Welfare, Employment and Income:
Evidence on the Effects of Benefit Reductions from California

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In recent years there have been unprecedented changes in welfare. The 1996 Personal Responsibility, Welfare and Opportunity Reconciliation Act (PRWORA) abolished AFDC and created Temporary Assistance for Needy Families (TANF), a set of block grants that gave states nearly complete freedom in designing their welfare programs. Between March 1994 and March 2001, welfare caseloads fell 59 percent, to 2.1 million families from 5.1 million. These changes in welfare caseloads mirror changes in employment rates of single women, which rose to 76.5 percent in 1998-99 from 67.5 percent in 1989-90.

After a recession early in the decade, the economy experienced the longest economic expansion in U.S. history beginning in March 1991, with GDP growing for 120 consecutive months. The unemployment rate fell to 4.0 percent in 2000, its lowest level since 1969. With the strong economy, state and federal budgets prospered. The good fiscal climate and the funding and flexibility of TANF allowed many states to expand childcare benefits, health insurance, and transportation services for low-income families and to change welfare rules so that recipients could keep a greater share of earned income than was previously the case.

The overwhelming majority of pre-TANF welfare waivers and current state TANF plans employ one or more of the following building blocks: mandatory employment services, earnings supplements, and time limits on welfare receipt. There is a considerable amount of emerging evidence that these changes along with the strong economy and expansion of the earned income tax credit increased employment of low-skilled families. (See, for example, Dan Bloom and Charles Michalopoulos, 2001; Jeffrey Grogger, 2001; V. Joseph Hotz, Charles Mullin, John Karl Scholz, 2001; and Bruce Meyer and Daniel Rosenbaum, 2001.) Yet if history is any guide to the

future, state policymakers facing deteriorating fiscal climates will contemplate cutting welfare benefits.

This paper summarizes results from a larger paper (Hotz, Mullin and Scholz, 2002) in which we analyze data from an experimental evaluation of welfare reform in California during the early part of the 1990s. Starting in 1991, California experienced a severe economic downturn. Prompted by the very weak state economy and sharply rising welfare caseloads, California implemented changes in its Aid to Families with Dependent Children (AFDC) program that included, among other changes, a 15 percent reduction in the maximum benefits provided to families on aid. We exploit these data to assess the impact of these changes on the employment, labor market earnings and levels of disposable income for low-income households. Because this experiment was run for almost 6 years, we are also able to assess the long-run effects of the benefit changes. Understanding how welfare reforms, especially benefit reductions, affect employment and financial resources available to poor households is important, given the goal of work-based welfare reforms to move these families towards economic self-sufficiency.

1. The California Work Pays Demonstration Project (CWPDP) and the Data

In 1992 and 1993, California altered several aspects of its AFDC program, including reducing the maximum aid payment by 15%. In addition, the State eliminated the 100 hour (per month) work limitation for remaining eligible for two-parent families on AFDC due to the unemployment of one or both of them (AFDC-U) and removed the time limit for the $30 and 1/3 income disregard. (California also implemented Cal-Learn, a program to encourage pregnant teen mothers to stay in school, increased the limits on personal assets used to determine eligibility for AFDC, and implemented some changes in the state's existing welfare-to-work programs.) Because the benefit reductions were greater than federal regulations allowed, the state was

required to obtain a federal waiver. The waiver included a requirement that an evaluation of the effects of the changes be conducted using random assignment. Thus, in the CWPDP families on welfare were randomly assigned to an experimental group that was covered by the new welfare provisions or to a control group that were subject to the pre-1992 welfare laws, including higher guaranteed benefits.[1]

Any experimental-control comparison using households from the CWPDP will estimate the combined effect of the set of changes noted above. Thus, this experiment does not allow one to directly isolate just the effects of the AFDC benefit reduction from these other changes. Nonetheless, we note that static models of labor supply would predict, under reasonable assumptions, that the combination of the *reduction* in the guaranteed levels of AFDC benefits and the *elimination* of the time limits on 33 percent benefit reduction rate would tend to increase employment. (This would occur if income effects for labor supply are negative and the positive substitution effects associated with a wage change dominate the latter.) Furthermore, we note that eliminating the 100 hour rule only applied to AFDC-U cases, reinforcing the notion that the primary changes confronting one-parent (AFDC-FG) households were the reduction in the welfare benefit guarantee and the reduction in the benefit reduction rates.

The CWPDP was conducted in four counties – Alameda, Los Angeles, San Bernardino, and San Joaquin. Fifteen thousand AFDC recipients in the four counties were randomly selected to participate in the study, with one-third of these cases assigned to the control group and the remaining to the treatment group. Subsequently, new welfare cases were randomly assigned to treatment-control status in this same proportion. This experiment continued until the end of December 1997, when all households in the CWPDP, including control group members, were subject to the provisions of California's TANF program and the other provisions of CalWORKs.

In our analysis, we focus on the households in the CWPDP that meet the following criteria. First, we only analyze households residing in Alameda, Los Angeles and San Bernardino counties, given administrative difficulties with data gathering in San Joaquin County. Second, we focus only on the households who were on welfare in October 1992, ignoring the households who joined the caseload during the experiment. Third, we limit our analysis to households that had one or two adults in an assistance unit at the time of their enrollment into the CWPDP.

Data on AFDC and food stamp participation and payments are derived from the County Welfare Administrative Databases (CWAD) and the State's Medi-Cal Eligibility Data System (MEDS). We also use quarterly data on employment and earnings from the California Employment Development Department (EDD) Base Wage Files, which contain information on wages and salaries from jobs covered by unemployment (UI) and disability insurance (DI). In Hotz, Mullin and Scholz (2002), we compare these earnings data from EDD records with earnings reported by recipients to county welfare offices and find evidence of substantial underreporting of earnings reported to welfare officials. This pattern is consistent with the incentives created by welfare programs to underreport earnings so as to maintain eligibility for benefits.

In our analysis sample, roughly two-thirds of the households are headed by a single parent (AFDC-FG cases) with the remainder being unemployed, two-parent households (AFDC-U cases). In 98.5 percent of the cases, all adults were successfully matched to UI/EDD earnings records, the data that we use to measure employment.

2. Effects of Benefit Reductions on Employment

Table 1 presents treatment and control group means, as well as treatment-control differences, for employment rates, earnings, welfare payments and disposable income for

families in the CWPDP from 1990 through 1998. One can see that employment rates fell from 1990-92. As mentioned earlier, California was hard hit by the recession in the beginning of the 1990s. Given that these adults are on welfare at the end of 1992, it is not surprising to see declining employment rates prior to this date. After 1992, employment increased steadily for the control and experimental groups, by more than 25 percentage points for the experimental group and more than 20 percentage points for the control group.

In the first year of the experiment, employment rates for the experimental group exceed employment rates of the control group. The experimental-control differences range from 1.9 percentage points in 1993 to 4.6 percentage points in 1996 and 1997. In all cases these differences are statistically significant at usual levels of confidence. Note that these differences are fairly sizable. Employment rates of experimental households are more than 10 percent higher than employment rates of control households in 1996 and 1997.

As the table shows, the treatment-control differences fell by 37 percent between 1997 and 1998, when the experiment ended and the same welfare program was available to the two groups. Finally, we note that the employment rates are very low for both treatment and control households in all of the years. Nonetheless, by the end of the period analyzed, roughly half the households have some employment income reported to the UI system at some point during the year. In Hotz, Mullin and Scholz (2002), we also examine the treatment effects for this experiment, controlling for a variety of covariates in an attempt to improve the precision of these estimates. None of the inferences drawn from the simple mean differences in Table 1 are altered.

To give a sense of the magnitudes of the economic relationships shown in Table 1, the average AFDC benefit was $8,217 for households in our sample in 1993 (in 1998 dollars, the unit for all dollar amounts in the paper). A 15 percent reduction in benefits, therefore, would

result in an average annual benefit reduction of roughly $1,232. Based on the results in Table 1, the elasticity of the employment rate with respect to the guarantee (and other changes in the package) is about –0.68 to –0.77. These elasticities are similar to those reported by Sheldon Danziger, Robert Haveman and Robert Plotnick (1981) in their survey of the effects of transfer programs on the employment of female-headed households.

Finally, we note that between 1992 and 1997 (the end of the CWPDP), employment rates of control households increased by 19.2 percentage points and by 25.4 percentage points for experimental households. The difference is 6.2 percentage points. This is a sizeable effect, but it also implies that more than 75 percent of the employment changes of the treatment group is driven by other factors, presumably including the strong economy, expansions of the EITC, and other factors influencing labor supply and demand.

3. Effects of Benefit Reductions on Household Financial Resources

One of the goals of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 is to "end the dependence of needy parents on government benefits by promoting job preparation, work, and marriage" (see Section 401 of H.R. 3734). To satisfactorily meet this goal, families must be able to find and hold jobs that allow them to nurture the physical and psychological well-being of the adults and children in the household. While the rhetoric of self-sufficiency is appealing, it collides with often exceptionally difficult circumstances facing low-income households.

A considerable amount of prior work examines earnings growth of families leaving welfare. For example, David Card, Charles Michalopoulous and Philip Robins (2001) report that people induced to work by the Self Sufficiency Project (SSP) in Canada experienced real log wage growth of about 2.5 to 3 percent per year. However, they note "the slow rate of real wage growth

for people who were induced to enter work by the financial incentives of SSP suggests a limited role for work experience to boost the earnings of welfare leavers." Tricia Gladden and Christopher Taber (2000) find no significant differences in the rate of wage growth for less well-educated women relative to other average-skill groups. They caution that "work experience is not a magic bullet ... evidence indicates that low-skilled workers will not have huge wage gains from work experience."

The data on labor market earnings displayed in Table 1 portray a similar picture for the low-income population analyzed in this paper. First consider the evolution of labor market earnings for the households in the CWPDP. As noted above, it is not surprising that there is a sharp downward annual earnings trajectory between 1990 and 1992, given that all sample members were on welfare in late 1992. Average earnings increase over time, going from under $1,000 in 1992 to over $5,500 in 1998. There are significant differences in earnings between households in the experimental group and in the control group equaling, in the last year of the experiment, $496. Real log earnings increase by 1.3 percent per year between 1990-98 and by 3.9 percent per year between 1992-98 among control group households. In contrast, earnings grow by 1.4 percent per year between 1990-98 and 4.3 percent per year between 1992-98 among experimental group households.

While labor market earnings grow, Table 1 shows that AFDC and food stamp benefits decrease steadily over the same period. There are also significant differences in benefit receipt between households in the experimental group and in the control group, reaching $495 in 1997. The change in AFDC and food stamp benefits shown in Table 1 are roughly equivalent to the increase in earnings for CWPDP treatment households. Consequently, there are no significant experimental-control group differences in disposable income until the experiment is over (in

1998). These calculations account for the earned income tax credit, which increased sharply over this period, as well as the cash value of food stamp (and AFDC) benefits, less the employee portion of social security payroll taxes. (See Hotz and Scholz, 2001 for more details of the EITC.) Consequently, it is a broad measure of the resources available to households.

Putting aside, for a moment, treatment-control differences and looking at the changes in disposable income over time, there is little evidence that families in our sample are acquiring sufficient resources to avoid poverty. Households in both the treatment and control groups go from roughly $12,000 in disposable income in 1993 (in 1998 dollars) to roughly $10,500 in 1998. This occurs despite the unusually strong economy and EITC expansions that occurred during this period. Both the low level and downward trend of disposable income are worrisome, as average disposable income in all years is well below the poverty line. (In 1998 the poverty line was $10,850 for a 2-person household, $13,650 for a 3-person household, and $16,450 for a 4-person household.)

But, these conclusions about what happens to the financial well-being of welfare-prone households may be misleading. Howard Rolston (1999) notes that changes in individual income account for only 40 to 50 percent of exits from welfare. (Calculations from Daniel Meyer and Maria Cancian (1998) suggest this concern is economically important.) Thus, to have a complete picture of the effects of welfare reform, analysts need information on other economic and demographic changes occurring in the family. Unfortunately using income from UI records—as does our study and most “welfare leavers” studies—fails to include sources of non-employment income and income of partners. More needs to be learned about the importance of the issue raised by Rolston in assessing the level and trend in family well-being following welfare reform.

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Table 1: Experimental-Control Differences for in Employment, Earnings and Disposable Income for CWPDP Sample

	Year	*Control*	*Experi-mental*	*Difference*
Employment	1990	35.2%	34.4%	-0.7%
	1991	28.7%	28.2%	-0.5%
	1992	25.3%	23.6%	-1.7%*
	1993	26.5%	28.5%	1.9%**
	1994	32.4%	34.7%	2.3%**
	1995	36.7%	39.8%	3.1%***
	1996	39.6%	44.2%	4.6%***
	1997	44.5%	49.0%	4.6%***
	1998	46.0%	48.9%	2.9%**
EDD Earnings	1990	$2,480	$2,477	-$4
	1991	$1,521	$1,495	-$25
	1992	$979	$863	-$116*
	1993	$1,553	$1,606	$53
	1994	$2,381	$2,496	$115
	1995	$3,120	$3,345	$225
	1996	$3,763	$4,112	$349**
	1997	$4,730	$5,226	$496**
	1998	$5,692	$6,131	$439*
AFDC+FS Payments	1993	$10,363	$10,160	-$203*
	1994	$8,824	$8,520	-$304**
	1995	$7,642	$7,325	-$316**
	1996	$6,762	$6,269	-$493***
	1997	$5,585	$5,090	-$495***
	1998	$4,232	$4,168	-$64
Disposable Income (EARN+AFDC +FS+EITC)	1993	$11,989	$11,836	-$153
	1994	$11,374	$11,186	-$187
	1995	$11,007	$10,927	-$80
	1996	$10,817	$10,714	-$104
	1997	$10,636	$10,696	$60
	1998	$10,242	$10,675	$433*

Notes: * significant at 10% level; ** significant at 5% level; *** significant at 1% level. These tests are for one-tailed alternatives, i.e., we test for positive effects. All monetary amounts are in 1998 dollars.

ENDNOTES

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[1] See Rosina Becerra, Vivian Lew, Michael Mitchell and Hiromi Ono (1998) for a description of the CWPDP and an analysis of impacts over the first three years of this demonstration.