During the pandemic, Congress introduced SNAP emergency allotments, which provided all SNAP eligible households with at least the maximum benefit amount for their household size, eliminating the phase out completely until the point at which a household was no longer income-eligible for benefits. Research suggests these additional allotments kept millions of Americans out of poverty during the pandemic.

- **Increase the earned income deduction and housing cost caps in SNAP formula.** Another way to boost the size of SNAP benefits for households further up the income spectrum – thereby reducing the overall benefit tax as earnings rise – is to alter the formula used to calculate SNAP benefits. For instance, raising the amount of earned income that is deducted in calculating household benefits would extend larger benefits to households further up the income spectrum, thereby lessening the benefit tax. Similarly, if the federal government eliminated the cap on the amount of housing costs that can be deducted in calculating household resources, this would also have the effect of boosting benefit size and lessening the overall tax.

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**Finding #5: Improving access to benefits is part of the solution.** Though it would not change the underlying structure of the benefit tax, improving access to public benefits is a big part of the overall effort to enhance financial stability for low- and moderate-income households. Indeed, part of what contributes to the perception of a steep benefits cliff is that low-wage workers often have quite volatile income, and public benefit programs can often be difficult to access. Applications for benefits are often long and burdensome, offices often understaffed, wait times long. If an individual earns more money, and has their benefits reduced, they may be rightfully concerned that they could encounter trouble getting their benefits reinstated if their income were to decline again.

Indeed, over the course of our working group meetings, questions around benefit access were often conflated with the so-called cliff, such that when people complained about the benefits cliff, they were really bemoaning the range of inefficiencies present in the public benefits system more broadly. So, as we dug deeper into the details of our public benefits system and began to understand the levers the state did and did not have control over, we began to give more focus to the issue of benefits access – of simply making our public benefits systems work better for those that needed them. At the state level, we may have little control over the structure of public benefits programs, but we do have control over how well those programs work, and how easy it is for those that need them to access them.

Throughout our meetings, we heard three presentations from leaders working in human service delivery, that were instructive as we think about ways to make our public benefits systems work better for Michiganders. First, we heard from Mike Brennan, of the non-profit design studio Civilla, which worked for several years with the Michigan Department of Health and Human Services on different projects to ease access to public benefits in Michigan. On the most well-known of these projects, Project Re:form, Civilla and MDHHS worked to redesign Michigan's public benefits application, shortening it from 40 pages (the longest benefits application in the country) to just 8, and dramatically improving performance outcomes in the benefits application process. On a second project, Project Re:new, Civilla worked with MDHHS to change the timing and design of the mailers they sent to public benefits recipients reminding them of the steps they needed to take to renew their benefits. This project resulted in 95% of renewals being submitted on time. And on a third project, Project One Day, Civilla worked with MDHHS on a number of human-centered reforms to make it possible for public benefits applicants to receive an eligibility determination in a single day, rather than the standard month.

This kind of work is critical to creating a public benefits system that truly serves those in need, and these projects, and others like them, have made Michigan and MDHHS a national leader in expanding access to public benefits.

Still, as impressive as this work is, a number of stakeholders acknowledged that it represents just the start of all that needs to be done to ensure our public benefits system is adequately supporting those in need.

To get a sense of what's possible in the human service delivery space, we also heard from Secretary of State Joselyn Benson, who has overseen a complete overhaul of the way Michigan residents interact with the Secretary of State's office. These reforms include moving many processes online, but the overhaul was not completely, or even primarily, focused in the digital realm. Rather, much of the work centered on the in-person experience of those visiting SOS offices across the state – their wait times, how they interacted with staff, and what they were able to get accomplished. SOS leadership collected reams of customer experience data, invested in their front-line staff, and introduced a range of other reforms based around the principles of human-centered design. Secretary Benson also made a point of spending time in every SOS office across the state, to get a first-hand look at what was going right, and what needed improvement. Secretary Benson saw quality customer service at the Secretary of State's office as a core government function – and given that for many a visit to an SOS office may be their primary interaction with government, she wanted to make sure it was a good one.

Finally, we heard a presentation from Propel, an organization that created a digital platform that allows SNAP recipients to manage their benefits online. About half of Michigan SNAP recipients use the Propel app, the largest share of users in any state in the nation by far. And we see many opportunities to leverage the app to expand access to a range of services for economically vulnerable Michiganders. The app can be used to provide information on SNAP and other safety net programs, as well as facilitate tax filing and banking. Propel also regularly surveys its users, potentially making the app an important way to obtain information regarding the obstacles Michigan residents are facing in interacting with the public benefits system.

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**Finding #6: The one true "cliff" in our public benefits system is in the state's childcare subsidy program.**

We noted at the outset that what is commonly conceived as a benefits cliff is really more of a high benefit tax – a worker earning more money may lose benefits, and may not feel like they're getting ahead, but in almost all scenarios their net resources will still increase.

The one case where that may not always be true is in Michigan's childcare subsidy system. Under recent expansions to the subsidy system, families with incomes under 200% of the federal poverty line are now eligible for a subsidy, though the threshold may return to previous eligibility levels in the coming years. But no matter where this initial income eligibility level is set, the way it is structured here in Michigan presents a stark divide in who does and does not receive assistance. On one side of an income line you are eligible for a full subsidy; on another side, you are not. This is quite different from how most other public benefit programs are structured, where benefits slowly decline as earnings go up, gradually phasing out. In the childcare system, if you're on the wrong side of the eligibility threshold, you could be much worse off financially – having to bear the entire cost of childcare out of pocket – than someone who makes just a little bit less than you.

It's not entirely clear how this cliff plays out for Michigan families. The childcare subsidy system has a well-designed "exit" threshold that avoids a cliff, whereby if a household initially qualifies for a subsidy, and then begins to earn more, they do not lose that subsidy until household income reaches nearly $70,000. The cliff we outline here would only impact a household on the wrong side of the income eligibility threshold at the time when they first need childcare. So, it's not clear how many families are impacted by this faulty program design, particularly because the childcare subsidy system serves relatively few Michigan families in need (roughly 38,000 children are served by a subsidy in a given month, though we estimate there are nearly 600,000 Michigan children between under the age of 13 who would qualify for assistance).

One fix, though potentially difficult to implement, is relatively straightforward. Whereas Michigan provides a standard subsidy amount to all households that qualify for assistance, many states provide subsidies on a sliding scale based on income, with household copays covering the remainder of the cost. This would allow subsidies to extend higher up the income spectrum, with the size of the subsidy gradually declining as income rises, eliminating the cliff-like design of the current system.

However, we did not spend much time on childcare in our workgroup meetings because the design flaw outlined above is only one aspect of an entire system in need of reform. We estimate there are roughly 185,000 children aged 0 – 3 in ALICE households, yet, as we noted previously, just a small fraction of these children receive support from the state's childcare subsidy system. To serve a much broader share of ALICE households would require policy changes well beyond alterations to subsidy eligibility thresholds and household copays, but a rethink of how we support individual families, and the childcare ecosystem more broadly.

To address both the high benefit tax for households with children and the challenges many families face in paying for childcare, we recently proposed a Working Parents Tax Credit, targeted to households with children under the age of six. The WPTC would provide a refundable tax credit of $5,000 per-child aged three and under, and $2,500 per child over three and younger than six, to all households who receive the federal Earned Income Tax Credit and have at least $10,000 of work earnings. We believe the WPTC is the primary way the state can both address steep benefit taxes for households with young children, and help working households afford childcare, at scale.