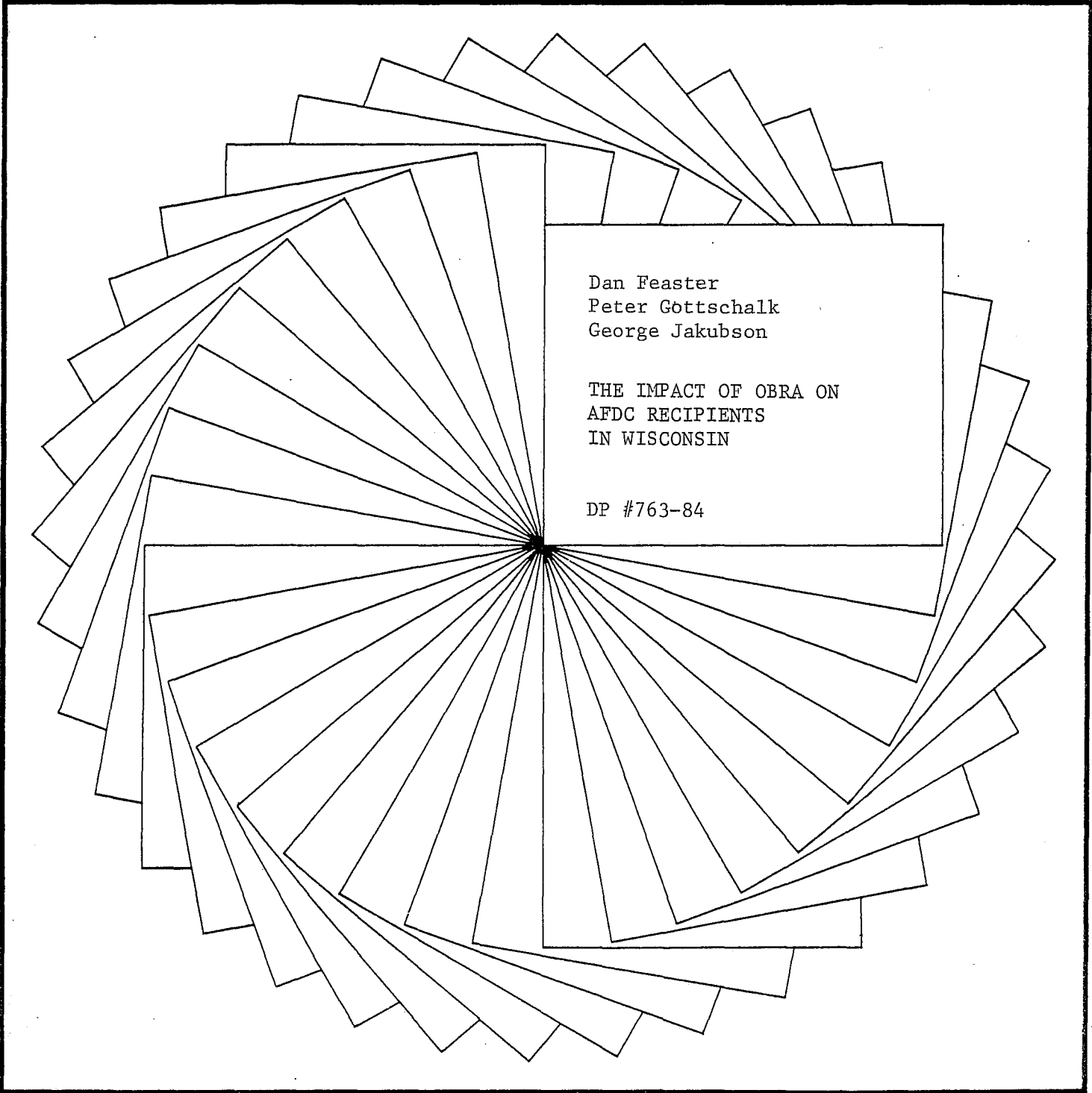

IRP Discussion Papers



Dan Feaster
Peter Gottschalk
George Jakubson

THE IMPACT OF OBRA ON
AFDC RECIPIENTS
IN WISCONSIN

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Institute for Research on Poverty
Discussion Paper 763-84

The Impact of OBRA on AFDC Recipients
in Wisconsin

Dan Feaster
Graduate Student, Department of Economics
University of Wisconsin-Madison

Peter Gottschalk
Project Associate
Institute for Research on Poverty

George Jakubson
Assistant Professor
Department of Economics
Cornell University

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ABSTRACT

Two panels of Wisconsin AFDC recipients are used to measure the impact of OBRA on (1) the duration of AFDC spells, (2) the probability that nonworking AFDC recipients either start working or leave the program, and (3) that working recipients would leave the program, or continue to work while on welfare, or quit working while on welfare. The first panel covers a period prior to OBRA. It serves as a control group against which to compare the second panel, which spans the OBRA change. The study shows that for working AFDC recipients, OBRA increased the probability of staying on AFDC, lowered the probability of recidivism, and lowered the probability of continuing to work among those who stayed on the program. The impact of OBRA on nonworking recipients was much smaller.

The Impact of OBRA on AFDC Recipients in Wisconsin

The Omnibus Budget Reconciliation Act (OBRA), enacted in October 1981, instituted the following major changes in AFDC:

1. After receiving earned income for four months, a recipient would no longer be eligible for the thirty-and-a-third income disregard.
2. Gross, rather than net, income would be used to calculate the thirty-and-a-third disregard during the first four months.
3. Eligibility would be limited to families with incomes below 150 percent of the state's standard of need.
4. Stricter asset limits were put in force.
5. Work expenses were standardized and reduced.
6. Stepparents' income would be counted in determining benefits.

Conceptual Impact of OBRA

These rule changes had two conceptually different effects. First, some recipients became immediately ineligible for AFDC. Mechanical changes, such as lowering the break-even to 150 percent of the state's standard of need, automatically reduced the caseload and the duration of welfare spells for people who were on the program when OBRA was implemented. These changes were not brought about by decisions of recipients.

Second, some of these changes may have led to behavioral responses-- those resulting from decisions made by AFDC recipients. For example, eliminating the thirty-and-a-third disregard imposes a 100 percent benefit reduction rate on earnings and lowers the break-even. This may lead to a change in the number of hours worked. The direction of the change is, however, ambiguous, because some recipients will find that they are

better off if they reduce their work hours to zero while others will find that their best option is to increase work hours sufficiently to work their way off the program.¹ The observed change reflects both the mechanical and behavioral responses to OBRA.

Special Focus of This Study

Previous studies have tended to pay little attention to AFDC cases with little or no earnings. Since most of the rule changes did not immediately affect these cases--they did not face thirty-and-a-third or have incomes above 150 percent of the standard of need--it was assumed that OBRA had little impact on them. While it is true that the mechanical impact of OBRA on this group is small, it is possible that OBRA did cause behavioral responses.

A potential behavioral response is suggested by one commonly held view of welfare reciprocity. Suppose that a woman enters the program and is totally dependent on AFDC while "putting her life together." She then starts to work on a part-time basis before being able to become self-sufficient. If this is a typical pattern, then OBRA may have raised long-term welfare dependency by making part-time work financially unattractive. The institution of a 100 percent marginal tax rate on AFDC after working four months may have significantly reduced the probability that a recipient would start working her way off the program. Previous studies which have only looked at women with prior work experience have overlooked this potential impact of OBRA.

Question Posed

Our study asks two questions. The first concerns duration of AFDC spells. Did OBRA have a different impact on the duration of AFDC spells among those recipients with prior work experience than among recipients with little or no work experience? The second question focuses on the difference in experiences for nonworkers before and after OBRA. Did OBRA change the probability of making the transition from being totally dependent on AFDC to being at least partially self-supporting--by either working while receiving AFDC or leaving the program and not returning?

Limitations of the Study

Two important limitations of this study should be kept in mind. First, it focuses only on the recipient population. It does not address the related and important question of whether the OBRA changes altered the probability of entering AFDC. Second, we cannot separate the impact of OBRA from other factors which occurred simultaneously. Most important is the fact that we cannot separate its effect from that of the rise in unemployment rates that took place in the same period. With only limited time series data on a panel of AFDC recipients, it is impossible to differentiate the induced changes in labor supply from the effects of decreased labor demand caused by the simultaneous recession.

Our report is in four parts. The first describes the data base and the basic concept used in the rest of the report. The second describes the differences in the impact of OBRA on the probability that working and nonworking AFDC recipients would leave the program. The last section compares the experiences of nonworking recipients before and after OBRA.

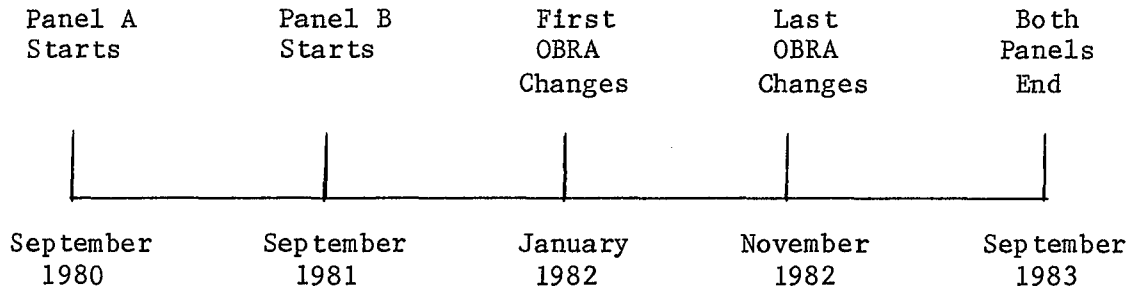
DATA AND METHODOLOGY

We use two panels of AFDC recipients in the State of Wisconsin to measure the impact of OBRA. Chart 1 shows the dates covered by the two panels. The first panel (Panel A) can be used as a pseudo-control group by following recipients only in the pre-OBRA period, September 1980 to December 1981. The second panel (Panel B), can be followed from September 1981 to December 1982, which includes the OBRA changes. By using data on Panels A and B each for equal periods of time, we control for changes in sample composition as recipients leave the sample--i.e., with a single panel it would not be possible to separate the impact of OBRA from the impact of changes in sample composition, since recipients with sufficiently long spells to experience OBRA's effects might have been less willing or able to work than the recipients who left the program prior to OBRA. Any decrease in work effort could be attributed to changes in composition of the sample rather than to OBRA.

Both panels are drawn from 2 percent random samples of Wisconsin AFDC cases in September 1980 and September 1981. The data come from administrative records compiled by the Computer Reporting Network (CRN), used by the State of Wisconsin to monitor the caseload monthly. Both panels contain cases which include only AFDC-R recipients, aged 18 to 65 in the first month of each panel, having the same household head each month. Panel A contains 1,038 recipients; Panel B contains 1,146 recipients.

For each recipient we calculate the duration of the spell which was in progress at the start of the panel. Since information is available on the beginning date of the spell, our measure of duration does not suffer from left censoring (i.e., not knowing the beginning data). However,

Chart 1



some spells are censored on the right (i.e., we do not know how long those still on the rolls at the end of the panel duration continue to remain recipients).

It should be noted that our sample consists of cases which had a spell in progress, rather than case openings. It is well known that this results in "length-bias sampling," since long-term AFDC recipients are more likely to enter our panel than short-term recipients. However, the assumption of a functional form allows us to correct for this bias when we estimate parametric models.

Table 1 presents the mean demographic characteristics of the two panels. Cases are classified according to whether the recipient worked prior to OBRA or after OBRA. "Pre-work" is defined as working anytime during a three-month period prior to OBRA (November 1981 to December 1981). "Post-work" is defined as working anytime during the three-month post-OBRA period (May 1982 to July 1982). Looking across the columns in Table 1 shows that the two panels are very similar. Forty percent of each panel are nonwhite. Roughly a third of each panel worked either before or after OBRA.

IMPACT OF OBRA ON DURATION

OBRA and Unemployment Effects

Table 2 shows the monthly calendar of the key OBRA changes and the unemployment rate in each month. OBRA was passed in August 1981. Implementation started in January 1982. The last major change (monthly reporting) took place in November 1982.

Table 1
 Means of Demographic Variables for
 Recipients in Panels A and B

	Panel A N = 1038	Panel B N = 1146
<u>Totals</u>		
Age	28.7	28.8
Nonwhite	41%	40%
<u>Pre-work^a</u>		
Yes	33%	30%
Age	30.8	31.2
Nonwhite	26%	30%
No	67%	70%
Age	27.6	27.8
Nonwhite	49%	45%
<u>Post-work^b</u>		
Yes	30%	69%
Age	30.7	27.9
Nonwhite	28%	47%
No	70%	69%
Age	27.8	27.9
Nonwhite	46%	47%

^aPre-work defined as yes if worked in either 10/81, 11/81 or 12/81.

^bPost-work defined as yes if worked in either 5/82, 6/82, or 7/82.

Table 2

Timetable of OBRA Changes and Unemployment Rates

(1)	Timetable of OBRA Changes (2)	U.S. Employment Rate Among Women Aged 20-24 (3)
Aug. 1981	OBRA passed	11.1%
Oct. 1981	OBRA goes into effect--4 month limit for 30-and-1/3 rule goes into effect	11.5
Jan. 1982	Assets, work expenses, net versus gross income calculation, 150 percent rule, day care maximum all become effective	12.0
Feb. 1982	For cases working in October 1981, 100 percent marginal tax rate becomes effective	11.9
Apr. 1982	Stepparent income counted	13.3
Nov. 1982	Monthly reporting instituted	14.6

Column 3 shows that over the same period unemployment rates among women 20 to 24 years old rose from 11.1 percent to 14.6 percent. This points to the inherent difficulty of separating OBRA's effects from cyclical effects. If welfare dependence increased, it would be difficult to attribute the rise solely to either factor. The converse is, however, not true. If dependence decreased, then the combined mechanical and behavioral impacts of OBRA were sufficiently strong to overcome the cyclical effects tending to increase dependence.

Transition Probabilities

Table 3 shows the number of people in Panels A and B who were no longer on welfare one year after the panels began. It also shows how many were on welfare and working and on welfare and not working after one year. All of these numbers are cross-classified by work status in the first month of the panel. These proportions can be loosely interpreted as transition probabilities. No attempt has been made, however, to ensure that the recipients remained in the original state for the full year. Another important point is that OBRA was phased in over this year (for Panel B), so the observed transition in Panel B is a mixture of pre- and post-OBRA effects. Even with these reservations, the comparison is still interesting and informative. For nonworkers, the proportion on welfare and not working remained relatively constant, at about 77 percent. The proportion leaving AFDC increased from 11.8 percent to 16.1 percent, and the proportion on AFDC and working decreased from 10.5 percent to 6.8 percent. This decrease clearly indicates that OBRA had an effect on AFDC recipients, lowering the probability that they would work. Whether the effect is behavioral or mechanical, however, is not clear,

Table 3

Work and Welfare Transitions in
Panels A and B after One Year

	<u>Nonworkers at Beginning</u>		<u>Workers at Beginning</u>	
	<u>Panel A</u> (pre-OBRA)	<u>Panel B</u> (during OBRA)	<u>Panel A</u> (pre-OBRA)	<u>Panel B</u> (during OBRA)
Number at beginning of year	746	813	278	290
Off rolls after one year	88 (11.8%)	131 (16.1%)*	38 (13.7%)	130 (44.8%)*
On rolls and working after one year	78 (10.5)	55 (6.8)*	171 (61.5)	90 (31.0)*
On rolls and not working after one year	580 (77.7)	627 (77.1)	69 (24.8)	70 (24.1)

*Proportion of Panel B is significantly different from proportion in Panel A at the .05 level.

since the asset limit and stepparent income provisions could have been responsible for this change. For workers, the proportion still on welfare and working one year later fell from 61.5 percent to 31 percent, and the proportion of those leaving AFDC increased from 13.7 percent to 44.8 percent among the two panels. These changes are consistent with the mechanical implementation of OBRA. Surprisingly, the proportion remaining on welfare but leaving their jobs (to maintain eligibility) remained constant, at about 24 percent.

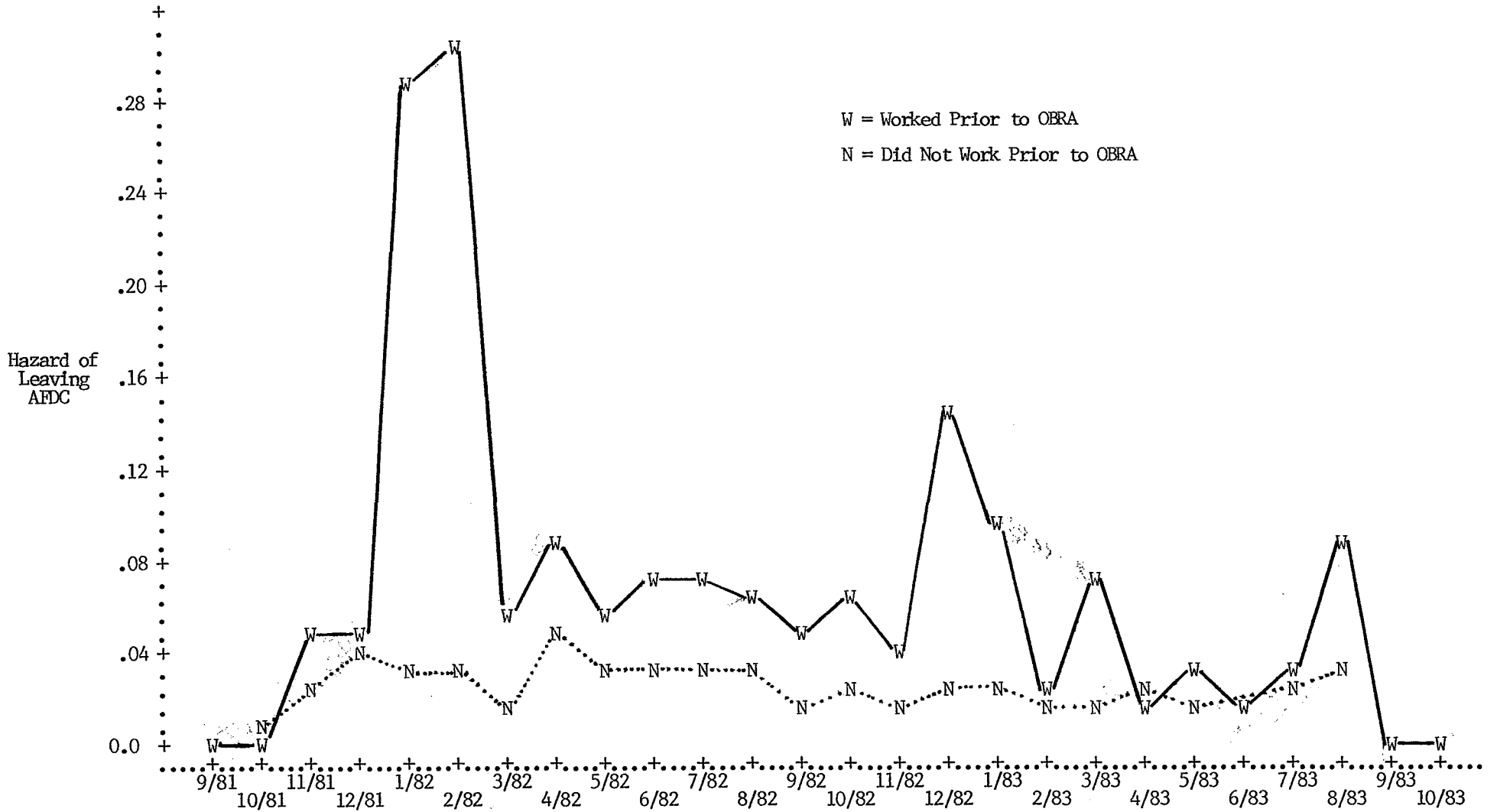
Hazards and Calendar Time

Chart 2 shows the proportion of people on the welfare rolls who had left welfare by the following month. This transition rate is termed the "hazard" of leaving welfare. This hazard rate is shown for recipients classified according to their pre-OBRA work experience. For example, in Panel B, 28 percent of those receiving welfare and working in December 1981 were no longer receiving welfare in January 1982. The sharp spike in January 1982 and the smaller spike in November 1982, for recipients who were previously working, dramatically shows the mechanical impact of OBRA. Those not working prior to OBRA show a much smaller increase in the hazard of leaving welfare, since few were affected mechanically by the OBRA changes.

Survival Probabilities

An alternative method of showing the impact of OBRA is to calculate the cumulative proportion "surviving"--i.e., remaining on the rolls--using Panel A for the 15-month period prior to OBRA and Panel B for the

Chart 2
 Hazard of Leaving AFDC
 by Calendar Time



15-month period spanning OBRA. (Spells lasting beyond December 1981 in Panel A and December 1982 in Panel B are treated as censored.)

Chart 3 shows the cumulative proportion surviving in Panels A and B for recipients classified by their pre-OBRA work experience. The length of spells is shown on the horizontal axis and the proportion of spells lasting at least that long is shown on the vertical axis. Both groups show lower survival probabilities in Panel B than in Panel A. However, it is again the recipients with prior work experience who show the largest drop in AFDC participation.

Average Duration

Table 4 shows the average number of months that recipients remained on the program during each of the first 15 months of each panel. Recipients are broken down by race and whether or not they worked in the pre-OBRA period. For all groups there was a drop in the number of months that recipients stayed on AFDC after the panels began. Again, workers experienced larger decreases than nonworkers. The largest drop was experienced by white recipients who worked prior to OBRA. Their average number of months of reciprocity dropped from 12.6 to 9.1 over the 15-month period. The smallest drop was for nonwhite nonworking recipients, who, on average, stayed on the program for 13.1 of the 15 months prior to OBRA and remained on the program for 12.8 of the 15 months after OBRA.

These descriptive statistics confirm the conclusion of previous studies that the net effect of OBRA was to reduce, not lengthen, the average duration of AFDC receipt among working AFDC recipients. Our study shows that this is also true for nonworkers. The mechanical

Chart 3

Cumulative Proportion Surviving

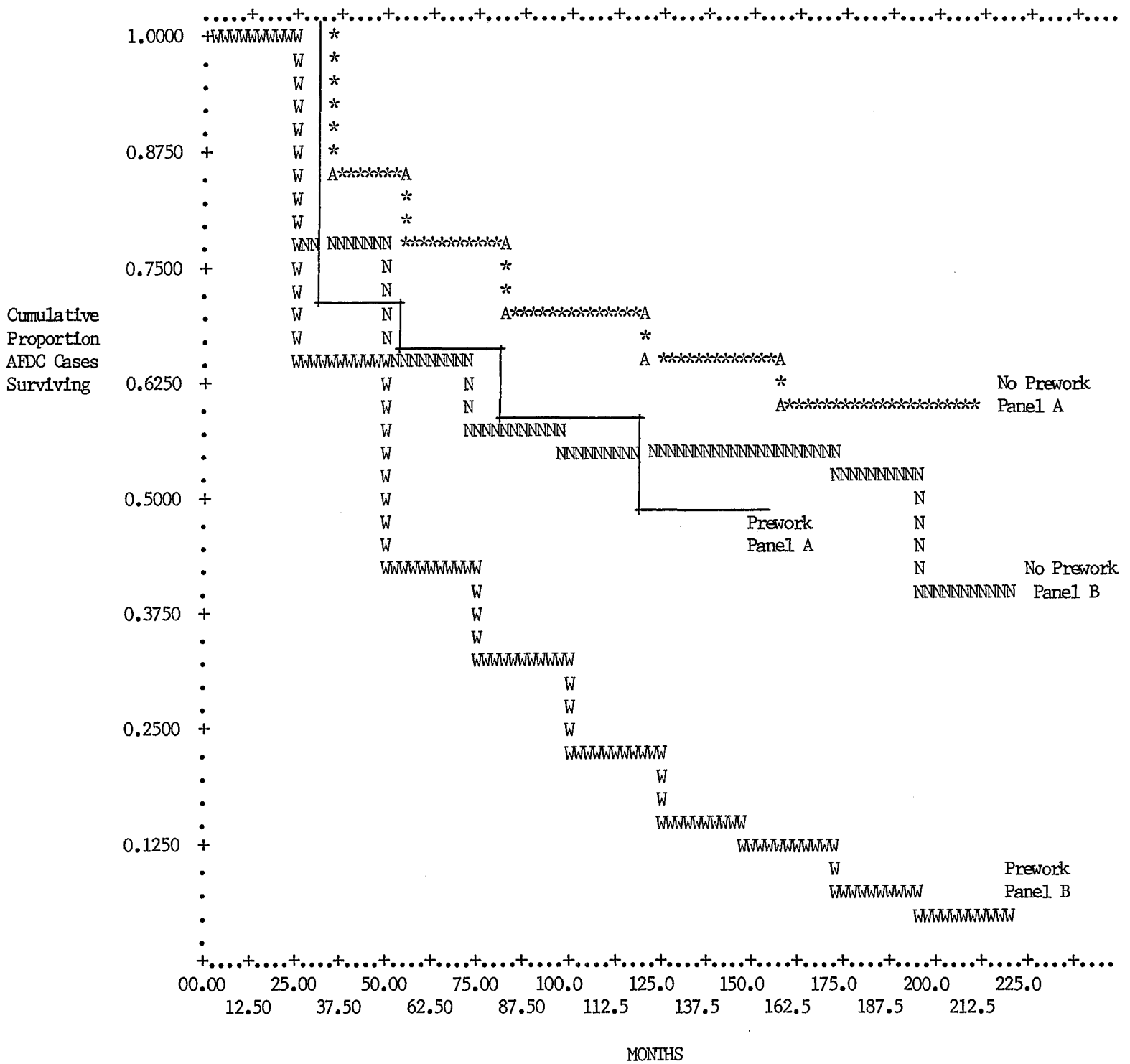


Table 4

Average Number of Months Receiving Welfare from
September 1980 to January 1982 for Panel A and
September 1981 to January 1983 for Panel B^a

	Panel A	Panel B
<u>Worked before OBRA</u>		
White	12.6	9.1
Nonwhite	12.7	10.6
<u>Did not work before OBRA</u>		
White	12.6	12.0
Nonwhite	13.1	12.8

^aMaximum number of months for each panel is 15.

changes in the program, which should reduce duration, were either accompanied by behavioral responses which shortened duration or were sufficiently large to overcome any behavioral response which tended to lengthen duration.

Parametric Models

In future work we will turn to a parametric model of welfare duration in order to see whether the length of spells increased after the mechanical effects played out. These models impose structure on the data by assuming that the hazard rate follows a particular functional form. We will use a cubic function which allows the hazard to change in a flexible way with duration. In order to try to isolate the behavioral response to OBRA, we will use two dummy variables to capture the mechanical impact of OBRA--the first capturing effects of the major rule changes between January and April 1982, the second capturing effects of monthly reporting, instituted in November 1982. The third dummy variable will take a value of one after November 1982. It should capture behavioral changes that are less contaminated by administrative case closings. Equations will be estimated separately for workers and nonworkers.

These estimated models have several advantages over the tabulated evidence presented thus far. First, we can control for personal characteristics. Second, the evidence presented in this study suffers from length-bias sampling--cases with long durations are overrepresented in the sample. We can correct for this by adjusting the likelihood function to reflect the probability that a case would be included in the sample. Third, imposing structure on the hazards allows us to see whether OBRA had an effect lasting beyond the period of administrative case closings.

IMPACT OF OBRA ON RECIDIVISM AND WORK WHILE ON WELFARE

Although OBRA did not lengthen the duration of AFDC receipt, it may have increased the probability that a person would return to the rolls (recidivism) or that a recipient would not work while receiving AFDC. Increased recidivism would occur if people who were terminated by the OBRA rule changes adjusted their assets or work behavior to regain eligibility. Likewise, recipients remaining on the program may have reduced their work effort after four months as a reaction to the 100 percent benefit reduction rate on earnings.

In order to test these two hypotheses, we again compare the 12 month-histories of recipients in Panels A and B. Recipients are classified according to their work experience during the first four months in each panel. Table 5 shows the number of recipients who left AFDC during each panel history and the number of months worked by those who stayed on all twelve months.

Numbers in parentheses show percentages at the next level of aggregation. For example, of the 642 recipients in Panel A not working in the first four months, 14 percent left AFDC during the next eight months. 55.2 percent of the 90 recipients who left the rolls remained off for the remainder of the year. Asterisks indicate proportions of Panel B that are significantly different from Panel A.

The first two columns show the histories of recipients who did not work during the first four months of each panel. Since they did not earn any income over this base period, we call them the "pre-dependent." The next two columns show the histories of recipients who had earnings in at least one of the first four months. They are called the "partially independent."

Table 5

Recipients In Panels A and B Classified
by Work Experience in First Four Months, Whether They then
Left AFDC, or Whether They Continued to Work while Receiving AFDC

	Did Not Work during First 4 Months of Panel		Worked and Received Welfare during First 4 Months of Panel	
	Panel A	Panel B	Panel A	Panel B
Total	642	691	396	455
Left AFDC ^a	90 (14.0%)	113 (16.3%)	125 (31.5%)	289 (63.5%)*
Remained off	47 (55.2)	63 (55.7)	67 (53.6)	203 (70.2)*
Returned ^b	43 (47.8)	50 (44.3)	58 (46.4)	86 (29.8)*
Remained on AFDC ^c and worked	552 (86.0)	578 (83.7)	271 (68.5)	166 (36.5)*
0 months	489 (88.6)	526 (91.0)	19 (7.0)	39 (23.5)*
1-4 months	46 (8.3)	36 (6.2)	53 (19.6)	24 (14.5)*
5-8 months	17 (3.0)	16 (2.8)	199 (73.4)	103 (62.0)*

^aDuring the first 12 months of the panel.

^bWithin the first 12 months.

^cOn AFDC during the first 12 months.

*Proportion of Panel B is significantly different from proportion for Panel A at the .05 level.

Recidivism

The top half of Table 5 shows that a higher proportion of recipients left AFDC in Panel B, which covers the OBRA period, than in Panel A. The proportion only increased, however, from 14.0 to 16.3 percent for recipients who were not working during the first four months of each panel. This difference is small and statistically insignificant. Among the partially independent, however, the proportion leaving AFDC increased from 31.5 to 63.5 percent. These were the people most likely to be administratively terminated by the rule changes.

Of the pre-dependent in Panel A who left welfare during the 12-month period, 55.2 percent stayed off all twelve months. The comparable figure for Panel B is 55.7 percent, a negligible difference. However, for those who worked while receiving welfare during the first four months (the partially independent), the probability of staying off increased from 53.6 to 70.2 percent. This indicates that for those with work experience, OBRA both increased the probability of leaving and reduced recidivism.

Work Experience of Recipients Remaining on AFDC

The lower portion of Table 5 shows the work experience of recipients who received AFDC during all twelve months of each panel. The rows in lower portion of Table 5 show the number of months the recipient worked during the last eight months of each panel. Since a recipient who worked more than four months after OBRA took effect would then face a 100 percent marginal tax rate, we show the number of those working in the periods of 0, 1 to 4, and 5 to 8 months later.

Again the changes for the pre-dependent are small and insignificant. The proportion continuing not to work at all increased from 88.6 to 91.0 percent. On the other hand, the proportion of recipients with some work experience during the first four months of the panels who did not work in the next eight months increased from 7.0 percent to 23.5 percent, indicating that the 100 percent marginal tax rate may have had some behavioral consequences. This is reinforced by the fact that the proportion of those working 5 to 8 months later declined from 73.4 to 62.0 percent.

These changes in work experience may, however, again reflect mechanical as well as behavioral changes. If the recipients terminated by the rule changes were those who would have continued to work had they stayed on AFDC, then the proportion of recipients not working would automatically increase even if none of the remaining recipients changed their work behavior. Given the data and the methodology used in this report, it is impossible to separate mechanical from behavioral changes.

Commitment to Work

The most striking result from Table 5 is that a significant minority of welfare recipients not only worked initially, but continued to work even when the current financial rewards to work were very low. Of the 1,146 recipients in Panel B, 455 (40 percent) were partially self-sufficient (i.e., worked during the first four months). Of these, 289 then left AFDC. Of the remaining 166 who stayed on AFDC, 103 (62 percent) worked in at least 5 of the next 8 months. They continued to work in spite of the 100 percent marginal tax rate.

Simple models of labor supply do not adequately model the work behavior of these welfare recipients--choosing to work while facing a 100

percent marginal tax rate is not rational, if one is maximizing utility only in the current period and even if leisure is not an inferior good. These recipients must place value on work beyond its monetary compensation. For them work itself may be preferable to the alternative of staying home with young children. If work-expense allowances are sufficiently high to cover child care and other work-related expenses, and if work outside the home is preferred to home production, then a recipient may rationally choose to work even if work does not raise one's income.

Recipients may also be maximizing utility over an extended period and may recognize that future earnings depend on today's earnings. This may occur because recipients are gaining on-the-job training, whose value does not reduce benefits, or that they are investing in "job market signaling." By continuing to work they will develop a work record and be able to avoid the statistical discrimination faced by other welfare recipients who try to work in the future and lack a work record.

CONCLUSION

OBRA clearly had a large impact on the AFDC caseload. The probability that a working recipient would leave the rolls, jumped over 30 percentage points, regardless of the definition of working recipient used. For those working in the first month of the panels it jumped from 13.7 percent to 44.8 percent while for those working in all of the first 4 months, it jumped from 31.5 percent to 63.5 percent. This was primarily a result of rule changes which made many of these recipients ineligible.

At this point, there is little evidence of behavioral responses to these rule changes. Working recipients did not quit their jobs in large numbers to regain eligibility. In fact, recidivism fell after OBRA. While there was a small decrease in the probability that a nonworking recipient would start working, the change was not always statistically significant.

It may be too early to see behavioral responses to OBRA. Behavioral responses may be delayed, or large mechanical changes in caseloads, which result from recipients being administratively terminated, may be submerging the behavioral changes. Nevertheless what emerges is a picture of working welfare recipients who are willing to work despite large work disincentives. Roughly a quarter of the recipients who were working prior to the OBRA changes continued to work in spite of the fact that they faced 100 percent marginal tax rates.

These findings suggest that more research is needed in two areas. First, it is important to continue to monitor AFDC recipients to see whether there is a delayed response to the work incentives (or disincentives). Second, the evidence suggests that the standard one-period models may be inappropriate. We need to develop alternative models which accurately depict recipients who continue to work in spite of the 100 percent marginal tax rate.

NOTES

¹See Robert Moffitt, "Assessing the Efforts of the 1981 Federal AFDC Legislation on the Work Effort of Women Heading Households: A Framework for Analysis and the Evidence to Date," Institute for Research on Poverty, Discussion Paper no. 742A-84.