

**The Clinton Welfare Reform Plan:  
Will It End *Poverty* as We Know It?**

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## **Abstract**

The central elements in President Clinton's proposal to reform the welfare system are: increasing the earned income tax credit, improving the child support system, educating and training the poor, and limiting the amount of time people can receive assistance. The authors commend the first two components of the president's plan but question the likely effectiveness of the last two: even with the education, training, and child care programs that the president has proposed, few welfare recipients will be able to command wages that would lift them out of poverty, and successful education and training programs would cost more than the government appears willing to spend. They recommend that the president consider giving tax credits to, and subsidizing the wages paid by, employers who hire low-wage workers and assist young people and poor families to save for future opportunities. In their view, poverty will not be alleviated by only getting tough on welfare recipients; instead, labor market interventions should be adopted so as to expand opportunities for low-wage, low-skilled workers.

## **The Clinton Welfare Reform Plan: Will It End *Poverty* as We Know It?**

In 1973, Henry Aaron posed a deceptively simple question as the title of his Brookings monograph, *Why Is Welfare So Hard to Reform?* (Aaron, 1973). At that time, the Nixon administration was in its third year of efforts to gain congressional passage of its modified negative income tax (the "Family Assistance Plan," or FAP, as it was known) designed to replace the nation's welfare system. FAP was defeated (albeit narrowly), as were the large-scale welfare reform proposals of every subsequent president other than George Bush, who had none. In 1994, the nation is again participating in this quadrennial event, wrestling with a Clinton administration plan designed to "end welfare as we know it." As before, efforts to reform welfare are weighed down by a mind-numbing number of constraints and tradeoffs, only some of which can be affected by policy.

The unexpected parallel trends in real antipoverty expenditures and the size of the poverty population over the last twenty years show why presidents want to end welfare. The antipoverty strategy we have adopted over the past two decades has failed to reduce the number of people living in families with incomes below the poverty line.

Several reasons account for this failure. First, the budgets for antipoverty programs have never been large; moreover, real expenditures devoted to some of the most important of them (for example, Aid to Families with Dependent Children) have declined since 1973. Second, antipoverty programs often discourage desirable behavior like working, saving, and taking initiative, all of which contribute to income growth and an expansion of opportunity. Third, the system is a bewildering patchwork in which households in identical economic circumstances can receive widely different levels of support, based on their state of residence, household structure, and health status. Finally, there seems to be a fundamental gap between the basic rationale for those antipoverty programs now on the books and society's current judgments about the nature and causes of poverty.

Against this background, the Clinton administration has prepared a welfare reform package that has four main themes: "make work pay," strengthen the nation's system of child support enforcement and collection, provide education and training to poor people, and place limits on the length of time that many recipients are able to collect welfare benefits.<sup>1</sup> These proposals take some steps toward addressing the problems of existing antipoverty programs. At the same time, past experience tells us that the magnitude of the poverty problem will not be reduced significantly unless budgetary resources are increased to match the rhetoric accompanying the proposals. Terminating recipients from access to income support or enforcing public service employment as a requirement for income support—ending welfare as we know it—cannot be accomplished without major increases in spending on child care, health, and education and training, unless the nation is prepared to become more harsh and punitive toward the poorest among us than it has ever been.

#### AN OVERVIEW OF ANTIPOVERTY POLICY

Table 1 provides an overview of antipoverty programs since 1970. The years in the table correspond to peaks in the business cycle (1990 was the business cycle peak, 1989–1992 are included for completeness). The first two columns of the table show the number of persons with market incomes below the poverty line before and after cash transfers in the United States.<sup>2</sup> In 1960, 39.9 million people (22.2 percent of the population) had incomes after cash transfers below the poverty line.<sup>3</sup> By 1970, this number had fallen by 36 percent, to 25.4 million (or 12.6 percent of the population), because of the economic expansion, demographic changes, increased coverage and generosity of the Social Security system, and the War on Poverty/Great Society programs. Since 1973, however, the poverty population has increased sharply. The gain from 1979 to 1989 is particularly distressing; the sustained period of economic growth from 1982 to 1990 failed to raise the economic position of the poorest among us. Contrary to earlier experience, this rising tide did not lift

TABLE 1

## Poverty Population and Real Cash and Near-Cash Transfer Program Expenditures, Selected Years

Year	Number of Pretax, Pretransfer Poor (1000s)	Persons in Official Poverty (1000s)	Percent of Population in Official Poverty	AFDC Benefits <sup>b</sup>	Food Stamp Benefits	SSI Benefits <sup>b</sup>	Total Benefits	EITC Expenditures	Benefits as a Percentage of GDP
1970	n.a.	25,420	12.6	\$15,051	n.a.	\$10,627	\$25,678	n.a.	0.70
1973	n.a.	22,973	11.1	22,382	\$7,186 <sup>a</sup>	10,801	33,183	n.a.	0.78
1979	42,783	26,072	11.7	19,382	11,184	13,672	44,238	\$3,966	0.92
1983	52,700	35,303	15.2	17,975	16,585	13,247	47,807	2,528	1.00
1989	49,052	31,534	12.8	18,120	13,760	16,640	48,520	7,462	0.82
1990	50,851	33,585	13.5	18,529	15,717	17,277	51,523	7,437	0.87
1991	54,679	35,708	14.2	19,319	18,463	18,520	56,302	9,689	0.96
1992	57,350	36,880	14.5	20,431	21,884	21,258	63,573	11,783	1.05

**Sources:** U.S. Congress (1993), pp. 678, 867, 1058, 1312–13, 1342, 1609; U.S. Bureau of the Census (1993a), p. xviii; Council of Economic Advisors (1994), Table B-1 p. 268, Table B-59 p. 335.

**Notes:** Benefits in millions of 1992 dollars.

<sup>a</sup>Includes administrative costs of the program in 1973.

<sup>b</sup>Includes state and federal benefits.

all boats, and as a result, the common belief in the antipoverty impacts of good macroeconomic performance has been shaken.

Columns 4 through 6 show federal expenditures on the largest cash or "near-cash" means-tested antipoverty programs. Through these programs, the nation currently spends around 1 percent of GDP on families and individuals with incomes below the poverty line. Aid to Families with Dependent Children (AFDC), commonly referred to as "welfare," is the largest antipoverty income support program directed at families with children.<sup>4</sup> It is jointly funded by states and the federal government and is largely administered by the states. As shown in the table, the real value of aggregate AFDC benefits peaked around 1973; over the next ten years real AFDC expenditures fell by almost 20 percent, although the number of persons in families with incomes below the poverty line increased by 54 percent. Real AFDC expenditures have grown since 1983.

The decline in AFDC benefits has been more than offset, in the aggregate, by a rapid increase in expenditures on the food stamp program, the nation's only antipoverty program available to all of the poor. The food stamp program provides vouchers, redeemable for food, to any individual or family that falls below the program's income and asset cutoffs.<sup>5</sup> Real food stamp expenditures more than doubled between 1973 and 1983, thereby compensating for the decline in AFDC. Since 1983 there has been modest growth in the combined value of AFDC and food stamps, while the size of the poverty population has remained roughly constant.

Supplemental Security Income (SSI) is a cash assistance program directed at poor people who are elderly, blind, or disabled; and like food stamps, it is funded by the federal government and has uniform nationwide eligibility standards. SSI has grown fairly steadily since the early 1970s.

In addition to these cash or near-cash programs, a number of additional federal programs have significant antipoverty components. The government spent \$75.8 billion in 1993 providing health care benefits through Medicaid, \$21.5 billion on housing benefits through public housing and rent subsidies,

and \$9.5 billion on Head Start and other compensatory education programs. Moreover, a significant share of Social Security and veterans' benefits are paid to families and individuals who, in the absence of these payments, would have incomes below the poverty line. The earned income tax credit (EITC), a refundable subsidy to earned income directed primarily toward low-income workers with children, is a major antipoverty program administered on the tax side of the budget (Scholz, 1994). By 1996, the EITC is expected to be the largest cash or near-cash program directed toward low-income families with children.

This constellation of existing tax and transfer measures contributes importantly to improving the lives of the nation's most disadvantaged, and to reducing the incidence of measured poverty. Indeed, according to the *1993 Green Book* (U. S. Congress, House of Representatives, 1993, pp. 1342–1343), the full panoply of cash and noncash transfer programs (including federal income and payroll taxes) existing in 1991 removed from poverty nearly 23 million of the 55 million pretax and pretransfer poor; without these programs, the nation would have had a poverty rate of 21.8 percent, but with them in place the actual poverty rate was 12.6 percent.<sup>6</sup> Without the programs in place, it would have taken over \$160 billion (in 1991 dollars) to have closed the poverty gap; with them, the remaining poverty gap stood at about \$52 billion.<sup>7</sup>

Although this set of tax and transfer measures plays an important role in reducing poverty, not all is well with this policy mix. In the following paragraphs, we summarize a number of shortcomings that afflict this system.

#### THE EFFICIENCY OF CURRENT TAXES AND TRANSFERS AS ANTIPOVERTY POLICY

If the ultimate test of antipoverty policy is its outcome, our current system of tax and transfer programs appears to be slipping. While these programs pulled 48 percent of the nation's pretax and

pretransfer poor above the poverty line in 1979, they lifted 42 percent of the market-income poor out of poverty in 1991 (U.S. Congress, 1993, pp. 1342–1343).<sup>8</sup>

There are many reasons for this result. As we pointed out in the previous section, the real value of those transfers that are the most highly targeted on the poor—AFDC and food stamps—grew at a slower rate (43.1 percent) than the rate of growth in the number of the official poor since 1973 (60.5 percent). At the same time, eligibility was tightened for large programs such as the disability portion of Social Security and Unemployment Insurance.

There has also been a striking increase in earnings inequality in the nation, beginning in the 1970s, but accelerating over the 1980s (Levy and Murnane, 1992; Haveman and Buron, 1994). The figures in Table 2, which show median incomes of men and women by their level of educational attainment, reflect this increase and show the deterioration at the bottom of the distribution which has contributed to the growing gap. In 1973, the median male with 1–3 years of high school had \$24,079 in income (in 1989 dollars); by 1989 the median worker with the same level of education had only \$14,439 in income. The trend is nearly as dramatic for males with only a high school degree. In 1973, the median male had an income of \$30,252; this had fallen to \$21,650 by 1989.<sup>9</sup> The erosion of labor market opportunities for people with low levels of education has placed an enormous strain on the nation's antipoverty programs.

In addition to the erosion in transfer benefits and the deterioration in labor market opportunities for low-wage workers, the programs themselves have, in all likelihood, contributed to the growth of the poverty problem. As suggested above, the programs carry with them a disturbing set of incentives. The most prominent of these incentives are the high marginal tax rates placed on the earnings of households that receive benefits. Interestingly, this high-tax-rate problem does not lie with the individual income tax. As shown in Table 3, except for a brief period in the early 1980s, the combination of personal exemptions and the standard deduction has been enough to keep almost



TABLE 2

**Median Income of Persons 25 and Over, by Educational Attainment and Gender,  
Selected Years, 1989 Dollars**

Year	Males			Females		
	High School		College 4+ Years	High School		College 4+ Years
	1-3 Years	4 Years		1-3 Years	4 Years	
1967	\$22,858	\$26,894	\$39,186	\$7,574	\$10,800	\$19,205
1970	23,442	28,034	40,527	7,629	10,866	19,735
1973	24,079	30,252	41,065	7,920	11,087	19,667
1979	18,697	26,416	36,626	6,726	9,085	16,923
1983	15,138	21,932	35,188	6,531	9,326	18,427
1989	14,439	21,650	37,553	6,752	10,439	21,659

**Source:** U.S. Bureau of the Census (1990), for 1967–1983 figures, and U.S. Bureau of the Census (1991), for 1989 figures.

TABLE 3

**Poverty Line, Tax Threshold, and Marginal Tax Rates for 4-Person and 3-Person Families,  
Selected Years**

Year	2 Parents, 2 Kids		1 Parent, 2 Kids		Lowest MTR <sup>b</sup>	Combined Payroll Tax	EITC Subsidy Rate
	Poverty Line	Tax Threshold <sup>a</sup>	Poverty Line	Tax Threshold <sup>a</sup>			
1970	\$3,968	\$3,600	\$3,099	\$2,975	14%	9.60%	n.a.
1973	4,533	4,300	3,537	3,550	14	11.70	n.a.
1979	7,412	7,400	5,784	5,300	14	12.26	10%
1983	10,178	7,400	7,938	5,300	11	13.40	10
1989	12,675	13,200	9,885	10,550	15	15.02	14
1990	13,359	13,650	10,419	10,900	15	15.30	14
1991	13,924	14,300	10,860	11,400	15	15.30	17.3 <sup>c</sup>
1992	14,343	15,200	11,187	12,150	15	15.30	18.4
1993	14,772	15,600	11,522	12,500	15	15.30	19.5

**Sources:** U.S. Department of the Treasury (1992), pp. 32, 79, 137; U.S. Department of the Treasury (1993), pp. 22, 71, 130; U.S. Congress (1993), Table 2, p. 1310; Pechman (1987), Tables A1, A3, and A11; Internal Revenue Service (1972), pp. 284, 291; Internal Revenue Service (1976), pp. 186, 192.

<sup>a</sup>1970 and 1973 tax threshold assumes the low income allowance standard deduction was taken.

<sup>b</sup>The marginal tax rate on income after exemptions and deductions (or zero bracket amount).

<sup>c</sup>This rate applies to taxpayers with two or more qualifying children. The rate is 16.7 percent with one qualifying child.

all families with market incomes below the poverty line from paying federal income taxes. In addition, the subsidy rate in the refundable EITC has offset much of the combined employer and employee share of the Social Security payroll tax. Instead, the largest disincentives caused by high marginal tax rates stem from the benefit reduction rules of the primary income transfer programs.

The AFDC program, for example, allows recipients with earnings to shelter \$90 per month for work expenses, as much as \$175 per child per month for child care expenses, and, for the first four months of work, \$30 plus an additional one-third of remaining earnings. This implies that the marginal tax rate on income that exceeds work and child care expenses (and the \$30 disregard) is  $66\frac{2}{3}$  percent for the first four months of work. After four consecutive months the implicit tax rate increases to 100 percent after work and child care expenses are considered.<sup>10</sup> In addition, the implicit marginal tax rate on countable income (which excludes 20 percent of earned income) from food stamps is 30 percent. Therefore, the marginal tax rate for a poor family receiving both AFDC and food stamps is at least 70 percent.<sup>11</sup> While effective tax rates may be lower than these statutory rates due to noncompliance and other factors, estimated effective marginal tax rates are still quite high (see, for example, Fraker, Moffitt, and Wolf [1985]). The high marginal tax rates imposed on welfare recipients—lowering the after-tax wage rate to a small fraction of the before-tax wage, which reflects social productivity—are only the most prominent of the efficiency distortions caused by the system.<sup>12</sup>

In addition to placing these high marginal tax rates on earnings, the transfer system makes it nearly impossible for recipients to legally accumulate the assets necessary to make a wide range of choices leading to independence—helping a child attend college, acquiring additional training, or moving away from a dangerous neighborhood.<sup>13</sup> While asset tests might help target benefits to the poorest members of society, they also make it extremely difficult for program recipients to acquire skills that may help them or their children avoid poverty in the future. As with high implicit tax rates

on labor earnings, asset tests distort the economic decisions of low-income households and hence reduce the efficiency of antipoverty policy.

A third problem with existing policy is that it is a patchwork: programs are designed to serve particular categories of people, and each program has a different eligibility standard. As a result, only if people fall into particular boxes—are poor, unmarried, and responsible for children; are poor and blind, or poor and unable to engage in "gainful activity" because of health reasons; or are working at paid employment, have children, and are the primary worker in the family—are they eligible for income support. The categorical nature of the system provides incentives for couples to split up or not to marry, for women to have children, and, in general, for poor people to adopt behaviors that in the absence of the program they would not choose. Whether people respond to these incentives in an economically significant way is a matter of intense research and debate, but the structure of incentives is clear.

A categorical antipoverty system will have gaps—cracks in the safety net through which people will fall. Perhaps the largest crack is the one through which working poor people fall. Of all of the available programs that exist to help poor people, families headed by someone who works full-time or nearly full-time are eligible for only food stamps and, if they have children, the EITC.<sup>14</sup> In addition to differences in support available to poor working and nonworking people, there are other forms of horizontal inequity. Because benefit levels and eligibility standards for major parts of the tax and transfer system are determined by state governments, equally poor people in different parts of the country are treated very differently. For example, in 1992, a mother with two children and with no earnings would have received a combined AFDC and food stamp benefit of \$4,944 per year in Mississippi; the same mother would have received benefits from these two programs of roughly \$10,000 if she had lived in Vermont or Connecticut (U.S. Congress, 1993, pp. 1251–1253). In addition

to creating inequity, such large interstate differentials in benefits provide incentives for poor households to make migration decisions they would not make otherwise.<sup>15</sup>

In sum, the system of cash and near-cash transfers causes reductions in work effort (that involve output losses that are valued by society more highly than the gains from the increased leisure), causes reductions in private savings (with associated reductions in economic productivity and growth in excess of the value of the increased consumption spending), and provides incentives for marital break-up, out-of-wedlock births, and migration decisions that are likely to entail social costs in excess of the benefits conveyed. In addition to these effects, there are other distortions that have been created, such as encouraging transfer recipients and taxpayers into activities outside of the regular economy, some of which—drug trafficking or failing to report earned income—are illegal.<sup>16</sup>

Our most fundamental critique of the structure of the existing tax and transfer system concerns the dysfunction between the basic purpose of the programs and society's current judgments regarding the nature of the poverty problem. At their core, existing tax and transfer programs seek to secure for the market-income poor a level of after-tax (disposable) income that exceeds some minimum standard. This is accomplished by offering direct cash payments, by directly providing goods judged to be basic essentials for living, and by insuring relief from fiscal burdens that other citizens face.

Yet when citizens today contemplate the poverty problem, they see something quite different than the simple need for income assistance. And the reasons for their perceptions are not difficult to understand. Over the thirty years since the current system was designed, U.S. society has witnessed enormous changes in economic performance and individual behavior, and as a result expectations have changed. With the rapid growth in female labor force participation, we now expect that able-bodied women with children should contribute to their own well-being through work. Similarly, with the growth in the coverage and generosity of Social Security benefits, we no longer view older people as a particularly disadvantaged group. And with the serious erosion in earnings opportunities for young and

less-educated workers, concerns with employment and training needs for low-skilled workers have replaced the focus on income support. In short, the poor population of thirty years ago—that for which the current system was designed—had a larger percentage of people who were regarded as "worthy" and who were not expected to work than it does today.

These changes in the composition of the poor population and in our expectations of them have created doubts regarding the wisdom of the income support approach. These concerns have been reinforced by what are perceived to be dysfunctional behaviors and choices of some of the poor. While these images may be colored by stereotypes and prejudice, it is clear that some of those in the bottom tail of the distribution today are there because of choices they have made—the choice to bear children out of wedlock as a teen, the choice not to complete high school, the decision to refuse minimum wage employment when it is available, the decision to abuse drugs and sell them, the willingness to run in gangs and to engage in crime and violence, often against other poor people. And while economic and social factors, urban schools, and the barriers created by racial prejudice may make these choices a rational response to the options available, it is also true that these outcomes are socially costly and destructive. The prevalence of these behaviors among today's poor relative to the poor two or three decades ago also tinges the nation's assessment of our current antipoverty strategy.

If this characterization is true, the questions so often asked today about the current tax and transfer system become much more reasonable: If transfer recipients are able to engage in work, why don't we require it as a condition of providing cash and in-kind assistance? If they are unable to break into regular jobs because of a lack of training (or a lack of child or health care support), why don't we make sure they get the training and the child and health care services while we give them cash? If they are having additional children that can be supported only by additional taxpayer assistance—or working "off the books," or drug dealing while they should be learning, or opting not to marry in order to sustain public payments and subsidies—why should we simply provide support without attempting to change

the behavior? Concerns like these are not addressed by the structure of the current income support system.

## IMPROVING TAX AND TRANSFER ANTIPOVERTY POLICIES: ENCOURAGING RESPONSIBILITY AND SELF-SUFFICIENCY

For all of the reasons we have outlined, reform of the nation's current tax-transfer antipoverty strategy is high on the nation's policy agenda. Especially at the state level, policymakers are discussing themes and programs like "Work, Not Welfare," "Ending Welfare as We Know it," "Learnfare," "Bridefare," "Workfare," "Time-Limits," and "Benefit Caps." And while the changes that are proposed are described as "reforms," and while some of them correct gaps and inefficient incentives in the current system, many reflect a harsh posture toward the poor that has not found its way into policy heretofore. Widespread adoption of them would send policy down a quite different road than the nation has followed until now.

While much of the experimentation in antipoverty policy in recent years has occurred at the state level (Wiseman, 1993), the Clinton administration has now taken center stage by proposing a national reform of welfare and antipoverty policy. Reports of their plans—both formal and informal—suggest a far-reaching change in the direction of policy.

### The Clinton Administration's Welfare Reform Plan: A Critique

The primary provisions of the Clinton administration's welfare reform proposal reflect the inadequacies of the current strategy, and directly respond to the general perception that our current tax and transfer redistribution strategy is not structured to help the poor achieve economic independence.

The administration's proposal expresses four broad themes. The first is to "make work pay."<sup>17</sup> Large steps have already been taken toward achieving this goal through the major expansion of the earned income tax credit that was part of the 1993 Omnibus Budget Reconciliation Act (OBRA93). By

1998 the program is projected to cost \$24.5 billion, \$7 billion of which is the result of the 1993 expansion. For taxpayers with incomes in the lower earnings range of the credit, the expanded EITC can be thought of as a well-targeted increase in the minimum wage, to \$5.95 per hour for families with two or more children (\$5.70 for one-child taxpayers), from \$4.25 an hour. The expanded credit will deliver benefits to more than six million working taxpayers with incomes below the poverty line, will close the poverty gap by \$6.4 billion, and will raise the incomes of over one million taxpayers to a level above the poverty line (see Scholz [1994]).<sup>18</sup>

The second theme is that parenting implies responsibility. Paternity will be established for children, absent parents will be sought, and mandatory payments in support of their children will be obtained through wage withholding. Such "child support enforcement" is not a new proposal, as it was a central part of the 1988 Family Support Act. Consistent with this theme, extensive efforts designed to reduce teen nonmarital childbearing—through moral suasion and grants for innovative prevention programs—have been planned.

The third theme recognizes that education and training are necessary if poor people are to become self-sufficient in today's economy. Therefore, income support recipients will be simultaneously assisted (indeed, required) to acquire training, education, and/or work experience; they will experience "workfare." In addition, support for child care will be expanded to facilitate participation in mandatory training programs and to ease the transition from welfare to work.

The fourth theme is that the receipt of welfare benefits (as distinct from the EITC) cannot go on indefinitely. Those subject to this provision (the youngest one-third of the five million current recipients—those born after 1972—and who are able to work) will be forced to operate in a world in which income support is a temporary and transitional "help," a mechanism designed to enable people to get their lives in sufficient order to live independently, relying on the returns from their own efforts. This is "time limited welfare"; it is often popularized as "two years and out." When the time limit for



support has been reached, recipients will be turned out to find their own way in the world of work, assisted by child care subsidies and, of course, health coverage as a part of the president's health care reform proposal; if they are unable to find work, the government will guarantee them a low-paying public service job (or subsidize the private sector for providing jobs).

How do these elements of the Clinton proposal fare, given our critique of current policy?

While each analyst may have his or her own assessment of the plan, we offer the following. Expansion of the EITC as part of the first theme is an extremely important, effective policy; it increases the return to work for taxpayers with children and does so in a coherent manner within the structure of the personal income tax.<sup>19</sup> Further changes to improve the advance payment option so that families can secure work-related income support throughout the year rather than at tax-filing time, and to lower incentives for noncompliance, would improve an already good initiative (see Yin, Scholz, Forman, and Mazur [forthcoming] for a discussion of these issues).

The next theme, increasing efforts to collect and assure child support and to routinize the collection system, are to be commended. Nevertheless, those who have studied this possibility and who are its biggest advocates suggest that no more than a marginal increment in available income support will accrue to most mothers now on welfare (Meyer, 1993; Meyer, Garfinkel, Oellerich, and Robins, 1992). The initiatives designed to heighten awareness of the costs of teen nonmarital childbearing are too vague and untested to enable a judgment one way or the other.

The third and fourth themes—involving time-limited welfare, training and education through workfare, child and health care assistance, and a guaranteed public service job—are, in our view, dangerous territory. While changing the rules and benefit structure of welfare programs to minimize the rewards available for dysfunctional behavior is one thing, the threat to cancel income support is quite another. Most current recipients lack the basic skills to work themselves out of poverty on their own, even if they were to work full-time, full-year at the wage rate that their education, experience, and

health characteristics would command (Haveman and Buron, 1993; Burtless, 1994). And it is but a dream that the sort of training and remedial education that will be offered through "workfare" will make these people job-ready and economically independent. Indeed, only the most successful of the intensive training programs targeted at welfare recipients have secured earnings increases of as much as \$1000 per year two years after the end of the program. While these programs may pass a benefit-cost test, they do not convey the sort of gains in wages necessary to escape poverty (Gueron and Pauly, 1991). Moreover, the total costs of operating a reasonable public service jobs program are sufficiently high—in the neighborhood of \$15,000 per worker per year<sup>20</sup>—that current budgetary constraints insure that the supply of slots would be far exceeded by the demand.

The limited funds available for welfare reform must cover additional training, education, child care, and public service employment. The monies available for the last of these—public service employment jobs—will determine how many job slots are available. The number of slots available, together with some estimate of the number of recipients encountering the two year limit and who will not be able to secure private sector jobs, will determine the number of recipients who will be made subject to the two year and out provision. And, this number will ultimately drive the level of exemptions that are ultimately granted.

A policy of time-limited welfare, combined with child care, education, and job guarantee measures, could run the gamut from being harsh and punitive to being merely rhetorical or, in the best of circumstances, it could offer an effective route to independence and self-sufficiency. The policy's success will depend both on how time limits are implemented, and especially on the funds that are available and how those funds are allocated.

If a rigid time-limited welfare program is actually put in place and enforced, the nation would be engaging in social measures that are more harsh than any that currently exist in western industrialized countries, and more harsh than we have ever before been willing to accept. And while

one might acknowledge the need for harsh treatment for some adults who have made welfare reciprocity a career, the hardships imposed on them fall also on the children for whom they care. In our view, the imposition and enforcement of a rigid time limit on welfare receipt would, by itself, be an overly simplistic answer to a problem whose solution requires extensive social service support for dysfunctional families, an overhaul of schools that are not educating poor children, community-based services to combat gangs and violence, and housing initiatives that ensure the poor are given the opportunity to live in clean and safe housing. Because the Clinton initiative precludes additional expenditures, time limits become a potentially dangerous and mean-spirited approach to the poverty problem.

If time-limits are enacted together with a wide variety of exemptions and opportunities for delaying or avoiding their enforcement—for example, exemptions for women with small children, or those who cannot locate adequate child care, or for whom no private or public job seems available, or those who are long-term recipients with few job skills—this aspect of the program could be merely rhetorical. The long history of enacting, but failing to impose, work requirements in welfare programs makes this a real possibility, especially in the absence of funding to support the education, training, and job guarantee measures.

Indeed, the promise of time-limited reciprocity can be realized only if the training, employment, and child care support on which terminated recipients will depend provides the means for attaining independence and self-sufficiency. The effectiveness of the measures depends on the structure of and the financial support for these work-enabling programs.

#### Some Alternative Proposals: Strengthening the Low-Wage Labor Market<sup>21</sup>

The Clinton proposals get high marks for increasing the value of work through the expansion of the EITC and for realigning aspects of antipoverty programs with society's current judgments regarding the nature of the poverty problem. However, the plan fails to address the damper that the nation's

private sector labor market places on the opportunity for self-sufficiency of the nation's low-skilled, low-educated workers. In particular, the Clinton program presumes that there is either strong excess demand for low-skilled labor, or a very high wage elasticity of demand. Neither presumption seems warranted. In addition, the reforms fail to help low-skilled individuals and couples without children; their exclusion is horizontally inequitable and reduces the antipoverty effectiveness of the measures.

In our view, unless the operation of the bottom end of the labor market is changed or supplemented, no plan designed to substitute work for public income support can be effective in achieving economic independence for the nation's large and growing pool of low-wage, low-skilled workers. While the expanded EITC moves in the right direction, we offer a few additional suggestions aimed at increasing the flexibility and performance of the low-wage end of the labor market by offsetting a variety of constraints and rigidities with which it is now burdened.

The labor market problem that confronts disadvantaged workers is primarily a structural employment problem; joblessness for certain groups exists in spite of near full employment in the rest of the economy (Haveman and Buron, 1994). The most basic reason for this is the inherent lack of skills and education possessed by millions of low-wage, often inexperienced, potential workers. Hiring them often fails to generate additional profit for employers. This is compounded by the distortionary effects of the combination of minimum wage laws, union wage contracts, and the fringe benefits and payroll taxes that businesses are required to pay for every worker. These constraints contribute to the labor market disadvantage of the low-skilled.

A policy initiative to address this problem could be modeled on a modest effort that was in effect in 1977–78, known as the New Jobs Tax Credit (NJTC). The NJTC provided a tax credit equal to 50 percent of the first \$6,000 of wages paid to the fifty workers hired in a firm above 102 percent of the previous year's employment level.<sup>22</sup> Because the subsidy (\$3,000) was a higher percentage of total wages for less-skilled workers than for those with more education or experience, the incentive for

private employers to bend hiring decisions toward them was substantial.<sup>23</sup> Although the NJTC was never enthusiastically embraced by the Treasury Department (which administered it but never publicized it), research evaluations indicate that it was successful in creating jobs for low-skilled workers, and at a rather low cost to the Treasury—up to 30 percent of the 1977–78 employment growth in the studied industries was attributable to the program (Bishop and Haveman, 1979; Perloff and Wachter, 1979).<sup>24</sup>

In reinstating the NJTC, the new program should be made permanent, so that low-skilled labor is not merely "on sale" for a temporary period. The government should enthusiastically support the plan, publicize it widely, and work with the business community to minimize misunderstandings and bureaucratic difficulties. The earlier program parameters could be modified so as to increase the hiring incentive by increasing the amount of subsidy that is paid on the wage base. In addition, the cap on the subsidy available to any single firm could be removed so that the marginal employment decisions of large firms are subsidized to the same extent as those of small firms. Finally, the wage basis on which the subsidy is paid could be changed so as to increase the marginal incentive for hiring low-wage workers.

If additional steps were needed to employ low-income workers, the employer-based NJTC could be supplemented by an employee-based subsidy program that would complement the expanded EITC by directly "making work pay." In this plan, a target wage rate (say, \$10 per hour) would be set, and any worker taking a job at less than this level (say, \$6) would be subsidized at, say, 50 percent of the difference between the actual wage of \$6 and the \$10 target wage. In this example, the take-home wage would be \$8—the \$6 wage plus the \$2 subsidy. The effect of the subsidy would be to give a low-wage worker a labor market advantage, and hence an incentive to seek work; it is a program oriented to the supply side of the labor market for low-skilled workers.<sup>25</sup> At the same time, employers—given the NJTC—would have an incentive to seek out low-skilled workers and to favor them in hiring decisions.

In this program, as opposed to other employee-based subsidy programs, firms would not have to significantly alter their personnel practices, and particular categories of workers would not need to be identified and targeted for assistance. As in all proposals designed to change the operation of markets, however, concerns would arise. One oft-raised issue involves the possibility of employer-employee collusion, where employers would declare a lower wage rate than in fact is true, secure the subsidy, and then share the falsely generated subsidy with the employee. The overall effect of the supply response to the subsidy on the overall level of the market wage for low-skilled workers would also have to be assessed. Finally, the integration of the wage rate subsidy and the EITC would have to be considered, though the straightforward solution would be to count the EITC subsidy as realized earnings. The effect of these two programs would create a formidable "make work pay" combination and blunt the disincentive created by the claw-back portion of the EITC (see endnote 18).

The combination of this pair of employment incentives would improve the operation of the low-skilled labor market by generating ongoing demand and supply-side pressure for the creation of jobs for marginal workers at reasonable cost. As such, it would equalize employment opportunities. By targeting the additional employment on underutilized segments of the labor market, national income could be increased without significant inflationary pressure. The combination will fundamentally alter the wage structure in private labor markets, raising the take-home pay of low-skilled workers relative to those with more secure positions in the labor market. The cost of an employment subsidy arrangement such as this would be substantially lower than providing equivalent jobs through public service employment, which is one possibility that has been considered by the Clinton administration.

#### Some Alternative Proposals: Capital Accounts for Young People and Poor Families

A general concern with existing tax and transfer policy as it applies to the low-income population is that it forces individuals to spend or never accumulate assets to secure income support, and then eliminates the possibility of accumulating assets—even limited amounts of them—in order to

retain benefits.<sup>26</sup> These provisions erode still further the hopes and aspirations of those with few of these to begin with, and thereby stifle drive and initiative.

Recent proposals for encouraging savings—or, indeed, assigning assets—would address this problem. Haveman (1988), for example, suggests establishing a universal capital account of, say, \$20,000 that would be assigned to all youths at age eighteen who have graduated high school, which could be used to support human capital investments of their choice. Youths possessing such an account will have the incentive to shop for and choose the activity they judge will best serve their needs.<sup>27</sup> They could draw on this account at any time for purchases of education and medical care services from approved programs, as well as for some related living expenses, and an annual statement of the value of the account would be sent to each youth. Such an account, constrained by standards established for screening and approving proposed education and health care expenditures, increases the range of choices available to poor youths. It grants individuals the dignity of more freely planning their own lives, rather than being induced into certain activities through the incentives of existing institutionally based and paternalistic subsidy schemes.<sup>28</sup>

A less far-reaching variant also envisions the establishment of capital accounts for low-income families. Contributions to these accounts would be supplemented at some rate by matching contributions by the government.<sup>29</sup> The accumulated sums in these accounts could, after some period, be drawn upon for approved purposes that might involve the purchase of a home, the starting up of a small enterprise, or the support of education for a child. As with the capital account for youths, the objective is to create a stake in the future for those who now have little stake, and to enable them to use their resources for purposes that will enable independence and self-sufficiency.

## CONCLUSIONS

The inherent tension among the primary goals of antipoverty tax and transfer policy—providing a generous or humane level of benefits, having benefits that are well targeted, and maintaining desirable economic incentives (particularly low marginal tax rates)—makes it clear why welfare is so hard to reform. However, even if welfare is reformed, the problem of poverty goes well beyond these concerns. Any plan that simply improves the nation's tax-transfer system would leave untouched the problems of elementary and secondary education, crime, violence, and family disintegration that characterize poor communities, particularly those in our large cities.

There are positive attributes to the Clinton administration's welfare reform proposal. The expanded EITC makes work a more attractive option for millions of low-wage workers with children. Education and training may improve the labor market prospects of some workers, and the "tough love" components of the proposal may discourage unwanted behavior. At the same time, the proposal embarks on untested territory with the potential for treatment of disadvantaged people that many view as short-sighted and punitive. Even more important, the Clinton proposals are not likely to reduce poverty in America, primarily because of the constrained budgetary resources that have been allocated to them. While welfare as we know it may end, poverty as we know it will not.

Our proposals, designed to strengthen demand for low-income workers and to provide an opportunity for low-income workers to accumulate resources, are also not a panacea. It is difficult to efficiently alter markets to benefit low-income households, and it is costly to establish "capital accounts" for poor teenagers or subsidize the savings of low-income households. Nevertheless, labor market opportunities are bleak for youths and adults with low levels of education, and asset tests stifle opportunity. While our suggestions address these problems, they imply a quite different reform strategy than that which the Clinton administration has set before us.





### Endnotes

<sup>1</sup>In addition, there are a number of other proposed initiatives, including efforts to reduce teen nonmarital births and to better integrate AFDC and food stamp benefits.

<sup>2</sup>The poverty line is defined by the Census Bureau as a fixed real income that is sufficient to provide a minimally adequate standard of living (the poverty line for selected years and family types is given in Table 3). The Census money-income concept, which includes AFDC and Supplemental Security Income (SSI), but not the earned income tax credit (EITC) or in-kind transfers in the form of Medicaid, food stamps, and housing benefits, is typically used to assess poverty. The Census Bureau also publishes information on the size of the poverty population since 1979 using alternative definitions of income. In 1991, for example, 35.7 million persons were in poverty using the common Census money-income definition of poverty. If the income concept is broadened to include noncash transfers, taxes, and the net imputed return on equity in own home, the number falls by 27.9 percent, to 25.8 million people (U.S. Bureau of the Census, 1993a).

<sup>3</sup>U.S. Bureau of the Census (1993b), Table 735, and U.S. Congress, House of Representatives (1993), p. 1313.

<sup>4</sup>Historically, AFDC has been directed at single-parent households with children, though in recent years the program has served two-parent families in which one of the parents is unemployed.

<sup>5</sup>The food stamp program was implemented for the first time on a uniform national basis in fiscal year 1975, though uniform national standards for the program were established in 1972.

<sup>6</sup>If the official definition of poverty given in Table 1 is used, cash transfers removed from poverty about 19 million pretax and pretransfer poor in 1991. These calculations ignore all behavioral responses to the benefit programs.

<sup>7</sup>The poverty gap measures the amount of income that would need to be transferred to the poor to lift every household's income to the poverty line (again, assuming there are no behavioral responses to the

transfers).

<sup>8</sup>These estimates include the effects of in-kind transfers and tax provisions excluded from the definition of official poverty (Table 1). Using the official poverty definition, the comparable figures would be 39 percent in 1979 and 34 percent in 1990.

<sup>9</sup>As shown in Table 2, the income decline for women with different levels of educational attainment has not been nearly as dramatic. The figures in Table 2 are also consistent with Blank (1994, Table 2), who shows that average weekly earnings for nonelderly adult men with less than a high school degree fell 18.3 percent between 1969 and 1989, while the wages for women with the same educational attainment were constant over the period. Over this period, women's labor force participation increased sharply.

<sup>10</sup>The AFDC recipient can still deduct \$30 for eight more months.

<sup>11</sup>The interaction of AFDC and food stamp implicit marginal tax rates is complicated. A person receiving benefits from both programs and who has earned income exceeding the AFDC disregards would face a  $66\frac{2}{3}$  percent marginal tax rate on AFDC. From the perspective of the food stamp program, earned income increases by 80 cents for every dollar of earnings (there is a 20 percent disregard for earnings), but unearned income would have fallen by  $66\frac{2}{3}$  cents for every dollar of earnings (the reduction in AFDC benefits). The net of these amounts,  $13\frac{1}{3}$ , is the increase in food stamp "countable income" for every dollar of earnings, and is taxed at a 30 percent rate, which implies an additional 4 percent marginal tax rate. Thus, the marginal tax rate on earnings in the first four months of working is  $70\frac{2}{3}$ ; after four months it is 94 percent.

<sup>12</sup>Browning and Johnson (1984), Ballard (1988), and Triest (1993) examine the effects of expanding the tax and transfer system to transfer more from the rich to the poor. Considering labor supply effects and deadweight losses, Browning and Johnson concluded that upper-income groups bearing the costs of taxes would sacrifice \$350 for every \$100 that the poor gained. Subsequent work has strongly

contested the Browning and Johnson estimates. Ballard, in a well-specified numerical general equilibrium model, calculates that when taxes are raised on only those in the highest portion of the income distribution and transfers are received by only those in the bottom, it would cost \$114 to transfer \$100. Triest estimates the efficiency costs of expanding a program like the EITC, and finds that the cost of redistributing \$100 would range from \$116 to \$144 under his central parameter estimates.

<sup>13</sup>For example, a family receiving food stamps cannot have financial assets exceeding \$2,000 (\$3,000 if the family unit has a member older than fifty-nine), and cannot own assets and a car whose combined market value exceeds \$6,500. A family receiving AFDC cannot have more than \$1,000 of financial assets. In a well-publicized case, Cecelia Mercado was ordered by the Connecticut Supreme Court to repay \$9,342.75 in AFDC payments because her daughter, without her knowledge, had taken a part-time job and, in a year and a half, had saved almost \$5,000 toward attending college. To become recertified to receive AFDC, the daughter and her brother (who had saved nearly \$1,000) had to spend their savings until the household's assets fell below the \$1,000 asset limit (William Raspberry, *Atlanta Journal and Constitution*, 8/21/92, p. A10).

<sup>14</sup>Beginning in 1994, the EITC for the first time included a small (maximum of \$306) credit for childless taxpayers.

<sup>15</sup>Walker (1994), however, finds little empirical evidence that welfare benefits have a significant effect on the location decisions of low-income households.

<sup>16</sup>Moffitt (1992) surveys evidence on many of these topics. Also see Jencks and Edin (1990) for a fascinating study of the income sources and expenditures of a small group of AFDC recipients.

<sup>17</sup>This phrase was popularized by Ellwood (1988), who used it to refer to a set of policies that he argued would make work more attractive than welfare.

<sup>18</sup>Except for the EITC, the federal tax system plays a relatively minor role in antipoverty policy.

Because the income tax is uniform across the nation, relying more heavily on the EITC within the income tax would reduce one important source of horizontal inequity. As currently configured, however, the EITC is not available to working poor individuals and couples without children (except for the modest childless taxpayer credit). Yet, there are problems with relying more heavily on the tax system to fight poverty. Many poor persons, particularly those without earnings, do not file returns. In addition, it seems unlikely that the Internal Revenue Service is equipped to do the sort of outreach necessary to raise participation rates to acceptable levels, particularly toward those families with a weak attachment to the labor market. Moreover, the fact that fewer than .5 percent of EITC recipients receive payments as an incremental benefit throughout the year (U.S. General Accounting Office, 1992) raises the question of whether the IRS could successfully administer a system that requires periodic payments. Finally, given the extensive number of other in-kind and cash support programs, the IRS would necessarily become more involved with other government agencies in a variety of complex program integration issues.

<sup>19</sup>For taxpayers with two or more children and income in the phaseout range of the credit (which starts at \$11,000 in 1994 dollars), the EITC will claw back benefits at the rate of 21.06 cents for every dollar of earnings (the rate is 15.98 for taxpayers with one child) after it is fully phased in in 1996. While estimates vary widely, it is clear that these tax rates will reduce, to some degree, the labor supply of taxpayers in the phaseout range of the credit.

<sup>20</sup>Haveman (1980) cites a 1979 estimate of \$9,000 per job per year, which in current dollars exceeds \$15,000.

<sup>21</sup>A more extensive discussion of the policies discussed in this section is given in Haveman (1988).

<sup>22</sup>Presumably the threshold for incremental hiring could be set at a level that reflects the macroeconomic performance of the country or region, rather than using the 102 percent criterion.

<sup>23</sup>The NJTC differs in important respects from the Targeted Jobs Tax Credit (TJTC), which the

Clinton administration proposes to eliminate. The TJTC focuses on individual workers, who must be certified by the state employment office that they are a member of a disadvantaged group. If an employer hires a certified worker, the employer must complete a lot of paperwork to receive a subsidy. Hence, employer participation has been low. Certification of workers has appeared, in some instances, to stigmatize workers, making it harder for them to secure employment.

<sup>24</sup>Bishop and Haveman (1979) found that the NJTC would be paid on nearly 1 percent of the U.S. labor force at a cost of roughly \$2 billion. The evaluations of the program did not provide estimates of program costs per job created.

<sup>25</sup>The wage subsidy would tend to reduce the market wage rate of low-skilled workers by encouraging an increase in their labor supply. If this occurred, part of the benefit of the subsidy would accrue to employers. However, the minimum wage will lessen the erosion of market wages for the affected workers.

<sup>26</sup>Of course, there may be noncompliance with the statutory asset tests. We cannot assess the importance of noncompliance with asset tests, and we are not aware of any work that does.

<sup>27</sup>Hoff and Lyon (1994) discuss situations where targeted grants to low-wealth groups can increase overall economic efficiency by reducing agency costs that inhibit acquisition of human capital.

<sup>28</sup>Haveman (1988) estimates that the net budgetary cost of the individual capital account would be about \$10 to \$15 billion in the first years of the plan, rising to around \$20 to \$25 billion after a period of five to ten years.

<sup>29</sup>The government subsidizes contributions to IRA, 401(k), and Keogh plans for higher-income taxpayers by allowing contributions to be deducted from taxable income and by allowing interest to accumulate in the accounts tax free. These subsidies are not worthwhile for families with incomes below the poverty line because they generally have a marginal tax rate of zero. Individual capital accounts would broaden access to subsidized savings. Sherraden (1991) discusses saving-incentive

schemes for low-income households. The administration's plan does incorporate increased opportunities for welfare recipients to accumulate limited savings for specific purposes, blunting the adverse effects of existing asset tests.

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