

Welfare and Work Disincentives

Theoretical Effects; Empirical
Evidence; Making Ends Meet

Labor Supply - Theory

- Critical parameters are Guarantee (G) and Benefit Reduction Rate (BRR)
- Increase in G decreases hours worked among welfare recipients; Increases attractiveness of welfare for non-recipients and hence, reduces their hours worked
- Decrease in BRR; increases work incentives for recipients through substitution effect (decreases through income effect); Increases attractiveness of welfare for non-recipients and hence, reduces their hours worked.

Historical Perspective

- 1930s -- AFDC for the “unemployable” -- widows (white), the disabled.
- 1940’s-50’s -- the program administered by the states. No entitlement to aid. Some divorced/single mothers received aid, based on assessment of moral fitness and employability.
- 1960’s -- All female headed families with earnings below cut-off eligible. 100% benefit reduction rate for those who worked.
- 1970’s-80’s -- Growth in LFPR of women redefined employable. Negative income tax experiments.
- 1980’s -- Experiments with increasing “work” incentives for AFDC recipients. - WIN and JOBS

Experiments with Lowering the Benefit Reduction Rate

- Lowering BRR increases labor supply of current welfare recipients, but it also draws more persons to the program. Effects on aggregate hours worked are ambiguous.
- No significant effect of change in BRR on labor supply (negative income tax experiments; cross sectional studies) (Moffitt, 1992)
- Time series evidence corroborates this finding. Neither 1967 reduction nor 1981 increase had major influence on hours worked (Moffitt, 1992)
- But most recipients worked. Issue for some recipients was whether to report earnings or not. Also, nonlinearity of budget constraint induced packaging.

The “Leaky Bucket”

- AFDC generated nontrivial work disincentives
- Estimates vary about the magnitude of the effects.
- For every dollar transferred to female heads, about 37% leaks out.

Making Ends Meet

- Mary Ann Moore
- Gap between expenses and welfare benefits
- Edin and Lein, (1997) document importance of work off the books. 12% of total budget of welfare-reliant mothers came from unreported work.
- 43% of AFDC recipients 1984-1988 were also had earnings from work (IWPR, 1995)

Implications

- Welfare benefits inadequate
- Theory describes disincentives to report work rather than disincentives to work (potentially important in discussion of intergenerational transmission)
- Impact of welfare reform on income may be smaller than anticipated.