

HOW MUCH LESS WILL THE POOR WORK UNDER INCOME MAINTENANCE? QUESTIONS REVISITED

by

Felicity Skidmore

He knew he had to make some explanation for letting his good land run free. He said, "I guess I'm a lazy man. And my father didn't help me when he left me enough to get along on without working." He closed his eyes but he could feel the relief on the part of [his listeners]. It was not laziness if he was a rich man. Only the poor were lazy. Just as only the poor were ignorant.

John Steinbeck

Why, one may well ask, are people still estimating work disincentive effects? To find out about them, after all, the U.S. government has already spent over \$100 million on income maintenance experiments. Why do we need another study?

At least part of the answer given by Stanley Masters and Irwin Garfinkel is the inherent difficulty of narrowing the range of estimates enough to be really useful to policymakers who must estimate costs; no single method can do the job. Numerous studies using different methodologies and different kinds of data have yielded varying results. The authors discuss the strengths and weaknesses of the various approaches (including their own) and give reasons why they place reasonable confidence in their own estimates and in the other studies that yield estimates in the same range.

Another part of the answer, they are convinced, is that the American public and their representatives—those who in the last analysis decide the type and amount of income support there will be—remain much preoccupied for noneconomic reasons with how much less people who receive income support payments (i.e., the poor) will work as a result of those payments, and much concerned with ensuring that the beneficiaries of public programs not get a free ride.

When people worry about free rides they refer mainly to prime-aged, able-bodied men. Society tolerates idleness on the part of the young (who are permitted to spend their time in education and training), the elderly (who deserve leisure as a reward for a lifetime of work), and the disabled (who, for reasons that won't be discussed here, are not expected to work). Society seems somewhat ambivalent, at this time, about mothers—particularly mothers who head families. Raising young children is clearly an activity sanctioned by society. But certain features of AFDC and public attitudes toward it are indicative of changing attitudes toward the role of women and their place in our economy.

Issues of Data and Methodology

The Masters-Garfinkel book, in its careful and detailed discussion of the labor supply issue, provides a primer of what to do and what not to do when estimating labor supply ef-

ESTIMATING THE LABOR SUPPLY EFFECTS OF INCOME-MAINTENANCE ALTERNATIVES

by

Stanley Masters and Irwin Garfinkel

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fects of income maintenance. It includes a painstaking literature review of the methodology and results of others.

There are three basic ways to approach the problem and each is vulnerable to different criticisms, as the authors demonstrate. Their view is that each approach is relevant, and reconciliation of their differences provides insurance against gross prediction error.

The first method is to derive estimates using data collected from actual programs—General Assistance (GA) and Unemployment Insurance (UI) are the two that have been studied that aid prime-aged males. This would appear, at first blush, to be the obvious strategy—finding out what people actually do when they are beneficiaries of real programs. The estimates derived from such studies suffer, however, from two major weaknesses which cast doubt on their validity. First, both GA and UI give benefits not only to groups who are expected by society to work but also to groups for whom society has different expectations. The studies done so far have not differentiated among demographic groups in their calculations, leading to overestimates of the disincentive effects that are most relevant to society's concern—the effects on prime-aged, able-bodied men. Second, to get quantitative estimates of how the disincentive effects differ by benefit generosity, program studies are forced to make interstate comparisons. But labor force behavior is a function not only of the transfer benefit opportunities but also of labor market conditions. Since these studies generally cannot separate the different effects their results confound the two.

The second approach to labor supply response estimation is to collect data from income maintenance experimentation: Give one group benefits and measure how their behavior compares with the behavior of a group (the control group) whose characteristics and situation are similar except for benefit eligibility. Several such experiments have been undertaken and their results analyzed. Critics have been loathe to accept the findings without reservation, however, for three major reasons. First, the experiments provided only a temporary income support program. A real program might induce greater work reductions if the beneficiaries' knowledge that they could count on a permanent income guarantee changed their behavior. Or, a real program might induce smaller reductions than under a temporary program if people, knowing the experiment was temporary, decided to use the payments to take more time off than they would choose if they *knew* the payments would always be available.

The second reason involves people who drop out of the experiment before the payment period is over. Such attrition is less likely among those who will lose large payments

from the experiment (that is, those whose labor supply is low) than those with relatively high earnings and little or no income support from the program. This differential attrition will, therefore, lead to an overestimate of the disincentive effects.

Third, both because the experiments are temporary and because they affect only some of the potentially eligible population, the results cannot reflect any basic labor market or community changes that might result from a permanent program.

The third approach—the one followed by Masters and Garfinkel—avoids the weaknesses of the other two by using national survey data to estimate, from people's observed responses to the unearned income they happen to receive, what their responses would be to transfers of differing generosity. These data do not, of course, allow direct observation of the effects of income maintenance. But they do contain information on people who are otherwise similar but differ in the wages they command and the amounts of unearned income they receive. "We can thus get indirect measures of the probable effects of income maintenance," the authors argue, "by comparing the work effort of similar people who happen to have different wage rates and different unearned incomes." This approach, although avoiding the weaknesses inherent in the previous two, suffers from its own. For one thing, people with different wage rates and different unearned incomes are likely to differ in other important ways not captured by the survey which may affect labor supply—the attractiveness of their jobs, for instance, and how personally ambitious they are. For another, if someone does not work there will be no wage rate in the survey data and a rate will have to be estimated from other known characteristics (such as age, sex, race, years of schooling). This is especially important for women, since fewer of them work. Last, low-income persons receive very little unearned income except from government transfers, which are most frequently received because the individual cannot work—that is, received as a result of atypical work behavior. Such unearned income must properly be excluded, which leaves survey studies heavily dependent on the few respondents who have large amounts of unearned income not affected by the amount they work. To the extent that these respondents are atypical, the results will be distorted.

The Authors' "Best Estimates"

What is the resolution of all this?

The answer Masters and Garfinkel give is to say: Let's do whatever we can to minimize the causes for bias in our regression estimates. Let's use two independent data sources (the 1967 data from the Survey of Economic Opportunity and the 1972 data from The Michigan Panel Study of Income Dynamics) to see how sensitive the results are to the data used. Let's be extremely careful about what sources of

SELECTED PAPERS AND BOOKS

Irwin Garfinkel with the assistance of Felicity Skidmore, "Income Support Policy: Where We've Come From and Where We Should Be Going," Institute for Research on Poverty Discussion Paper no. 490-78.

Irwin Garfinkel, "The Effects of Welfare Programs on Experimental Responses," *Journal of Human Resources* 9, no. 4 (Fall 1974): 504-529. Institute for Research on Poverty Reprint no. 130.

Harold Watts and Albert Rees, eds., *The New Jersey Income Maintenance Experiment, volume 2: Labor Supply Responses*. New York: Academic Press, 1977.

unearned income data we include. Let's control as carefully as the data allow for health status and for personal ambition. Let's calculate separate estimates for the many different demographic groups, since public policy is much more concerned about some groups than about others. Let's then compare our results with the results of others (from studies using the same or similar data, studies using experimental data, and studies using program data) to see to what extent the sources of differences can be satisfactorily explained, and to what extent the various studies can be interpreted as indicating the same orders of magnitude. And throughout let's be aware of the limitations of social science research, even when done under the most meticulous conditions.

All this they do. And they find that their best estimates are generally consistent with those of the other studies they have been able to give high methodological marks to.

Their results indicate that beneficiaries would work somewhat less as a result of a generous noncategorical income maintenance program. A program with a guarantee at the poverty level and a tax rate of 50% could be expected to lead to a reduction in hours worked by beneficiaries of 12-21%. Only a small proportion of this reduction, however, would be attributable to able-bodied, prime-aged men (whose labor supply reductions would be in the neighborhood of just 1-3%). The aggregate expected reductions in labor supply would increase the costs of income maintenance to the taxpayers by a modest amount: 13-21%. But the economic costs to society as a whole would be much lower: A crude estimate suggests that the resulting reduction in Gross National Product would be "only about 3% as large as the potential GNP that Americans have voluntarily foregone by working substantially less than the norm of 75 years ago. More importantly, the efficiency losses to society as a whole [would be] less than 0.3% of total welfare."

The Bottom Line

What does this tell the authors about the appropriate direction income support policy should take?

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How Much Less Will the Poor Work . . . (continued from page 4)

They are refreshing in revealing the prime motivation of their research: "When we began work on this study in 1971 . . . we were advocates of either a universal credit income tax or a negative income tax program to aid the poor. We believed that opponents and potential opponents of such programs exaggerated their potential costs in terms of induced labor supply reductions."

They are not naive enough to believe that any estimates they come up with *per se* indicate anything about welfare reform.

They argue that (as the quotation that starts this article affirms) the work effort of the poor is considered by society to be an important issue in and of itself. The authors say they wanted to satisfy themselves as to the order of magnitude of the disincentive, because it would (and should) influence their policy recommendations.

Their bottom line is that, since the work disincentive effects would appear to be relatively minor, they favor a credit income tax (CIT)—that is, a program which gives the same absolute benefit to everyone and levies from everyone according to their ability to pay (as assessed by the positive tax system).

The reasons they give for favoring a CIT over a negative income tax (NIT)—accompanied by a more progressive tax structure, which would accomplish the same thing—are as follows: (1) They are in favor of increasing the standard of living of the poor, (2) they are convinced that a program which segregates the poor (i.e., they are eligible for a program *because* of their low income) submits them to conspicuous and unfavorable attention, and (3) they are convinced that a program that administers alike to the net receivers and net givers will minimize human divisiveness.

Although they advocate a credit income tax, they would have it implemented cautiously:

Thus our empirical results, despite their limitations, have reinforced our belief that we should move gradually toward the adoption of a CIT. We hope that they also convince those who have been hesitant . . . for fear that very large reductions in labor supply would result if a reasonably generous program should ever be adopted. Given the limitations on our current knowledge, however, we strongly advocate that new redistributive programs be implemented gradually so that they can be modified easily as we learn more about their effects.

⁵Stanley Masters is a Project Associate at the Poverty Institute; Irwin Garfinkel is Director of the Poverty Institute and a Professor of Social Work at the University of Wisconsin.

Moving up the Job Ladder (continued from page 2)

quality of the formal schooling received by black children and to provide manpower training programs that emphasize the acquisition of marketable skills.

The form that OJT programs should take is a highly controversial issue. Previous studies examining the effects of government sponsored but privately operated OJT programs (e.g., Job Opportunities in the Business Sector) have frequently yielded pessimistic conclusions regarding the effectiveness of the programs in training and placing secondary workers in jobs that offer career ladders. However, the alternative that the government create jobs to employ secondary workers runs into the objection that there is little evidence to indicate that public sector jobs provide the training that will qualify workers for primary jobs in the private sector. On balance, the evidence presented in this study speaks in favor of government-sponsored manpower training, especially in the private sector, over permanent public service employment.

Leigh argues, however, that some of the changes in government policy recommended by dualist adherents to restructure jobs held by secondary workers might be desirable. An illustration is reform of particular features of social welfare programs to encourage employment stability (for example, making changes in the Unemployment Insurance program that would raise the cost of labor turnover borne by employers). In addition, a federal wage subsidy applicable to public or private employment is likely to attract increasing attention as a policy measure to supplement the results of the labor market.

Any attempt to deal with institutional arrangements that restrict the intrafirm advancement opportunities of blacks runs into one basic problem: Gains in promotional opportunities or in job security by one group of workers usually mean equivalent losses for another group. Leigh suggests that future research and policy analysis might do well to direct more attention toward examining methods to shift costs away from the incumbent work force and the employer and toward the government, since discrimination in employment is, after all, a social problem and not a private one.

⁶This monograph was first prepared as a final report to the Manpower Administration (now the Employment and Training Administration) of the U. S. Department of Labor. ⁷For additional discussion of theories of discrimination in the labor market, see "The New Challenges to Orthodox Labor-Market Theory—How New? How Challenging?" FOCUS 1, no. 2:7+.

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