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Incentives, Challenges, and Dilemmas of TANF

Barbara L. Wolfe
Departments of Economics and Preventive Medicine
Institute for Research on Poverty
University of Wisconsin–Madison
E-mail: wolfe@lafollette.wisc.edu

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Abstract

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 changed the U.S. welfare system dramatically. Its primary goal was to reduce dependency by moving most of those receiving cash welfare into the work force. One tool to accomplish this objective was a change in the incentives facing actual and potential recipients. States were granted flexibility in how to accomplish this objective. This paper evaluates the program in four states in terms of efficiency and equity. It looks briefly at resulting labor force participation and incomes of those most directly affected by welfare reforms. The analysis highlights the difficulty of simultaneously providing incentives to work and incentives to increase individuals' labor market productivity while maintaining a minimal safety net and avoiding high marginal rates of taxation. None of the states studied is able to avoid a "poverty trap" in its program. The need to coordinate the benefit and withdrawal schedule of programs designed to help this population flows from the analysis.

Incentives, Challenges, and Dilemmas of TANF

The welfare system in the United States changed dramatically in 1996 with passage of the Personal Responsibility and Work Opportunity Reconciliation Act. The primary goal of the reform enacted then was to reduce dependency on the system by moving those on the rolls into the work force. Other goals included making both parents responsible for their children, decreasing teen pregnancy and births, and shifting responsibility for welfare to the states. The reform eliminated the cash assistance component of the welfare system, Aid to Families with Dependent Children (AFDC), eliminated cash payments to parents younger than 18, and expanded the employee-based subsidy for work. It also encouraged states to establish programs providing assistance to enable parents to work. As a result, the incentives facing low-skilled individuals have been altered. This paper evaluates the resulting efficiency and equity consequences for welfare recipients and those who would have been recipients. It then looks briefly at the labor force participation and incomes of those directly affected by the welfare reform and concludes by identifying a few programs that states and perhaps other countries may wish to consider in rethinking their social welfare programs. The emphasis is on programs that attempt to defy the traditional equity-efficiency trade-off.

To evaluate the success of welfare reform in changing incentives toward work, I first discuss the incentives of the "old" system, described in detail in Appendix A. I then compare these incentives to those of the new system, a nontrivial task, because each state has its own version of the program, Temporary Assistance for Needy Families (TANF), which replaced AFDC. Less generous versus more generous states are highlighted. How these incentives change if the head of the recipient unit reaches a time limit is discussed. The incentives in Wisconsin, the state that many see as a model for welfare reform in the United States, are considered in more detail. Whether the new programs can avoid a "poverty trap," the point at which marginal tax rates are so high that they discourage work effort, is a focus of the discussion.

THE OLD SYSTEM

The old welfare system was a cash assistance program primarily for single parents with dependent children, and benefits were based on family size.[1] Figure 1 provides an illustration for one state, Pennsylvania. A 45-degree line compares family income on the vertical axis to earnings on the horizontal axis for a family consisting of a single parent and two children, one of whom is assumed to be younger than school age and the other to be of school age (6 or older). All dollar values are inflated to 1999 dollars; the parameters are for the system in place in 1996. The lowest line, showing cash benefits (AFDC) plus earnings, demonstrates how this changes as earnings increase. (If income exactly mirrored earnings, all points on the graph would be on the 45-degree line.) In this typical state, whose benefit structure lies near the U.S. average, a three-person family would receive approximately $5,400 a year. (Note that larger families would get more, because cash benefits were conditional on family size.) As a single parent started to work, she could keep the first $30 of earnings per month and then her AFDC grant was reduced by two-thirds (67 cents) for every dollar, so that she soon faced a marginal tax rate of more than 69 percent, since the payroll tax also reduced take-home pay.[2] Soon, however, that rate rises to 93 percent, meaning that she loses nearly a dollar in her grant for each dollar earned. Beyond about $8,500, income depends solely on earnings, because she is no longer eligible for cash benefits.

The typical welfare family would be eligible for other noncash benefits, including Food Stamps (vouchers to buy food, which depend on income and family size); health insurance (Medicaid) for all

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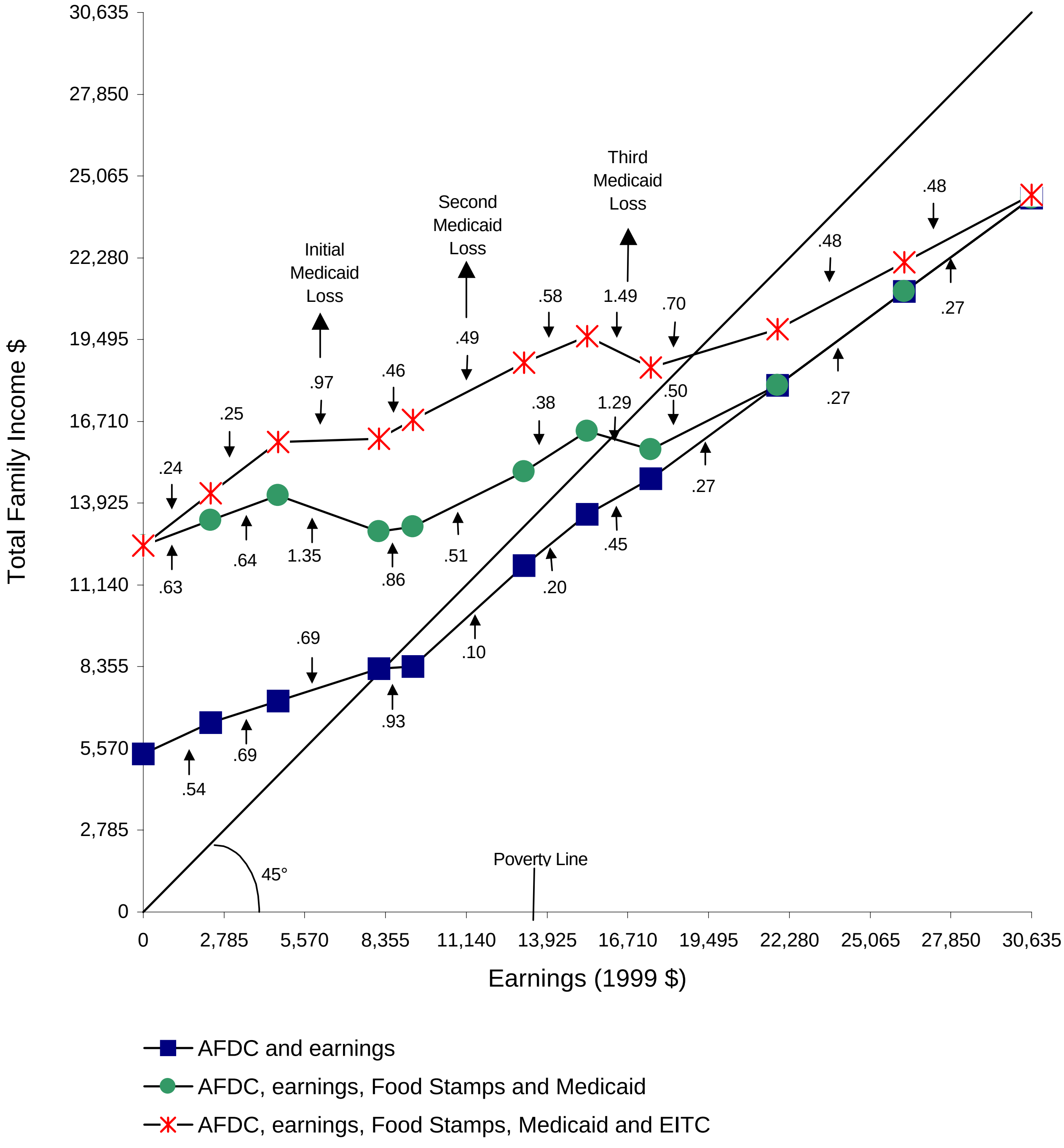
[1]The vast majority of cases on AFDC were single-parent families with a dependent child under age 18. A much smaller program, AFDC-UP, existed for two-parent families in which the principal breadwinner was unemployed.

[2]This is calculated for an earnings disregard of $30 plus one-third of earnings. In addition, the employee's share of payroll taxes is subtracted from earnings, so that the marginal tax rate equals .69.

FIGURE 1
Welfare, Earnings, and Income of a Single Parent with Two Children: AFDC in Pennsylvania, 1996



Source: Author's calculations based on data from *1998 Green Book*.
Notes: The AFDC benefit calculation includes a baseline deduction of $30, a $10 deduction for child care, and a deduction for transportation expenses which amounts to 10% of total earnings.
Food Stamps are calculated with the following formula: {[$313 - 0.3*((earnings - $134/month)- (earnings*0.4))] - 0.3*AFDC benefit}.
State tax calculations include a substantial "tax foregiveness credit" for lower income cohorts.
Data are inflated to August 1999.
The poverty line for this family is $13,880.

members of the family, another categorical program; and a housing benefit (available to about 30 percent of this population).[3]

This combination of programs (excluding the Earned Income Tax Credit, discussed below, and housing assistance) is captured by the middle line of Figure 1, showing the result of a set of programs that were income-conditioned.[4] As a woman begins to work, she at first faces a marginal tax rate of about 63 percent (which includes the payroll tax), but this quickly increases to more than 100 percent as benefits are reduced. As her earnings increase and the AFDC benefit is reduced, she soon loses eligibility for Medicaid;[5] then, as her earnings increase further, her older child also loses Medicaid coverage and, as family income reaches the poverty line, Food Stamps are reduced substantially. By the time the woman's earnings reach $15,000 she faces a marginal tax rate of more than 125 percent, as she begins to pay federal income taxes, loses eligibility for Food Stamps, and the youngest child loses Medicaid coverage. This line portrays the poverty trap—as a woman earns more, her family income (including the value of benefits in kind) increases very gradually, if at all.[6] Once all benefits have been eliminated and the woman's earnings are at about 160 percent of the poverty line, she faces a much lower marginal tax rate, 27 percent.

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[3]In 1995, expenditures on AFDC, Food Stamps, Medicaid, and the Earned Income Tax Credit (EITC) on behalf of nondisabled working-age families were more than $100 billion, or about 1.4 percent of the U.S. GDP. Of this, AFDC accounted for $22 billion, Food Stamps for $18.5 billion, Medicaid for $36 billion, and the EITC for about $25 billion.

[4]Food Stamps are valued at their cash value and Medicaid at two times the average expenditure per child and one times the average expenditure per nonelderly, nondisabled adult in this state. This understates the value of Medicaid for some families and overvalues it for others, as it captures average spending, which might be greater or less than the amount this family consumes—greater than the family would consume if it were not fully subsidized. It does not capture the insurance value of health care coverage.

[5]Rather than model the budget constraint as one with "sharp edges," in which the exact dollar of earnings at which an individual loses Medicaid eligibility is shown, the budget constraint here is smoothed. This is the author's preferred approach, because eligibility is determined on a monthly basis and individuals are likely to know, in general, about eligibility rather than know that if they work one more hour they will lose benefits.

[6]If the family received housing assistance, the marginal tax rates would be even higher, as housing accounts for 30 cents for every dollar increase in earnings.

An exception to this set of incentives, one which increases the gain to work, is the Earned Income Tax Credit (EITC).[7] This credit is paid only to those with children and with earnings. The top line of Figure 1 illustrates the effect of including the EITC as earnings increase. Over much of the range the EITC lowers the marginal tax rates, but as the EITC is reduced, marginal tax rates increase. As of 1996, as a result of changes passed in 1993, the EITC rewarded earnings of individuals with two or more dependent children at a 40 percent rate, reaching a maximum of $3,556 ($3,816 in 1999 dollars) when a family with two or more children received wages of $8,890, then remained flat until earnings reached $11,610, just below the poverty line. After this the EITC was "clawed back" at a rate of about 21 percent, and was fully phased out at earnings of $28,490.[8] (Appendix Figures A1 and A2 show the parameters of the EITC in 1993 and 1999.) The top line of Figure 1 shows the budget constraint of an AFDC recipient with two children including the EITC, as of 1996.[9] The EITC provided a substantial increase in income among low-earning families with children. It made work pay, over a limited range.

Even with the EITC, this recipient family faced substantial marginal tax rates as earnings increased. After an initial range in which the marginal tax rate was a relatively low 24 percent, the rate increased to nearly 100 percent as the mother lost Medicaid coverage. All three points (see Figure 1) at which eligibility for Medicaid is lost have extremely high rates.[10] And just beyond the poverty line (again see Figure 1), the marginal tax rates facing this family are increased as the EITC is clawed back, in addition to a reduction in Food Stamps and loss of Medicaid for the youngest child. It is not difficult to

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[7]The EITC was initially enacted in 1975 as a means of tax relief; it has been expanded three times, in 1986, 1990, and 1993.

[8]For a family with one child, the EITC supplemented earnings at a 34 percent rate up to a maximum credit of $2,152 and was fully phased out at about $25,000 of earnings.

[9]As of 1993 the EITC was less generous. Earnings up to $7,750 were subsidized at a rate of 20 percent for families with one or more children. After earnings reached $12,200, the subsidy was gradually clawed back. By $23,050, the EITC was entirely clawed back.

[10]One could view the incomes at which each family member loses Medicaid as "notches," marking an immediate shift to lower family income.

see why the program was disliked. It provided clear incentives to forgo work; its benefits were primarily paid to single parents and were thought to increase family breakup and illegitimacy. The program also did not eliminate poverty.[11]

THE NEW SYSTEM

Recognition of these negative incentives, combined with continued poverty, led to frustration and attempts to modify the system. Substantial changes resulted from the Family Support Act of 1988, which provided an entitlement to child care subsidies for AFDC recipients who entered the work force, required about 10 percent of recipients to enter a program of work or training, and offered a one-year extension of Medicaid (health insurance) for those who left AFDC because of increased earnings. In subsequent years states requested waivers from the federal government to experiment with alternative policies,[12] and various research groups evaluated these demonstrations. Wisconsin made significant changes under its waivers, and ultimately eliminated AFDC altogether. In early 1996 the state set up programs in a number of counties that attempted to move welfare recipients into employment and divert new applicants directly to work.[13] Under the state's current TANF program, Wisconsin Works (W-2), cash assistance is eliminated and all who receive assistance must work.

The general emphasis of the 1996 federal reform legislation is on getting recipients and would-be recipients into the work force. The message is that individuals must ultimately be self-reliant. The 1996 federal law:

- Ended entitlement to AFDC.

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[11]Table 2, below, compares AFDC and TANF in Pennsylvania.

[12]In order to change the parameters of the state AFDC program, states had to obtain a federal waiver under the cost-sharing arrangement for AFDC.

[13]Wisconsin's waiver programs were Self-Sufficiency First and Pay for Performance.

- Allowed each state to determine how it would treat its low-income population, subject to certain constraints. Funding was through block grants, whose amounts were based on historical expenditures.

- Established an expectation that most heads of families were to work within two years.

- Established a federal five-year limit for the receipt of cash assistance; states were permitted to impose shorter time limits.[14]

- Prohibited states from providing cash assistance to unmarried teens (under age 18) unless the mother stayed in school and lived with an adult.

- Required mothers of children older than 12 months to work, while allowing states to set stricter requirements.

- Prohibited the use of federal funds for assistance to immigrants, and set tighter eligibility requirements for the program for disabled individuals (SSI).

- Set limits on counting participation in vocational education as meeting work requirements.

Over time, states are required to meet certain reductions in their caseloads. Within these limits, states are given a great deal of flexibility.

Associated with, but not a direct part of, the welfare policy change was the expansion of the EITC, especially for families with two or more children, and an increase in the minimum wage. A comparison of the generosity of minimum wages and the EITC is presented in Table 1. The last row of the table sums up the potential impact of these changes for a three-person family headed by a single parent. If the parent worked full-time, full-year at a minimum-wage job, paid payroll taxes, and received the EITC, her income from these sources would have increased from 78 percent to 96 percent of the three-person poverty line. These changes are consistent with the goals of welfare reform and should work to further the work-not-welfare policy.

[14]States can use their own funds to provide assistance beyond 60 months. Michigan and Rhode Island plan to do so. Illinois will do so for families with earned income from working a minimum of 20 hours per week.

TABLE 1

Potential Impact of Raising the Minimum Wage and EITC on Income and Poverty of Three-Person, Single-Parent Families (1999 Dollars)

	1993	1997	1999
Minimum wage	$4.89	$5.33	$5.15
Maximum EITC, two-child family	$1,738	$3,786	$3,816
Minimum wage earnings, FTFY	$9,780	$10,660	$10,300
Minimum wage + EITC	$11,518	$14,446	$14,116
Minimum wage + EITC − payroll tax	$10,777	$13,636	$13,328
Ratio to three-person poverty line	0.776	0.98	0.96

Did the changes substantially alter incentives? Does work *pay* under the new system? Figure 2 provides a picture of the effects of these changes. The analysis starts with the same typical state, Pennsylvania, as in Figure 1, and again uses a three-person family. Dollars are in 1999 values.

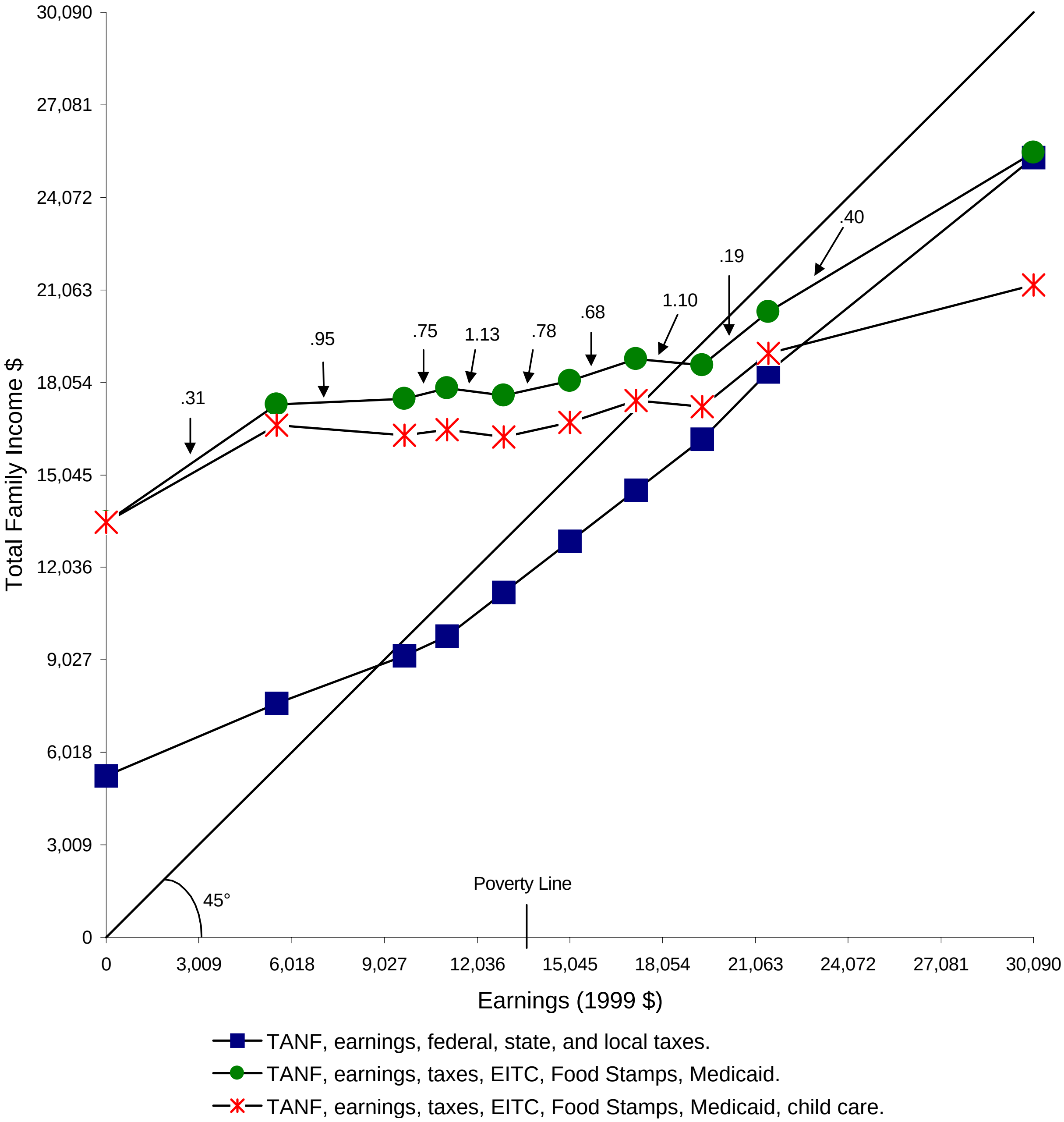
We assume that the family is eligible to receive cash assistance and has not been sanctioned. The bottom line shows the link between receipt of cash assistance (TANF monies), earnings, and taxes. The base amount the family would receive if it had no earnings, $5,060, is somewhat less than under AFDC. The amount the family keeps as the recipient works is about 45 percent. The incentives to work are clearly greater than they were under AFDC.[15] The top line adds the value of Food Stamps, Medicaid, and the EITC. Without work the family would receive benefits equal to $13,367. The figure illustrates that as a recipient works up to 1,000 hours per year at the minimum wage, the family's income increases at a rate of about 0.69 for each dollar earned. This is well above the 0.47 to 0.43 under the old system, so the incentive to work is improved relative to the former system. Income while working half-time at the minimum wage is 127 percent of income if not working. But the incentive problem worsens beyond this level of work effort. As the recipient increases hours of work from 1,000 to 1,750,[16] she faces a marginal tax rate of 0.95, so that for every dollar she earns, family income only increases by 5 cents. The poverty trap has not been eliminated. After about $9,000 in earnings, the marginal tax rate varies from 0.69 to more than 1.00 up to about $9.00 per hour ($18,000 per year) at a full-time, full-year job. Beyond this earnings level, her marginal tax rate declines to .40, reflecting federal payroll and income taxes, Pennsylvania taxes, and reductions in the EITC.

The explanation for the very high rates that begin with half-time work at the minimum wage lies in benefit reduction in cash assistance, Food Stamps, EITC, and Medicaid. Federal income taxes do not play any role until income rises to the poverty line ($13,880 for a family of three). Payroll taxes account

[15]Payroll taxes reduce earnings by an additional 7.65 percent.

[16]Or alternatively, as her wage rate per hour increases, while working similar hours.

FIGURE 2
Welfare, Earnings, and Income of a Single Parent with Two Children: TANF in Pennsylvania, 1999



Source: http://newfederalism.urban.org/incalc2/index.html and author's calculations based on data from *1998 Green Book*.
Notes: See Figure 1.

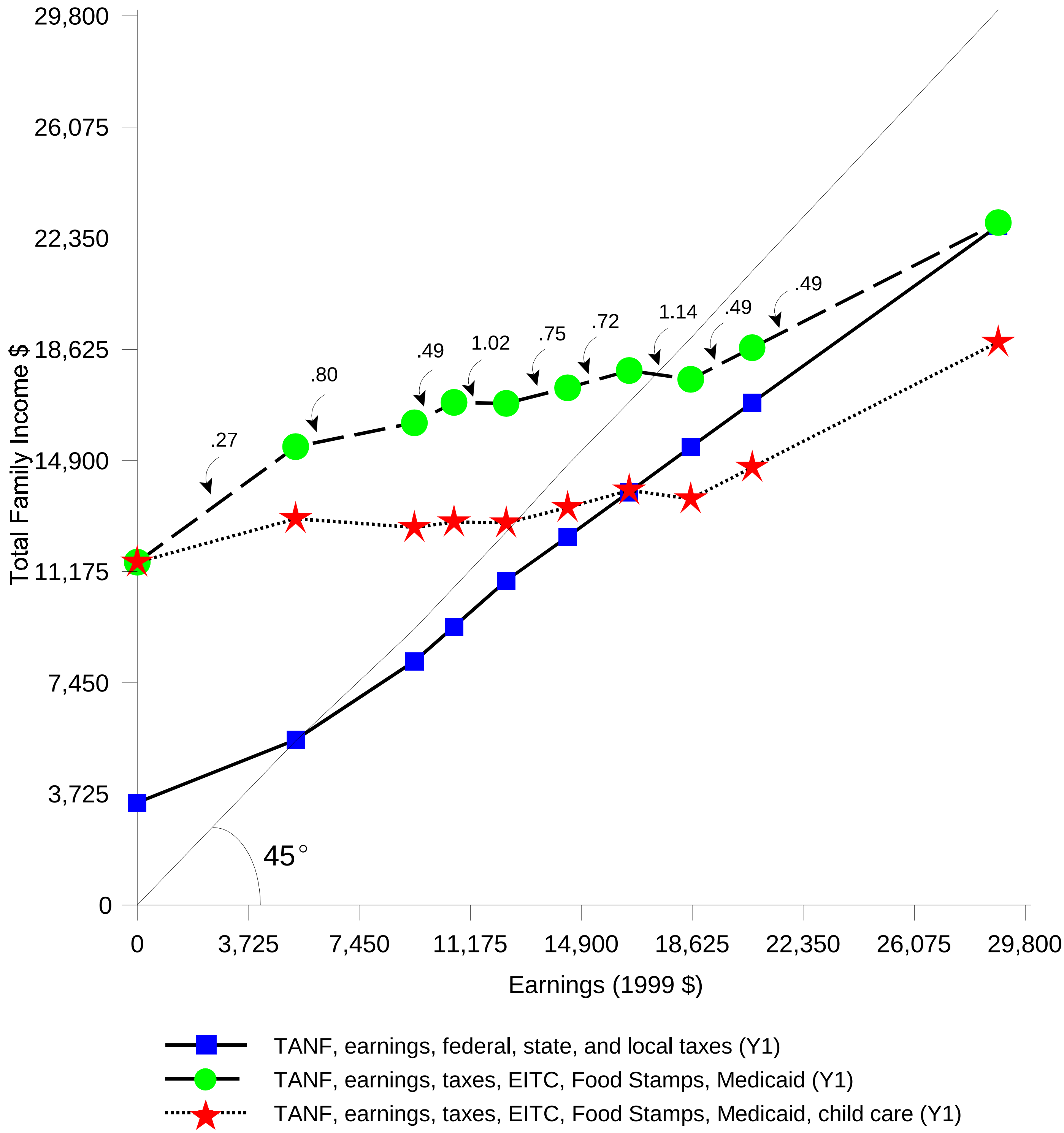
for a marginal tax rate of 7.65 percent over all earnings in the range under analysis.[17] The EITC adds to earnings throughout the full range reported here. It reaches a maximum of $3,816 for families with two or more children at $9,540 of earnings, remains at that level until earnings reach $12,460, then gradually decreases. At an earnings level of $30,580 the EITC is phased out.

The result is that a prototypical family of three in Pennsylvania after the 1996 welfare reform has higher income as earnings rise to about $10,500 than prior to reform. However, after this earnings level, marginal tax rates are stronger (see Table 2). In Figure 2, the middle line (stars) includes the cost of child care needed if this woman is to work. Initially the state subsidizes child care, but as earnings increase that subsidy is reduced and finally is terminated. The line subtracts the average cost of child care for children under age 5 and ages 6–11 (the average cost paid minus the state subsidy). This cost increases from $650 to $4,128 as earnings increase. The phaseout of the child care subsidy occurs after the phasing out of TANF, Food Stamps, and Medicaid. This coordination avoids even higher marginal tax rates at lower levels of earnings.

Figure 3 illustrates the incentives facing a similar woman in a less generous state, Indiana. The lowest line shows that the base cash grant for a three-person family in Indiana is $3,436, about two-thirds of the amount in Pennsylvania. The lower amount makes it easier to have lower marginal tax rates; in other words, if the base grant is low, there is less to be reduced and hence marginal tax rates can be lower. The top line adds the same benefits as for Pennsylvania: EITC, Food Stamps, and Medicaid. Income without work is $11,731 for this three-person family. The figure shows that as earnings increase, the marginal tax rate for those first dollars of earnings is .27, meaning that the woman adds 73 cents for every dollar earned. However, once she works 20 hours per week at the minimum wage, additional earnings face a much higher marginal tax rate—80 percent. And again, over the range of increased

[17]In this analysis only the employee's share of FICA is subtracted from the employee's wages.

FIGURE 3
Welfare, Earnings, and Income of a Single Parent with Two Children: TANF Parameters in Indiana, 1999



Source: Author's calculations based on data provided by the Urban Institute's 1998 State TANF Income Calculator.

Notes: See Figure 1.

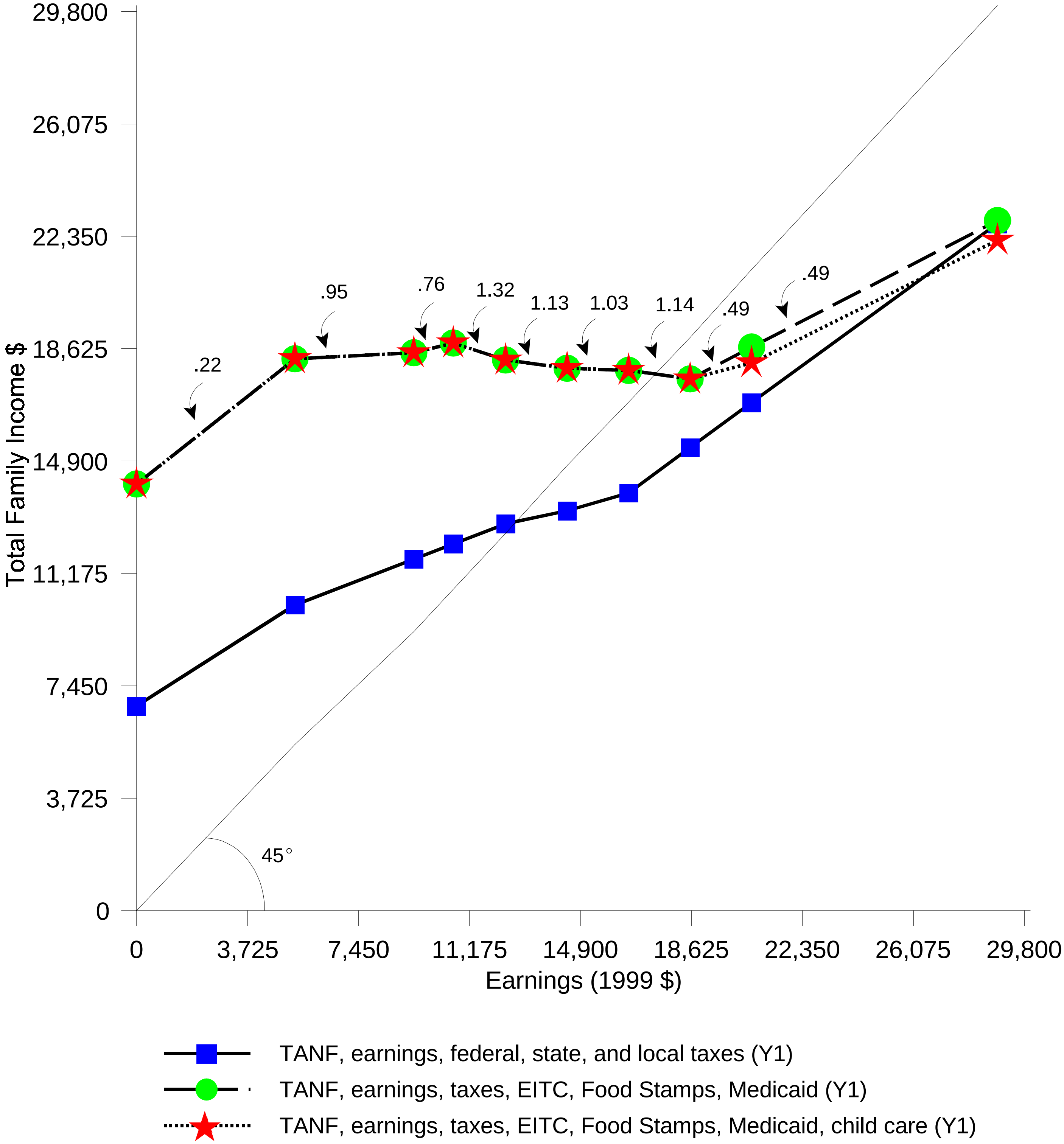
earnings till about $9 per hour working full-time, full-year, the marginal tax rates are very high. They vary between a low of 49 percent and a high of 114 percent.

Once all of these benefits have been phased out, the marginal tax rate again is 49 percent. The starred line shows the additional impact of subtracting child care expenses net of any subsidy. The overall picture is troublesome; the poverty trap is very much in evidence. There is less disincentive to work during the first 1,000 hours per year at minimum wage, but thereafter taxes are high and remain so until income rises above $18,000. Near the poverty line, marginal tax rates are extremely high, reaching more than 100 percent.

Figure 4 is for a more generous state, California. The base TANF cash grant here is considerably higher than in either Pennsylvania or Indiana. A woman who does not work is eligible for benefits equal to $14,561. A commitment to creating positive incentives to work is indicated by the willingness of the state to pay cash grants to those who work full-time, full-year up to about $6.00 per hour. The top line shows that the state has avoided disincentives to work over the interval of zero to about $5,000, where the combined marginal tax rate is 22 percent, so that the parent keeps 78 cents of every dollar earned. However, beyond this level, the greater generosity of the state leads to even higher marginal tax rates than in the other two states we analyzed, because the base grant plus Medicaid and Food Stamps are reduced over a narrower interval of earnings. The result is marginal tax rates that range from 76 to 132 percent, and rates are above 100 percent over much of the range till about $19,000. Greater generosity in child care subsidies is noted as well. The top line and the starred line (which subtracts child care expenses) overlap up to about $19,000, reflecting the generous child care subsidies in the California system. Even with this, TANF recipients gain little in terms of family income when their earnings reach $20,000. The state has not developed a program that entirely avoids a poverty trap.

An alternative approach to understanding these programs is shown in Table 2, which plots income ratios as earnings increase in the three states. Most startling in this table is how little incentives

FIGURE 4
Welfare, Earnings, and Income of a Single Parent with Two Children: TANF Parameters in California, 1999



Source: Author's calculations based on data provided by the Urban Institute's 1998 State TANF Income Calculator.

Notes: See Figure 1.

TABLE 2

Comparison of Income and Income Ratios under AFDC and TANF Programs

	Pennsylvania		Indiana	California
	AFDC	TANF	TANF	TANF
Income without Work	$12,211.17	$13,367.44	$11,731.29	$14,560.72
Income Ratios				
At earnings of $5.15/hour (half-time) relative to no work	1.278	1.274	1.353	1.299
At earnings of $5.15/hour (full-time) relative to $5.15/hour (half-time)	1.039	1.021	1.062	1.018
At earnings of $6/hour (full time) relative to $5.15/hour (full-time)	1.113	0.992	0.989	0.967
At earnings of $7/hour relative to $6/hour (full-time)	1.049	1.028	1.037	0.993
At earnings of $8/hour relative to $7/hour (full-time)	0.945	1.036	1.032	0.992
At earnings of $10/hour relative to $8/hour (full-time)	1.067	1.036	1.041	1.037
At earnings of $12/hour relative to $10/hour (full-time)	1.116	1.097	1.115	1.117

Note: Income includes AFDC/TANF, earnings, Food Stamps, Medicaid, and EITC.

have changed under welfare reform. The difficulty in providing income-conditioned benefits remains; reduction of benefits as earnings rise results in very high marginal tax rates, far in excess of what higher-earning families pay.

The Wisconsin System

Finally we turn to a state that offers no cash benefits unless an individual works, Wisconsin. Wisconsin Works, or W-2, requires *all recipients* of welfare assistance to engage in work or a worklike activity. A self-sufficiency ladder establishes four levels of activity. The highest level is unsubsidized employment, in which the recipient works in the private sector and receives a market wage greater than or equal to the minimum wage, plus the federal and state EITC and Food Stamps, as long as the parent is income- and asset-eligible.[18] The next level is Trial Jobs, in which the state pays a subsidy to employers to hire a TANF participant and the individual receives at least the minimum wage, plus the federal and state EITC and Food Stamps. Forty hours of work per week are required. The third tier is Community Service Jobs, for those not yet able to hold a private sector job. These individuals are required to work 30 hours per week and may obtain training or work an additional 10 hours per week. In this tier the individual is not eligible for the EITC, because she receives a grant rather than earnings, but is eligible for Food Stamps. Finally, for those least able to work, the bottom tier is W-2 Transitions, which requires 28 hours per week of productive activity and 12 hours of training. This also involves a grant, permitting receipt of Food Stamps but not the EITC. Activities in this tier may include care of a disabled child or parent. Thus *all* W-2 participants are required to work, and Tiers 3 and 4 ensure that there is a “job” for everyone. Mothers of newborn infants are exempt from these work requirements until the infant is 12 weeks old.

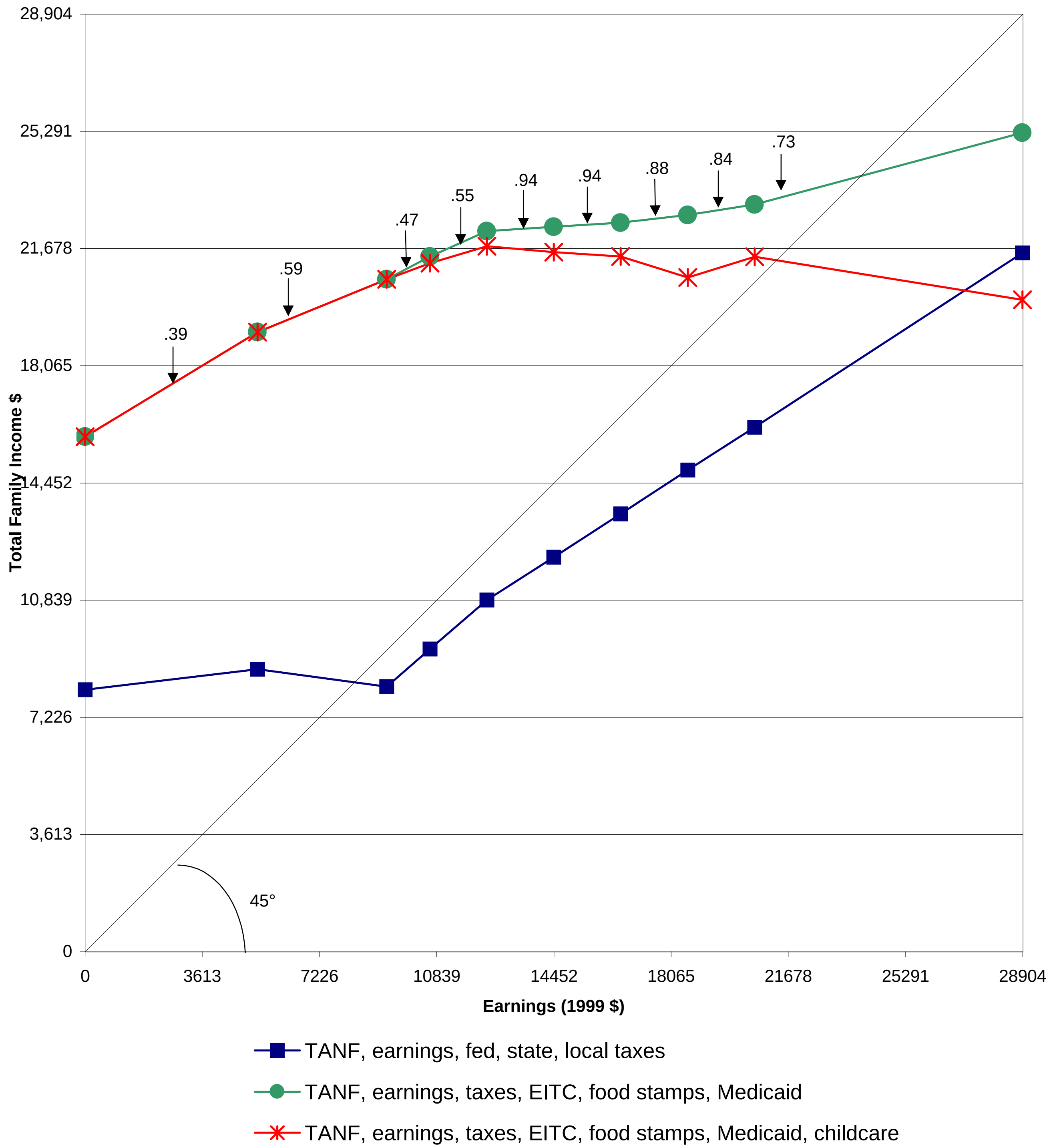
[18] Wisconsin is one of seven states that offer a refundable credit.

Everyone in W-2 has an opportunity for gainful employment and nearly everyone faces pressure to work. Those who do not fully participate are sanctioned at a rate of $5.25 per hour (the minimum wage) of missed required activity. Beyond wages, EITC, and Food Stamps, the state offers assistance in the form of subsidized health insurance to families with incomes below 185 percent of the poverty line, child care assistance, and transportation assistance. There is an attempt to provide tailor-made management in the form of job center assistance that helps coordinate benefits, obtain child support from absentee parents, and obtain health insurance, and that offers relevant referrals and provides short-term loans.

Figure 5 illustrates the incentives of the Wisconsin program for an individual starting in Tier 3, Community Service Jobs. This job provides the mother and her family with $8,076 per year in cash income. The lowest line shows what would happen if she moved up to Tier 2 and received the minimum wage. Her cash income would increase only modestly if she worked 20 hours per week—to $9,354, or by 15.8 percent. However, she would receive the EITC, so her income would increase more dramatically. The top line shows her full income as she moves from Tier 3 to Tier 2 and then Tier 1.

The top line indicates that this woman would face a marginal tax rate of 39 percent on the first dollars of earnings in Tiers 1 or 2, followed by a much higher marginal tax rate of 59 percent as she moves from $5,500 to $9,500, a slightly lower rate of 47 and 55 percent up to about $14,500 of earnings, followed by a very high 94 percent marginal tax rate up to about $19,000, or about 140 percent of the poverty line. After this level of earnings she faces marginal rates of about 84–88 percent up to more than $20,000 in earnings and a rate of 73 percent to about $29,000 in earnings, still extremely high relative to that of others in the economy. Again, the system has a “poverty trap,” though it does not fully hit until earnings are at about the poverty line. The trap is postponed, but not eliminated. The starred line shows further reduction in full income when child care costs are deducted. This accentuates the poverty trap

FIGURE 5
Welfare, Earnings, and Income of a Single Parent[a] with Two Children: TANF (W-2) in Wisconsin, 1999



[a]For a woman who is initially in Tier 3 with a Community Service Job.

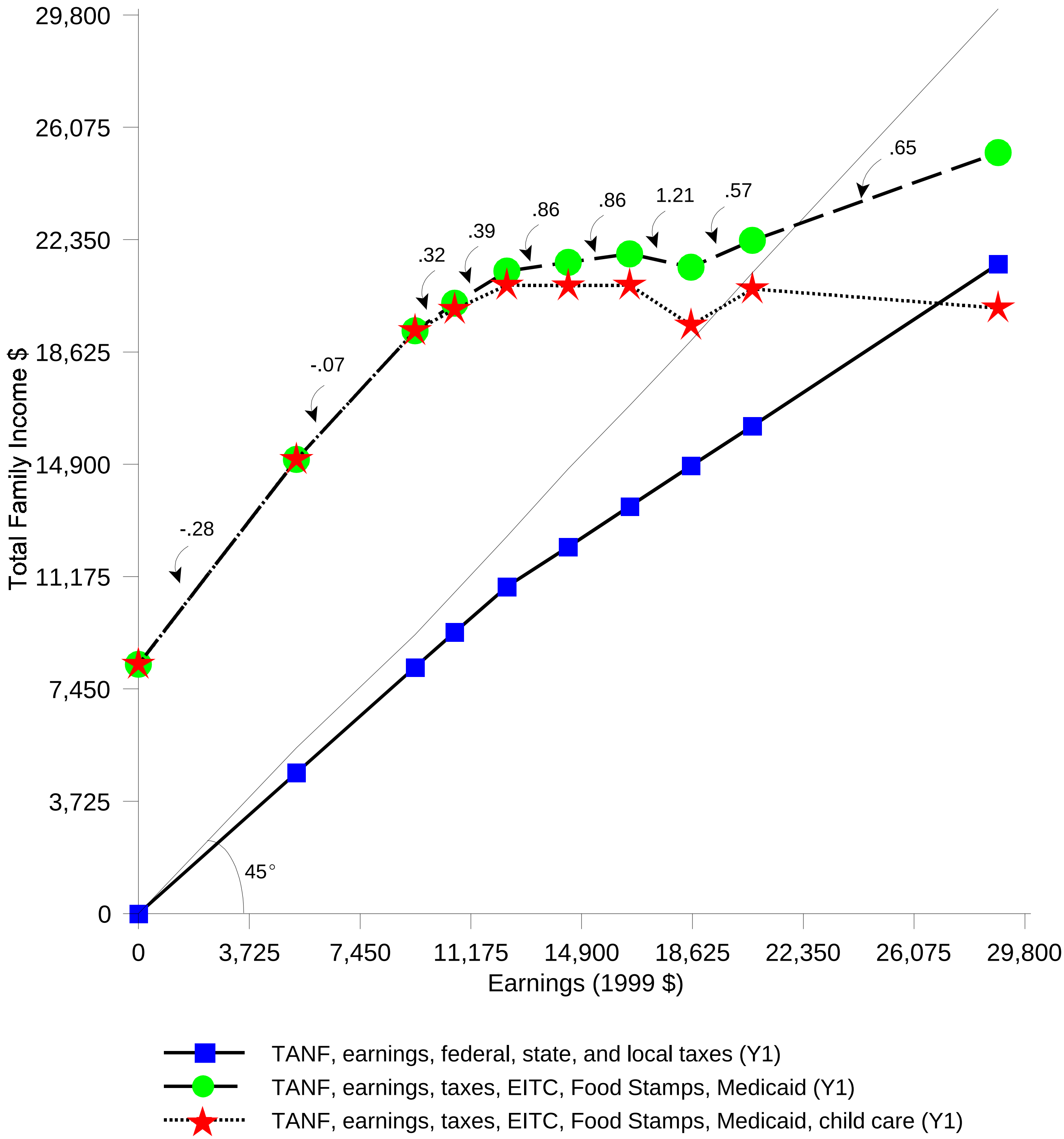
when earnings are between $6.20 and $9.30, and increases the trap as the subsidy is fully withdrawn at an income about 160 percent of the poverty line.

Time Limits

Figure 6 shows what happens if an individual in Wisconsin reaches the time limit and is no longer eligible for jobs in Tiers 3 or 4. This can be viewed as the long-run situation facing current recipients in Wisconsin. The lowest line, which combines TANF grants and earnings, begins at zero for those without earnings. The top line shows that Food Stamps and Medicaid would continue. But the important points illustrated here are (1) that it is far easier to set up a program with very low marginal tax rates if there are no (or very low) cash grants, and (2) that eventually the marginal tax rates become very high and create a “poverty trap.” The top line shows the full impact of the EITC for an individual who faces a negative marginal tax rate as she begins to work. The −28 percent means that for every dollar the woman earns, her family income increases by $1.28. Beyond this initial level, the rate she faces remains negative at 7 percent up to an earnings level of about $9,300. After this, her marginal tax rate increases so that by the time her earnings reach about $12,500, or about $6.00 per hour working full-time, full-year, she faces very high rates. These high marginal tax rates last through earnings of about $21,500, or about $11.00 per hour working full-time, full-year. Beyond this earnings level the rates remain high, at 57 percent and 65 percent, without taking child care into account. This illustrates the “iron law”: A program that provides targeted cash benefits must reduce these benefits as income rises, leading to high marginal tax rates, which discourage work effort.

The current form of child care subsidy (starred line) only accentuates this pattern. The starred lines in the figures above take child care into account by assuming that the state subsidy is accepted by all eligible families and that when the family is no longer eligible it will pay the state average cost for one preschool-age child and one school-age child requiring only after-school and vacation child care. Among families with an infant, the cost of care is far greater, so that losing the state subsidy would raise

FIGURE 6
Recipients Who Have Reached Time Limits under TANF Parameters in Wisconsin, 1999



the marginal tax rate considerably. For example, among Wisconsin low-income families with a child under age 2 receiving subsidies, the monthly cost of child care in spring 1999 was about $535. Families receiving state subsidies paid $42 on average, and the state paid $494. Families with incomes below 165 percent of the poverty line are eligible for the subsidy, and eligibility can continue up to 200 percent of the poverty line. The maximum payment is limited to 16 percent of gross income under the subsidy program. Loss of the subsidy would require this family to pay an annual amount for infant care equal to nearly 50 percent of the three-person poverty line.[19] In California, the average monthly cost of infant day care in 1998 was $585, more than 50 percent of the three-person poverty line (see Adams, Schulman, and Ebb, 1998, for more on the challenge posed by child care).

Thus we see that a system of multiple assistance programs targeted on the poor reduces the incentive to work longer hours. This is so even in the face of an expanded EITC, which is specifically designed to make work pay, is targeted on families with children, and has a rather low claw-back rate of 21 percent that begins at an hourly wage rate of about $6.23 (full-time, full-year) and continues to an hourly rate of $15.29 (full-time, full-year), or about 220 percent of the poverty line for a three-person family.[20] (See Figure A2 for the exact 1999 parameters of the EITC program.) More coordination of benefits might reduce the intensity of the poverty trap, but only more universal benefits are likely to significantly reduce the very high marginal tax rates facing the poor. It is possible to reduce these very high rates if we were to modify some of the benefit schemes of TANF. For example, a state could provide health insurance, either on a universal basis, by subsidizing it for all persons, or by withdrawing the subsidy after withdrawal of the EITC. The latter might be accomplished using a tax-refundable credit. Figures A3 to A5 show how incentives would change in Indiana, California, and Wisconsin if all persons

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[19]Estimates in this paragraph are based on Wisconsin administrative data for April and May 1999.

[20]For a family with one child the claw-back rate is below 16 percent. The lower tax rate on their credit is tied to the lower maximum credit. The maximum credit for a family with one child is about 60 percent of that of a two-child family.

(at least up to earnings of $28,000) were provided with health care insurance coverage without having to pay a premium or additional taxes. The work disincentives resulting from high marginal tax rates are clearly reduced and, while high rates remain, they are not even close to the much higher rates that result from income-conditioned medical care. A similar result could be achieved if all individuals and their families were provided health insurance at their place of employment with little or no cost-sharing required.[21] The children's health insurance programs (CHIP) change the income level at which children lose eligibility for subsidized insurance. CHIP does not change eligibility for adults. The only exception to this is the state of Wisconsin, which has a waiver to provide coverage to adults as well in its expanded CHIP program, BadgerCare. Table 3 shows the Medicaid eligibility levels and CHIP coverage as of 1999. The notes provide required payments for premiums and services. These programs are not yet incorporated in much of the analysis here, as take-up rates are not yet clear and eligibility formulas can be complicated and interact with employer-offered coverage.

Child Care

One of the most difficult issues in moving families off welfare and into work concerns child care. Child care is expensive and, unless subsidized, greatly reduces the take-home income of poor single-parent families, potentially making them worse off financially than if they did not work at all. In the figures above, the starred line represents income minus child care costs, after taking account of state

[21]Working, including working full-time, does not assure that individuals will have coverage. It is even less likely that their families will have employer-based coverage. Over all poor families in 1998, 47.5 percent of full-time workers were without coverage for the entire year (http://www.census.gov/prod/99pubs/p60-208.pdf). There are many reasons for low coverage: working for firms that do not offer coverage, not being eligible for a firm's coverage, or declining a firm's coverage due to substantial cost-sharing requirements. Lower-wage workers receive lower tax subsidies for private employer-based coverage, as the subsidy depends on one's marginal tax rate. (See Vanness and Wolfe, 1999, for more on employer-based coverage and coverage of low-skilled workers.) Those working part-time rarely receive health benefits. In 1994, the Bureau of Labor Statistics reported that only 5 percent of part-time workers in firms of 100 or fewer employees received health benefits (U.S. Bureau of Labor Statistics, 1994).

TABLE 3

Medicaid Eligibility Levels and CHIP Coverage in Selected States, 1999

	Medicaid Eligibility (pre-CHIP)				CHIP Coverage by Age			
State	0–1	1–6	6–14	14–18	0–1	1–6	6–14	15–18
Pennsylvania[a]	185%	133%	100%	39%	235%	235%	235%	235%
Indiana[b]	185%	133%	100%	100%		150%	150%	150%
California[c]	200%	133%	100%	85%	250%	200%	200%	200%
Wisconsin[d]	185%	185%	100%		185%	185%	185%	185%

[a]Families with incomes between 200 and 235 percent of the poverty line pay half the cost of premium for children.

[b]No premium imposed currently, but that will change if proposed expansion is approved.

[c]Ages 0–1: premiums 2% of family income; ages 1–19: 100–150% of poverty line, $7/month for one child, $14/month for two children; 150–200% of poverty line, $9/month for one child, $18/month for two children. Copayments: $5 for most services with a $250 annual cap.

[d]Parents of children covered by CHIP also covered; families can remain in program until incomes reach 200% of poverty line, at 150%+ of poverty line, premiums 3–3.5% of family income.

subsidies to offset those costs.[22] This is for a family with one preschool-age child and one school-age child. Without child care subsidies the families would gain little from working.[23] Under child care subsidy programs, most families must pay a share of the cost, and the subsidy is income-conditioned. This means that child care adds to already high marginal tax rates. Those families with younger children (infants) are likely to face even higher marginal tax rates as the higher subsidies are withdrawn. Requiring labor market participation of single parents with infants, when the costs of such care are equal to about two-thirds of a full-year, full-time job, raises questions of efficiency and further complicates the design of work incentives for the low-income population.

Recent evidence suggests that the picture presented in the diagrams may be more positive than is actually the case for many of the families eligible for assistance. According to an October 1999 news release by the U.S. Department of Health and Human Services, only 10 percent of children eligible for federal child care assistance in 1998 received it. The percentage ranged from a low of 4 percent in Mississippi to a high of 24 percent in West Virginia. Most states set limits below the federal maximums. The report found that "There were approximately 10 million children eligible under state-set limits in 1998, of whom only 15 percent were served. At the federal maximum limit, 27 states are serving less than 10 percent of eligible children, with the remaining states serving between 10 and 25 percent" (http://www.acf.dhhs.gov/news/cc98.htm).

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[22]Under the 1996 welfare law, the federal government estimates that 14.7 million children would be eligible at the federal limit of 85 percent of the state median income level. However, most states have set their income caps well below the federal ceiling (http://www.acf.dhhs.gov/news/cc98.htm).

[23]The Child Care and Development Fund is the major source of federal child care assistance for low- and moderate-income families. The program provides funding to states to subsidize care of the parent's choice, whether in a family child care home, with a relative, or in a child care center.

EARLY RESULTS UNDER THE NEW SYSTEM

To learn how recipients are faring under this new system, the traditional evaluation approach would be to use a national data set, such as the Current Population Survey or the Survey of Income and Program Participation, to model the parameters of the state rules in which the family resides and analyze whether these parameters influence outcomes. Unfortunately, the TANF programs are so new that such work is in the early stages.[24] We instead use state administrative data, which have the virtue of being more rapidly accessible and avoiding certain selection problems in data reporting.

This evidence points to several conclusions.

- Receipt of cash assistance is down dramatically. Figure 7 provides an overview of the AFDC/TANF caseloads over the period since 1987, using 1987 caseloads as the basis of the normalization. The caseload decreased dramatically after 1996, when the federal welfare reform was passed.[25] Wisconsin's reforms prior to the federal legislation appear to be reflected in the earlier and more dramatic decrease in that state.

- State studies of former AFDC/TANF recipients ("leavers" studies) suggest that 55–65 percent of former recipients have jobs about a year after exiting from AFDC/TANF; 35–40 percent are working full-time; perhaps 85 percent held a paying job at some time during the first year, but about a quarter returned to AFDC/TANF cash assistance within the first year.[26]

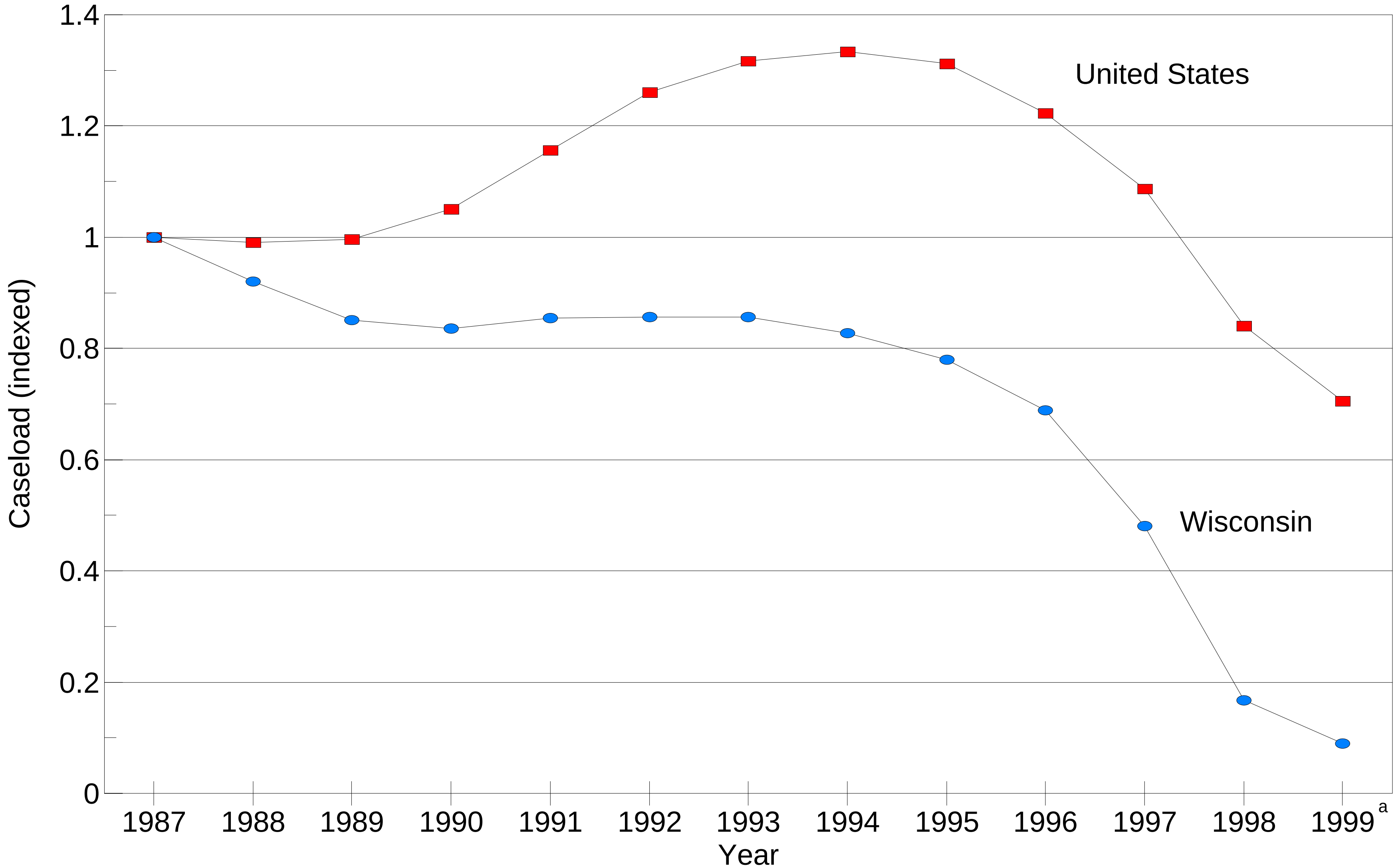
- Among those who are working, average quarterly earnings are about $2,500, and earnings drift up at about 8–10 percent a year for those who remain employed. This is consistent with the poverty trap noted above. However, this average masks large differences in quarterly earnings. For example, the most common industries of employment among former welfare recipients in Wisconsin are retail trade, health services, restaurants, and temporary agencies. According to Unemployment Insurance (UI) records, average first-quarter earnings in these sectors were, respectively, $1,960, $2,947, $1,630, and $1,782 (Cancian, Kaplan, and Meyer, 1999). Women who began

[24]Some recent work has used state waivers as the basis of analyzing the labor force response to welfare reform. See, for example, Moffitt (1999) and Figlio and Ziliak (1999). The potential endogeneity of state policy limits the usefulness of such studies for understanding the impact of the federal reform, however.

[25]The strong performance of the economy and the increase in the minimum wage are also likely to have contributed to the observed decline in caseloads. See, for example, a report by the Council of Economic Advisers, attributing about 35 percent of the decline to welfare reform, 10 percent to the macro economy, and 10–15 percent to the increase in the minimum wage (Council of Economic Advisers, 1999).

[26]For more detail, see Cancian, Kaplan, and Meyer (1999) and U.S. Department of Health and Human Services (1999).

FIGURE 7
AFDC/TANF Caseloads, 1987 - 1999, as a Multiple of the 1987 Caseload



Notes: Wisconsin data: calendar year monthly average. Wisconsin Department of Workforce Development, Economic Support Division; U.S. data: federal fiscal year monthly average: Health and Human Services, Administration for Children and Families.

[a]March 1999 data.

employment in temporary agencies tended to move to higher-paying jobs, especially among those with limited education and little or no prior work experience.

- The majority of former recipients still have at least one family member covered by Medicaid. This program provides either full coverage or no coverage. In contrast, fewer than half of these families receive Food Stamps, a program whose benefit is reduced as family income increases. Families that are eligible may only be eligible for small amounts, and requirements for recertification of eligibility at frequent intervals may deter claiming the benefit.[27]

- In terms of income, early evidence suggests that about 60 percent of former recipients have lower total income than they did while receiving AFDC/TANF. This analysis uses the combination of AFDC/TANF, the purchase value of Food Stamps, and the EITC with an adjustment for taxes. Perhaps 75 percent of these families live below the poverty line in their first year off of welfare. Poverty is higher among larger families, who are more likely to have experienced an income loss, because the cash assistance and Food Stamps they received under AFDC/TANF are conditioned on family size, while earnings are not.[28]

In most states cash benefit levels have been reduced, and those remaining on the rolls have less income than prior to reform. Some studies suggest that recipients continuing to receive aid are less able to work than are those who left the rolls in terms of education, mental health, a history of abuse, and the presence of disabled children.[29]

TANF programs can be expensive. Their costs include direct benefit payments, administrative costs, and costs of case management. A recent estimate in Wisconsin of the cost per family receiving benefits, excluding case management, was $13,500 (verbal communication, John Tuohy, Wisconsin Workforce Development). This reflects high administrative costs in areas with few recipients, and also reflects the high costs of a program designed to bring individuals who have limited if any job market experience into the work force.

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[27]Recent newspaper articles suggest another reason for low enrollment—reluctance by intake workers to provide information to potential beneficiaries on where or how to apply.

[28]These families may have additional income from a variety of sources such as earned and unearned income of other adult family members, earnings not subject to UI reporting and income from unreported activities (underground economy activities).

[29]A study by Primus (1999) using Current Population Survey data for 1993–1997 suggests that the bottom decile of the population has experienced a significant drop in income. For a description of those remaining on cash assistance see, Danziger et al. (1999).

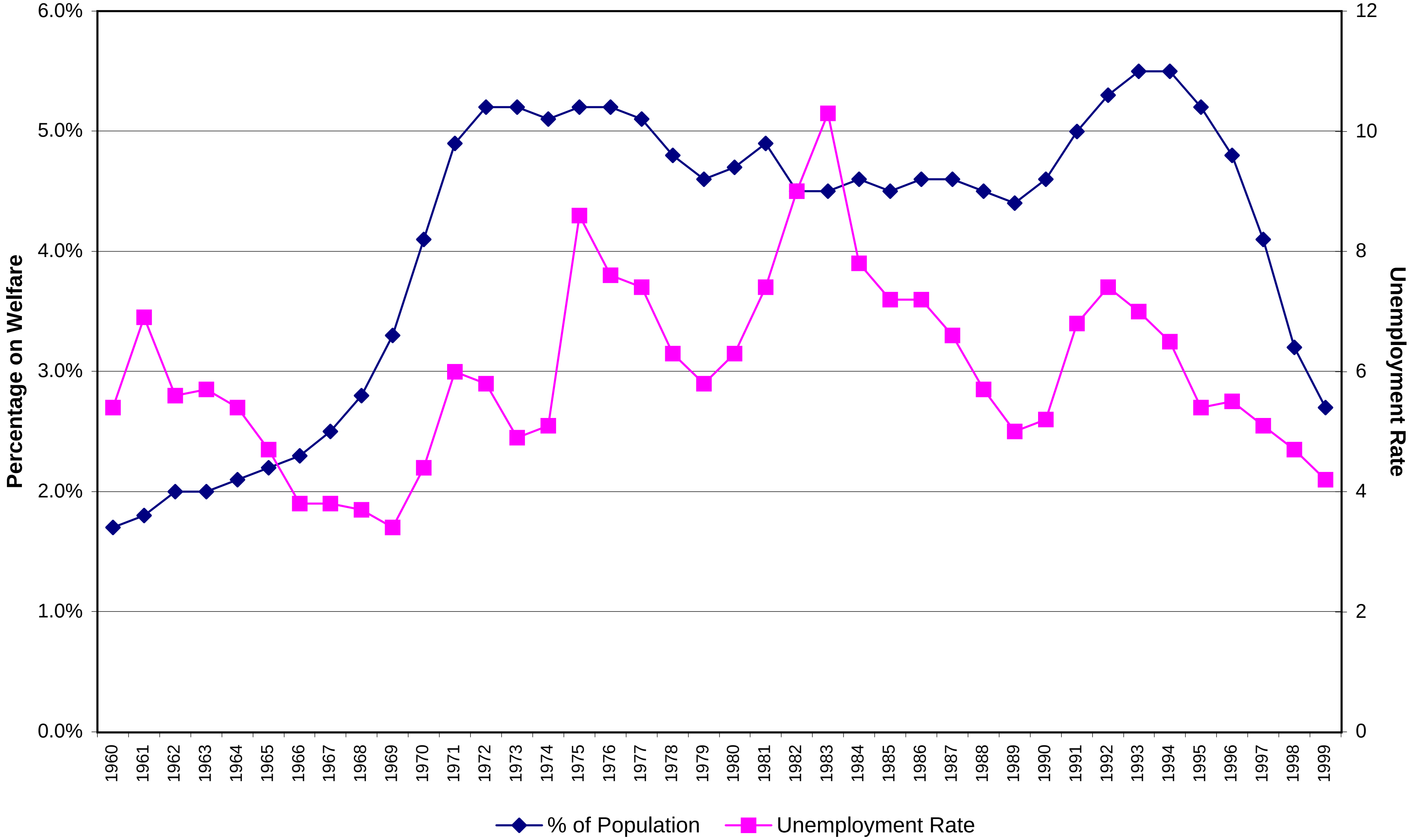
An additional issue concerns spillover to others in the labor market; that is, has the rise in labor force participation of former and potential welfare recipients had negative consequences on other low-skilled workers? Figure 8 indicates that it has not, owing to the creation of jobs, low unemployment rates, and increases in earnings among those in the lowest decile (see also Figure 9).

What then can be concluded from a review of the incentives of the new system and preliminary evidence concerning the new system? The current U.S. programs, as designed by states and constrained by the federal government, have not been successful in combining strong incentives to work with a safety net that can eliminate extreme poverty and provide an adequate income for those who will never succeed in the labor market. Federal law does permit states to allow up to 20 percent of their base-year caseload to waive many work requirements. The difficulty facing states is how to distinguish those who truly cannot succeed in the labor market from those who prefer not to work or to work only limited hours. States have not found a way to discourage cash assistance while encouraging full use of such in-kind benefits as Food Stamps. By deciding not to adopt a universal health insurance system, the United States lessened the incentives to work under TANF. The need to reduce health insurance benefits as income rises adds to high marginal tax rates. The decision to exempt from work requirements mothers who have children less than 12 months old greatly increases the public cost of the "welfare" system and adds to the difficulty of designing a system in which it pays to work.[30]

Is it likely that a TANF recipient will have earnings over the long run that keep her in the area of high marginal tax rates? Evidence from multiple sources all suggests yes. Table 4 indicates that white non-Hispanic and black non-Hispanic women aged 18–24 who had 9–12 years of education and who worked full-time, full-year had earnings of just under $12,000 in 1989. These earnings increased to only

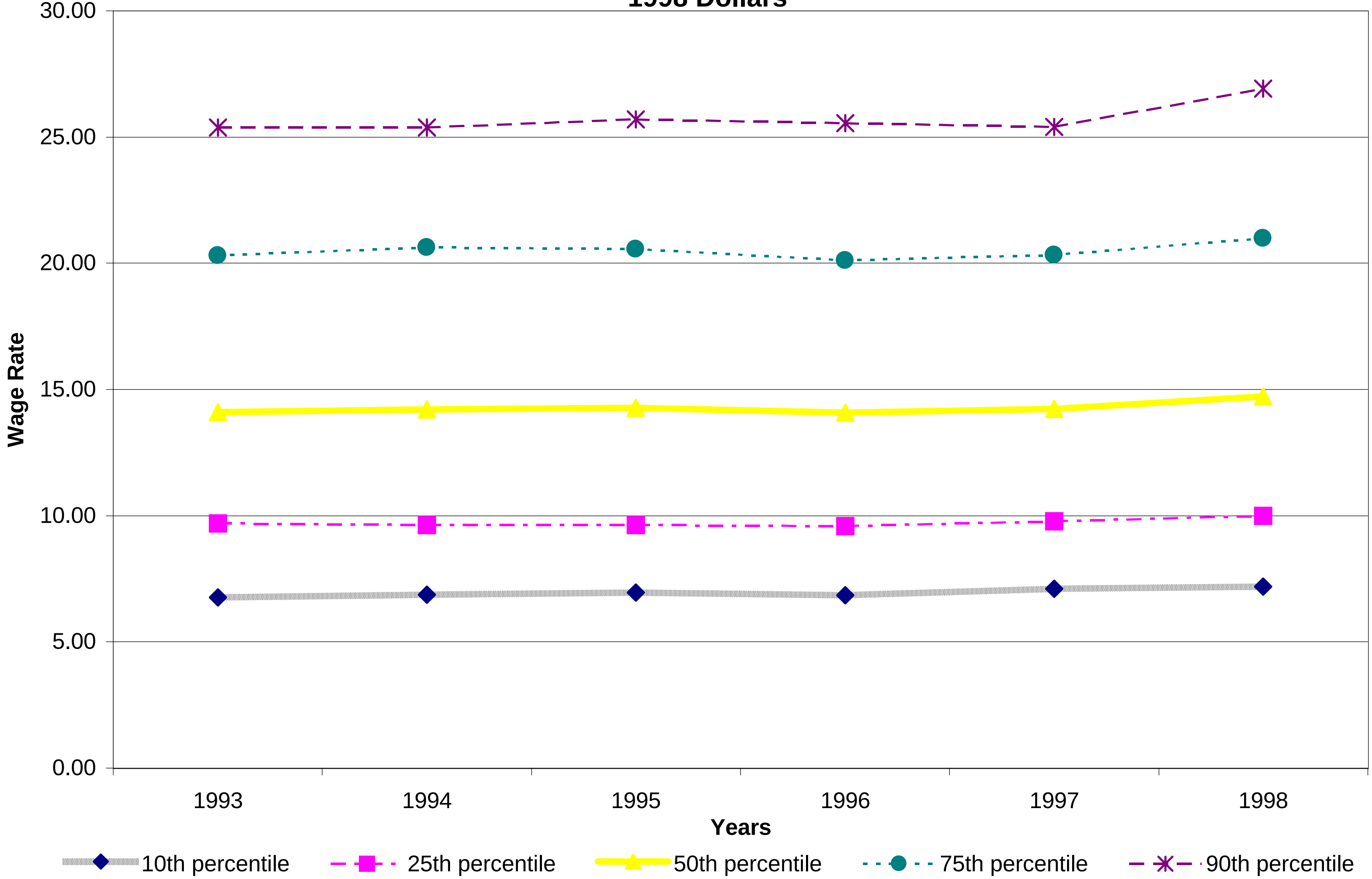
[30]Single individuals do not face these high rates, because they are eligible for only limited forms of assistance, such as Food Stamps and a small EITC. Figure A6 shows the relationship between earnings and income for such individuals. It shows that the marginal tax rate facing them ranged from .18 to .27; alternatively, their incomes were considerably lower than the three-person single-parent family that received all assistance for which the family was eligible.

FIGURE 8
Percentage of the U.S. Population on Welfare and Unemployment Rate since 1960



Source: U.S. Department of Health and Human Services, January 1999 <http://www.acf.DHHS.gov/news/stats/6090_ch2.htm> and U.S. Department of Labor, 1999, Labor Force Statistics from the Current Population Survey <http://stats.bls.gov/cpset.bs.htm>.

FIGURE 9
Hourly Wage Rates, Men Aged 25–55
1998 Dollars



Source: CPS Outgoing Rotation Groups, calculations by Deborah Reed, Public Policy Institute of California.

TABLE 4

Selected Labor Force and Earnings Profiles of White and Black Women, 1989

	9 to 12 Years of Education		High School Graduate[a]	
	White Non-Hispanic Women	Black Non-Hispanic Women	White Non-Hispanic Women	Black Non-Hispanic Women
Ages 18–24				
% of those who worked < FTFY	80%	79%	57%	65%
Average annual earnings	$3,848	$3,784	$5,725	$5,310
If work FTFY	11,974	12,099	13,272	12,837
Average hourly wage	5.62	5.68	6.26	6.07
Ages 25–29				
% of those who worked less < FTFY	56%	58%	42%	47%
Average annual earnings	$6,690	$6,166	$8,240	$7,906
If work FTFY	14,331	13,565	16,476	15,019
Average hourly wage	6.64	6.32	7.68	7.08
Ages 30–34				
% of those who worked less < FTFY	51%	52%	43%	42%
Average annual earnings	$7,166	$6,970	$8,330	$8,900
If work FTFY	14,444	14,091	17,834	16,269
Average hourly wage	6.97	6.60	8.27	7.65

Source: *1990 Census of Population and Housing.* SSTF22 Earnings by Occupation and Education <http://govinfo.library.orst.edu/earn-stateis.html>.

[a]Includes GED.

just over $14,000 among those aged 30–34. Women with a high school degree fared somewhat better: among white women aged 30–34, mean earnings were nearly $18,000. The full-time, full-year earnings of black women with a high school education was $16,269. In 1998 dollars, this is $23,443 among white women aged 30–34, but only $21,385 among their black counterparts, $19,742 among those aged 25–29. For those with 9–12 years of education, average earnings in 1998 dollars would be $18,986 among white women aged 30–34. Women working fewer hours have far lower average incomes, as can be seen in the table; these are the majority of working women with 9–12 years of education.

Median usual weekly earnings of full-time wage and salary workers for the third quarter of 1999, as reported by the Bureau of Labor Statistics (BLS), are $287 per week, or about $14,500 per year, for women aged 25 and over with less than a high school diploma, and $409 per week, or about $20,000 per year, for women of the same age group who are high school graduates (http://stats.bls.gov/news.release/wkyeng.t04.htm). The BLS also has reported annual growth rates in real hourly earnings over the years 1978–1995 among women aged 31–38 in 1998. For those lacking a high school diploma, these rates were 2.9 percent at ages 23–27 and 0.9 percent at ages 28–32. For women with a high school diploma, the rates were 3.3 and 2.9 percent, respectively (http://stats.bls.gov/news.release/nlsoy.t05.htm).

Another piece of evidence comes from a study of former recipients of AFDC/TANF in Wisconsin. Two groups of women were studied: those who left cash assistance in the third quarter of 1995 and those who left in the third quarter of 1997. In the first year after exit, the median leaver in 1995 had earnings (1998 dollars) in the range of $5,317 to $9,300; three years later the median remained in this range. Among women with earnings, the median was in the range of $10,633 to $12,384 in the first year after exit and $12,385 to $14,448 in the third year after exit. For women who left in 1997, median earnings in the first year were $5,316 or less among all leavers and in the range $5,317 to $9,300 among those with earnings. Table 5 gives a more complete picture of how the women who left cash assistance in

TABLE 5

Earnings and Work Experience of Wisconsin Leavers in Three Years after Exit (1998 Dollars)

	First Year after Exit	Second Year after Exit	Third Year after Exit
All Leavers (4th Quarter 1995, N=8042)			
Percentage with earnings	81.1	78.5	76.9
Among those working in year			
Mean earnings	$9108	$10294	$11450
Median earnings	$8608	$9627	$10924
Mean number of quarters worked	3.0	3.2	3.3
Percentage continuously employed	66.2	69.7	71.1
Percentage continuously employed by same employer	42.4	44.7	45.3

Source: Cancian, Haveman, Meyer, and Wolfe (1999), from Table 3.

1995 fared over the following three years. (For more on this population, see Cancian, Haveman, Meyer, and Wolfe, 1999.)

We conclude that the majority of single women with children can expect to continue to face high marginal tax rates even when they work full-time, full-year and increase their labor market experience. To avoid high marginal tax rates, they must earn more than $10 per hour and work full-time, full-year. When children requiring child care are present, most women need a wage rate of at least $15 per hour and must work full-time, full-year to avoid these rates. The incentives now are clearly to work, but working more or harder does not seem to pay.

Are there aspects of these programs conducive to achieving the goals of welfare reform? Several components of state TANF programs seem to achieve efficiency with equity. These include the federal EITC, which is supplemented in several states. (The data for Wisconsin incorporated its state EITC.) One advantage of the EITC is that it is (or can be) targeted on a particular group, such as parents of dependent children. A second advantage is that because it is an earnings supplement, it encourages work. A disadvantage of its current form is that because it is targeted on lower-income groups, it must be reduced as income rises, discouraging additional work effort.

The welfare reform policies in a number of states, including Wisconsin, provide a guaranteed job opportunity for everyone in the program. This is likely to require public service jobs as a backup or safety net for any system in which work is required. Any program that requires work as the basis of earning the right to benefits must provide a job for all those who request a job. Public service jobs, especially at times of high unemployment, may be the key to the success of work requirements.

Another positive component of state welfare systems is the use of skilled case workers to develop a plan to help low-skilled individuals achieve job preparedness, to act as job placement agents, to help arrange child care, and to assist recipients in applying for other assistance programs. This is part of the design of the Wisconsin program. Finding and training case workers who can do this is not an easy task, yet such a system can greatly improve the outcomes of the policy and the lives of the clients.

An aspect needing careful consideration is the provision of targeted child care subsidies. In addition to subsidies, some regulation of the quality of care statewide and an information network to facilitate locating care may improve the functioning of the system and the well-being of children. Combining direct subsidies with refundable child care tax credits may make care affordable and reduce the disincentives associated with increased earnings. Expanding the current exemption beyond the first 12 months of a child's life deserves consideration.

Another lesson to be learned from Wisconsin's welfare reform is that temporary jobs may be a useful transition into the work force for individuals without prior work experience. In temporary placements individuals receive training in the world of employment and learn about the expectations of employers. The experience of leavers in Wisconsin suggests that most move from temporary employment into higher-paying positions within one year.

APPENDIX A

The Welfare System until 1996

The core of pre-reform assistance policy consisted of four awkwardly integrated programs targeted at poor working-age families with children.

1. Aid to Families with Dependent Children (AFDC) *(discontinued under welfare reform, replaced by Temporary Assistance for Needy Families, TANF)*

   - Cash assistance to poor families with children headed by a single parent or guardian.
   - AFDC provided family-size-conditioned cash income support to about 14 million people in 5.1 million families, or about 5.5 percent of the nation's population. The support ranged from $740 per month in Connecticut to less than $150 per month in Mississippi. Average benefits had eroded over time from $704 per month in 1970 (1995 dollars) to $377 in 1995.
   - AFDC penalized earnings. For every $1 increase in earned income over allowable deductions, benefits were reduced by 67 cents initially. After four months, benefits were reduced dollar-for-dollar with an increase in earnings. Thus the statutory tax rate on earned income, or benefit reduction rate, for AFDC recipients was 67 or 100 percent, clearly discouraging work.
   - AFDC was an entitlement program; that is, if a family satisfied the eligibility condition(s) for AFDC, then it received benefits according to the appropriate benefit formula.
   - On average 55 percent of the cost of AFDC was financed by the national government.
   - States administered the program, set benefit levels, and shared costs.

2. Food Stamp Program *(continues under welfare reform, although changes were made to require work and reduce eligibility, described below)*

   - Poor families are eligible for Food Stamps, which entitle the holder to purchases at authorized food stores, depending on their income.
   - The federal government pays for the Food Stamp Program, but the local offices administering the AFDC/TANF program determine eligibility and amounts.
   - In 1998, the Food Stamp Program provided about $16.9 billion in benefits or $170 per month to the average recipient family. In that year, about 20 million of the nation's population received Food Stamp benefits. This is down from 25.5 million two years earlier (pre-reform).
   - To be eligible, a family must pass an asset test and a net and gross income test. Net income must not exceed the poverty line, equal to $13,880 in 1999 for a single parent with two children, and gross income must not exceed 1.3 times the poverty line. A household is limited to $2,000 in assets plus a car worth less than $4,650.
   - Maximum Food Stamp benefits vary by family size and are reduced as family net income increases. Net income includes AFDC/TANF benefits, and there are deductions for work expenses, child care expenses, and shelter expenses.
   - States generally require Food Stamp households to have their eligibility recertified every three to 12 months.

TANF Modifications to Food Stamp Program

- Under TANF, states may disqualify individuals from participation in the Food Stamp Program for TANF violations.
- Under TANF, able-bodied adults without dependents who, during the preceding 36-month period, received Food Stamp benefits for at least three months but worked less than 20 hours per week are disqualified. Similarly, the act required the states to remove most permanent resident aliens, who were previously eligible to receive Food Stamps.

3. Medicaid Program *(continues under welfare reform, expanded to cover more children)*

- Provides health care benefits to poor children (even those in two-parent families), single mothers who receive AFDC/TANF benefits, and pregnant women.
- The benefit package is quite generous, roughly equal to a private comprehensive package of health insurance.
- Medicaid is administered by the states (again, largely through the local welfare offices), which also bear some of the costs of the program, according to a matching formula.
- AFDC/TANF recipients losing eligibility because of increased earnings receive Medicaid for an additional 12 months. However, after this period the adults lose all benefits unless income remains below the cutoffs in effect in the state under AFDC.
- All states are now required to cover all children less than 6 years old with family income below 133 percent of the poverty line, and all children born after September 1, 1993, with family income below the poverty line. This change, which was made under AFDC, was designed to reduce the negative work incentive effects of the tie between Medicaid and AFDC.

4. Earned Income Tax Credit (EITC) *(continues under welfare reform)*

- EITC works through the federal income tax. It is available to all low-income working taxpayers but is targeted on those with dependent children. It is a refundable credit: If the amount of a family's credit exceeds its tax liability, the family receives from the Internal Revenue Service a refund check for the difference. If a working family earns too little to owe federal income tax but qualifies for the EITC, the IRS sends the family a check.
- Only those who work can qualify for the EITC. For families with very low earnings, the value of the credit increases as earnings rise. The EITC operates effectively as a wage supplement, lifting low-wage working families with children closer to, or in some cases above, the poverty line.
- The benefit subsidizes annual earnings at a 40 percent rate up to about $9,500 for a family with two children (for a credit of more than $3,000 per year). This maximum credit is reduced as family earnings rise above about $11,500; no EITC is available for families with income in excess of about $29,500.
- Increases in the EITC enacted in 1990 and 1993 provided a larger credit each year from 1991 through 1996 to qualifying families with children.
- A number of states enacted EITCs that supplement the federal plan.

- The federal EITC was established in 1975 to offset the adverse effects of Social Security and Medicare payroll taxes on working poor families and to strengthen work incentives.

The major provisions of welfare reform in the U.S. include:

- Eliminating the Aid to Families with Dependent Children (AFDC) program, thereby eliminating the right to public financial support when destitute.
- Reassigning fiscal and regulatory responsibilities for assisting the nation's poor families from the federal government to state and local governments.
- Providing a "block grant" to each state, paid for with money saved by eliminating AFDC, and giving states wide discretion in the use of these funds.
- Imposing responsibilities on states for enforcing work—often full-time, year-round work—by poor, often single-parent, families.
- Creating a new and less supportive environment in which poor families have to cope.

Federal requirements imposed on states by welfare reform:

- States must meet stiff goals in terms of the proportion of assisted families that have full-time workers; for example, by 2002, 50 percent of all assisted one-parent families must have a worker employed at least 30 hours per week.
- States are required to collect child support payments from noncustodial parents.
- States must impose rules that eliminate the provision of income support to any family after it has received a total of five years of help.
- States must require that unmarried teen parents who receive help attend school and live with their parents (or other adult supervisors).
- States must deny income support to anyone convicted of a drug-related crime, to mothers who won't identify the fathers of their children, and to legal immigrants admitted to the country after August 1996.

Definition:

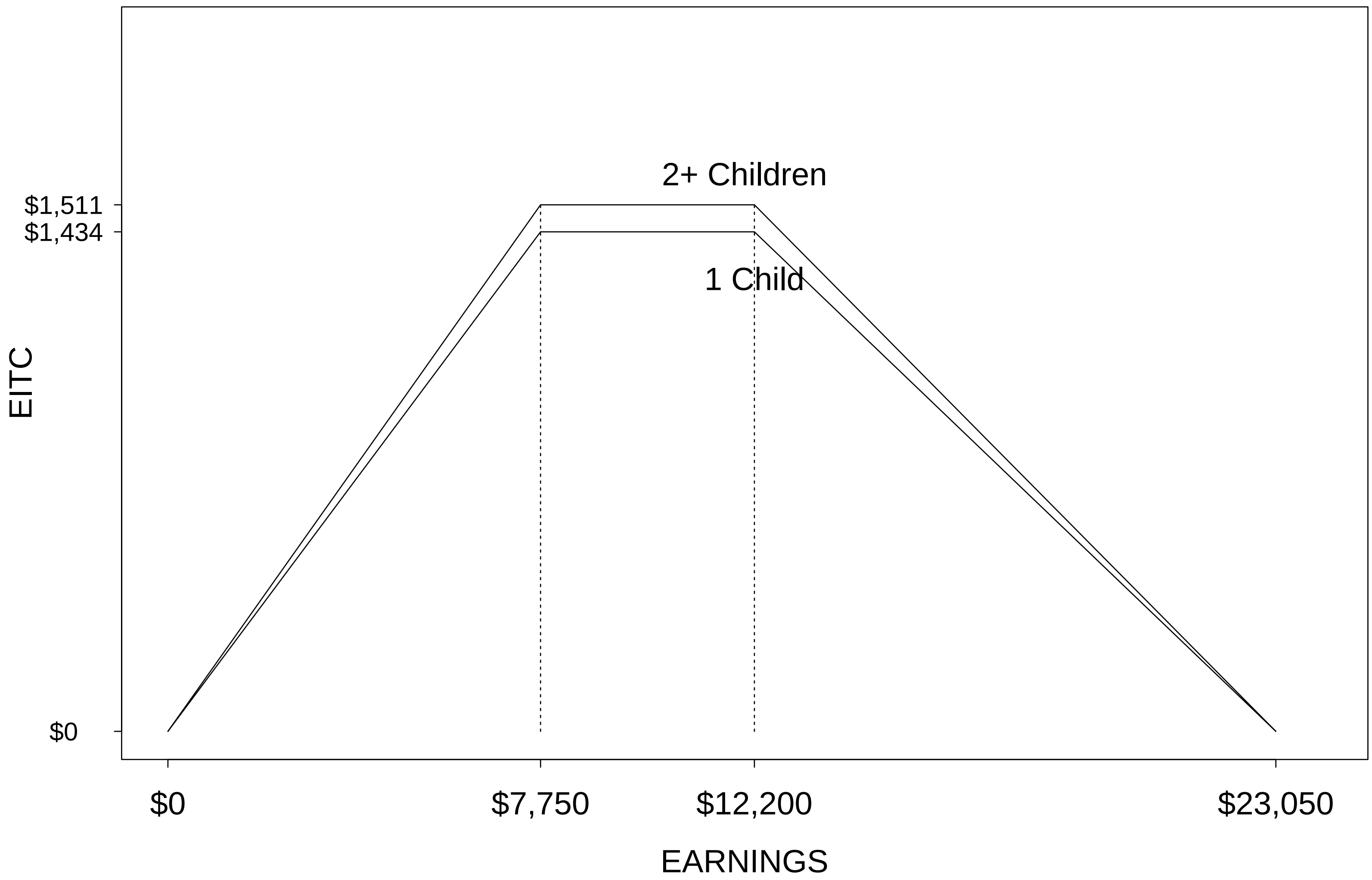
MOE – Maintenance of Effort: In enacting TANF, the U.S. Congress imposed an MOE obligation on states, providing that a state would be penalized if it failed to maintain spending of at least 80 percent (or 75 percent if the state met TANF participation rates) of a "historic state spending" level each year.

Forms of Subsidy for Child Care:

1. Nonrefundable tax credit for taxpayers who incur work-related child care expenses. Maximum amount goes to those at 140 to 160 percent of poverty line; $2.8 billion in 1998.
2. Block grants to states that can be used to subsidize child care for low-income parents who are working or participating in work-related activities or education programs. Average federal subsidy is $66 per week; total expenditure $2.9 billion in 1997.
3. Employers may exclude the provision of child and dependent care or employee contributions to such care accounts from employees' taxable income and Social Security earnings. Worth most to those in high marginal brackets.

FIGURE A1

Federal EITC Parameters 1993

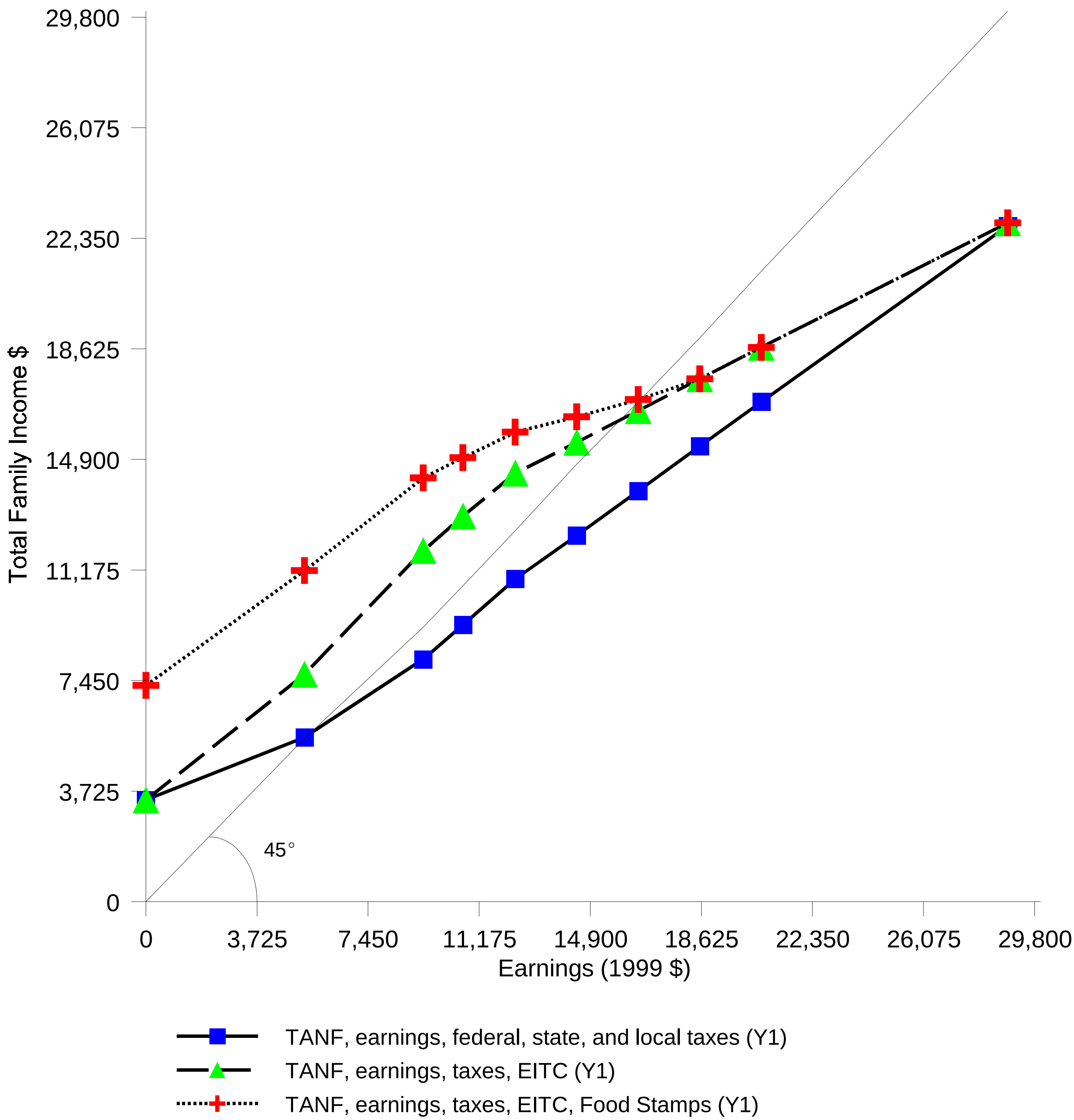


Source: Dickert-Conlin and Houser, 1999.

FIGURE A2
Federal EITC Parameters 1999

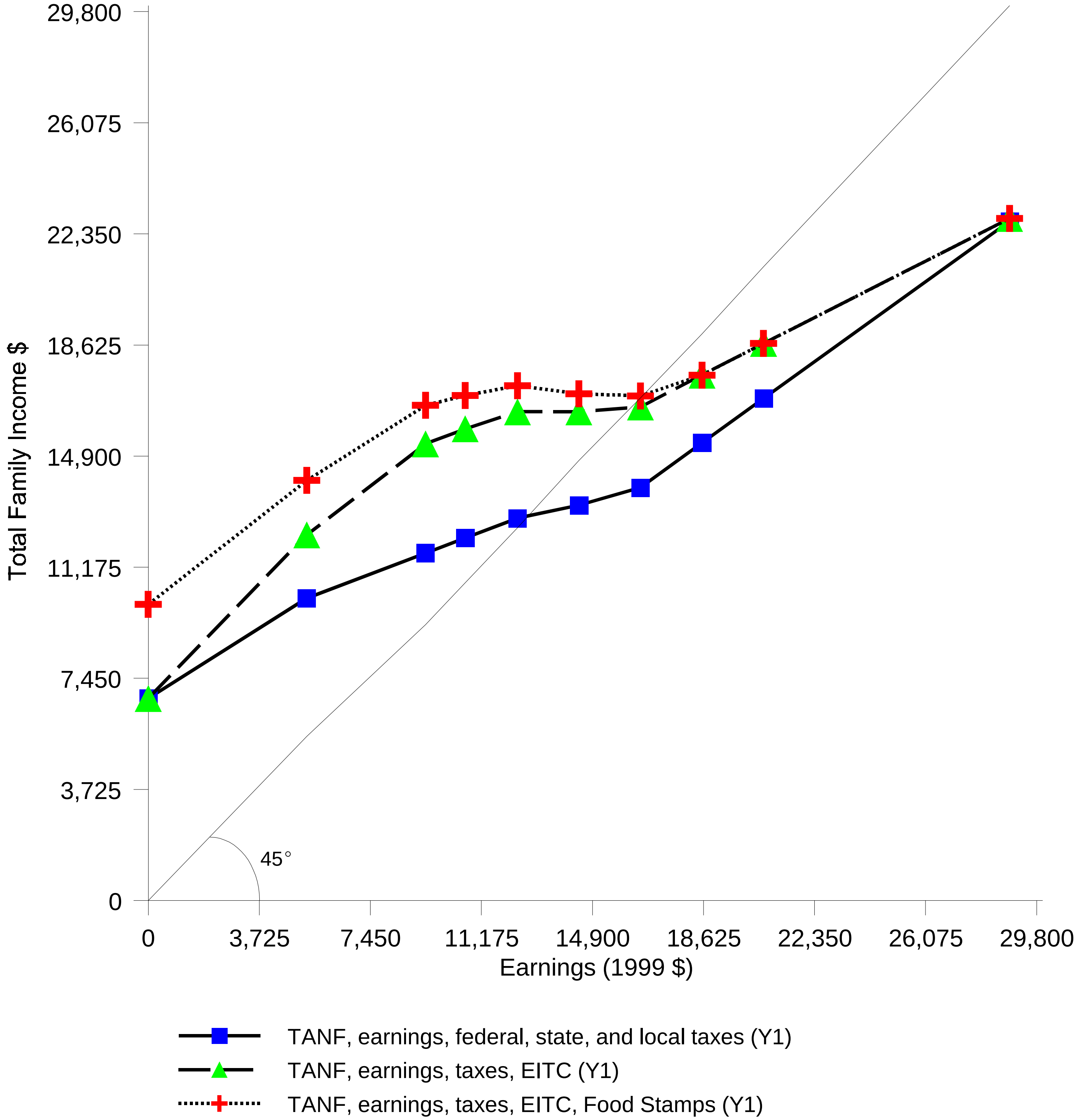
Source: Dickert-Conlin and Houser, 1999.

FIGURE A3
Indiana - TANF Parameters with Universal Health Coverage[a]



[a]The value of the coverage is not included in the income constraints.

FIGURE A4
California - TANF Parameters with Universal Health Coverage[a]



[a]The value of the coverage is not included in the income constraints.

FIGURE A5
Wisconsin - TANF Parameters with Universal Health Coverage

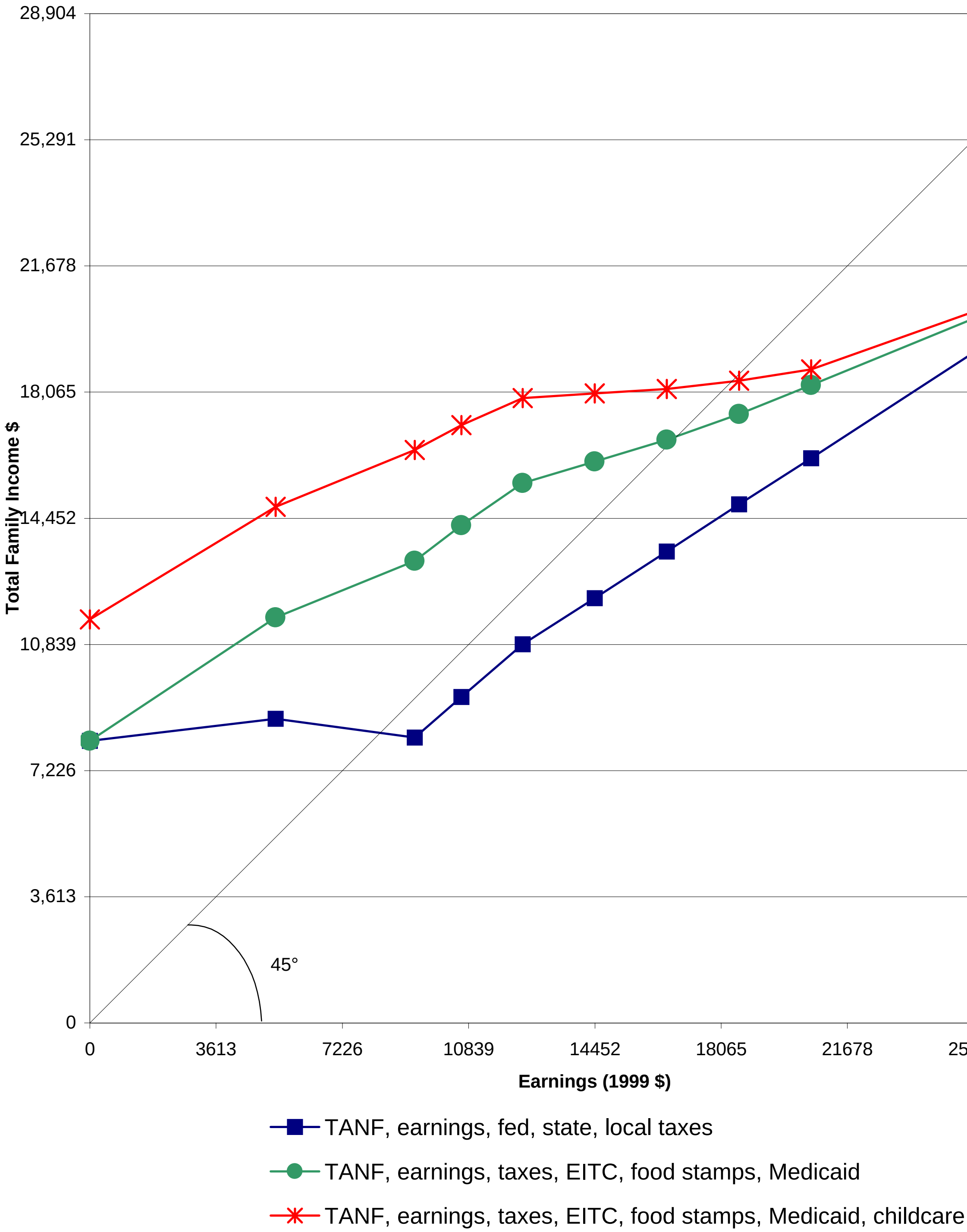
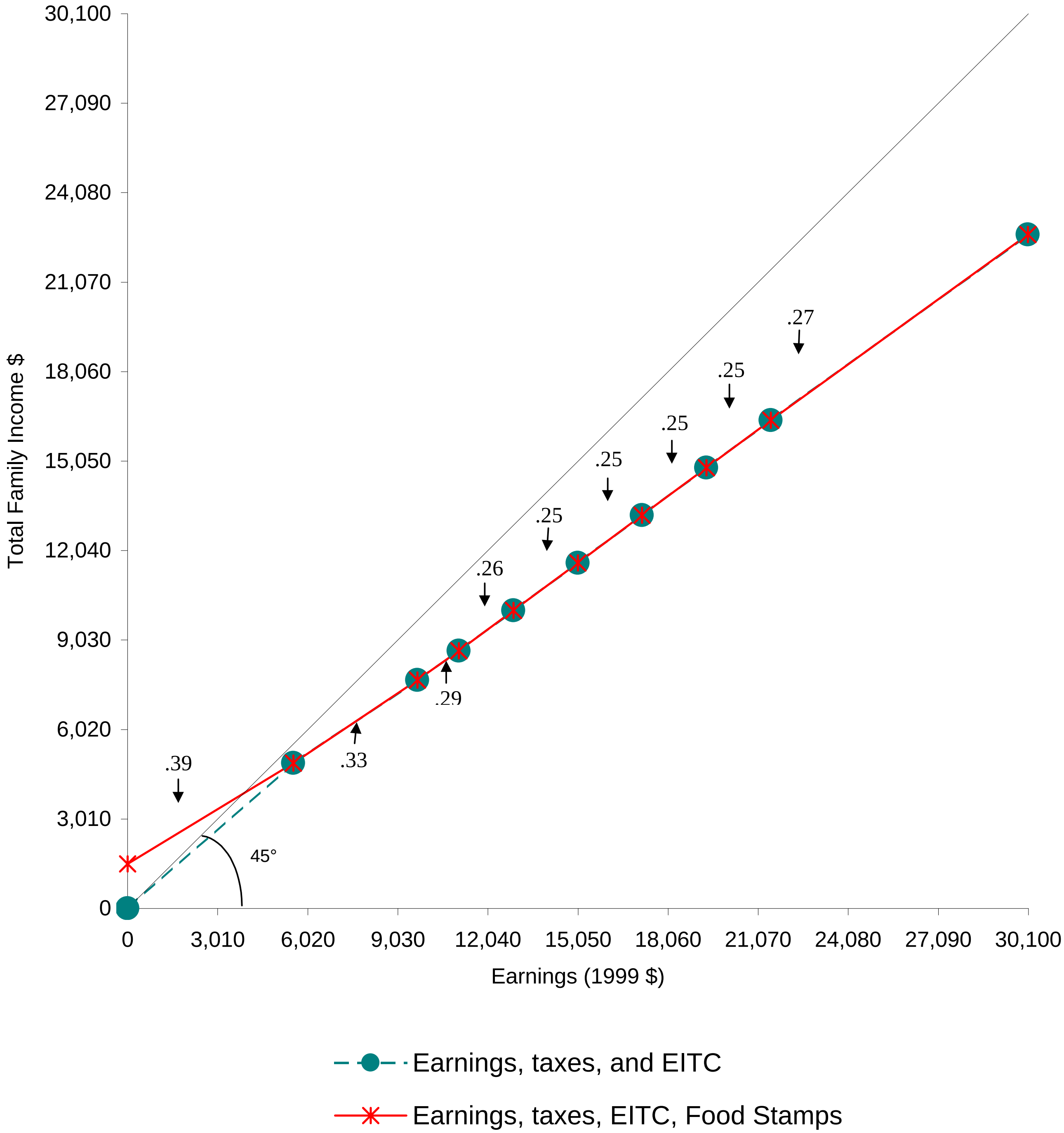


FIGURE A6
Earnings and Income of a Single Individual, Pennsylvania, 1996



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