



*Canadian International  
Labour Network*

## **Labour Market Outcomes:**

**A Cross-National Study**

CILN is a collaborative research venture between the Social Sciences and Humanities Research Council (SSHRC) and McMaster University. Additional funding is provided by the University of British Columbia, the University of Toronto, Queen's University, York University and Human Resources Development Canada (HRDC).

McMaster University

DEPARTMENT OF ECONOMICS

# **THE JOB PROSPECTS OF U.S. WELFARE RECIPIENTS: LOUSIER PAY BUT BIGGER EARNINGS SUPPLEMENTS**

*by*

GARY BURTLESS<sup>\*</sup>

May 29, 1998

Copyright © 1998 by Gary Burtless,  
1775 Massachusetts Avenue, N.W.  
Washington, DC 20036 USA

---

<sup>\*</sup> Senior Fellow, The Brookings Institution, Washington, D.C. This paper was prepared for the annual meetings of the Canadian Economics Association, Ottawa, May 30, 1998. It is based on earlier papers prepared for conferences sponsored by the Odyssey Forum, Baltimore, Maryland, November 21-22, 1997 (“The Employment Experiences and Potential Earnings of Welfare Recipients”) and the Centro Nazionale di Prevenzione e Difesa Sociale, Stresa, Italy, May 7-9, 1998 (“Rising Wage Disparity and U.S. Poverty: Recent Developments and Policy Responses”). The views are those of the author and should not be ascribed to the Brookings Institution.

## **The Job Prospects of U.S. Welfare Recipients: Lousier Pay but Bigger Earnings Supplements**

*by*

GARY BURTLESS  
The Brookings Institution  
Washington, D.C.

THE U.S. CONGRESS PASSED the Personal Responsibility and Work Opportunity Act in August 1996. The new law changed the nature, organization, and financing of a crucial part of the U.S. safety net. Under the old cash assistance program established in the 1930s, the federal government offered states open-ended grants for welfare benefits for needy children and their parents. States were obliged to match the federal dollars to get the grants, but federal spending had no fixed limit. States were free to define need, establish benefits, and determine eligibility as they saw fit, though the federal law required that families be eligible to receive assistance payments for as long as they remained poor and contained a dependent child under age 18.

The 1996 law replaced aid to families with dependent children (AFDC) with a federal block grant called Temporary Assistance for Needy Families (TANF). While minor exceptions will be made for low-income states with fast-growing populations and states in recession, most states' TANF grants will be determined by their federal AFDC grants during the two or three years before the 1996 law was passed. The new law ends the individual entitlement to benefits. Under new state programs, poor children may no longer be automatically entitled to cash benefits. The 1996 law gives states more program flexibility in many areas, but it also imposes tough new federal requirements. In particular, each state must now ensure that a rising percentage of its adult aid recipients is engaged in approved work. The head of each family on welfare is required to work within two years after assistance payments begin. Work hours requirements are stringent, and states will face increasingly harsh penalties for failing to meet them. States will not be permitted to use the federal grant to pay for cash benefits that last longer than 60 months for a particular family. Although exceptions can be made for some hardship cases, Congress's clear intention is to limit benefits to the great majority of families to no more than five years. States may adopt even tighter

restrictions on the length of benefit payments. Several have already decided to impose time limits shorter than 60 months.

The 1996 law represents the culmination of a determined effort to reduce the number of single mothers who collect public aid and to increase the number who support themselves through work. U.S. liberals once hoped to achieve this goal by improving the job qualifications of poor single mothers, by supplementing the earned incomes of low-wage breadwinners, and by increasing the support services available to low-income workers. Conservatives favored an approach that limited single parents' access to welfare, trimmed monthly benefits, and forced welfare recipients to participate in work or job search programs. For the most part, the new law represents a triumph of the conservative approach, although Congress has increased federal funding for several kinds of supportive services, including child care and worker training. Taking a longer term perspective, Congress and successive presidents back to Ronald Reagan have increased the Earned Income Tax Credit (EITC), a cash supplement to earnings, and liberalized the eligibility conditions for Medicaid. These improvements in benefit generosity have made it easier for unskilled breadwinners to support their children, even in very poorly paid jobs. At the same time cash assistance payments have become much less generous for parents who do *not* work, liberalization of EITC and Medicaid has improved the potential living standards of parents forced to work in low-wage jobs.

It is not yet clear how quickly or effectively states will implement new welfare-to-work and workfare programs. Nor do analysts know how states will ultimately react to the financial incentives in the new law. How many states will use their own resources to pay for cash assistance, child care help, or transportation grants to recipients who exhaust eligibility for federally subsidized benefits? Will competition among states lead to lower monthly payments or tighter time limits? How will recessions affect states' willingness to pay for family assistance? As of spring 1998, many states had not yet implemented a full strategy to move recipients from welfare rolls to employment.

This paper considers a fairly narrow question: Is it likely that single parents who have been dependent on welfare will be able to support themselves with jobs currently available to them? I examine the challenges faced by welfare recipients in their search for employment, the job skills they bring to the job market, and the changing nature of the market in which they will work. Because the employment rate of public aid recipients has historically been low, it is plausible to expect states can

significantly boost the percentage of recipients who hold jobs. In fact, in many states a sizable increase has already occurred. Perhaps surprisingly, it is also realistic to expect that the great majority of new jobs will be unsubsidized jobs in the private labor market. The U.S. labor market has enormous capacity to produce private-sector jobs, even for unskilled workers, if an ample supply of workers is available to fill these jobs. Unfortunately, aid recipients typically have such limited education and skills that few of them will qualify for well-paying jobs. The evidence suggests that most assistance recipients will earn \$6.00 to \$7.50 per hour or less if they are forced to hold jobs. Moreover, the trend in wages over the past two decades has been negative, especially for workers with limited skills. If welfare reform forces millions of aid recipients to find jobs, the added supply of unskilled workers could accelerate the long-term trend toward lower wages.

The best evidence suggests that a substantial minority of welfare recipients and their children would face extreme hardship if forced to rely solely on the adult recipients' earnings. While it is realistic to expect that most adult recipients can find and hold jobs, at least eventually, it is unrealistic to believe the U.S. job market will provide all of them with an adequate standard of living. Fortunately, public policy in the United States has moved gradually toward providing far more benefits to low-wage workers who are the breadwinners of families containing children. The Earned Income Tax Credit, Medicaid health insurance, and child care subsidies have been significantly expanded since 1986. The increased value of these kinds of benefits has more than offset the drop in real earnings and employer-provided fringe benefits for many parents who must support their children in low-wage jobs.

### **Characteristics and Work Experience of Dependent Single Mothers**

The goal of the new federal law and most state reform efforts is to move dependent parents off the assistance rolls and into jobs. The great majority of families receiving cash aid for indigent children are headed by single mothers, many of whom face formidable challenges in finding and keeping full-time jobs.

*Preparation for work and recent job experience.* One way to assess the job prospects of welfare recipients is to examine the job qualifications and actual work experience of aid-dependent mothers. The Department of Health and Human Services (DHHS) regularly publishes information

about the characteristics, including the work behavior, of aid recipients using data obtained from its quality control surveys. Data from these surveys show that few recipients work and suggest that many recipients would face serious problems in finding and holding jobs. The age distribution of children collecting public assistance has grown younger over time, as the percentage of children younger than age 6, and especially under age three, has climbed. Women, whether married or unmarried, raising very young children usually find it much harder to work than do women who are childless or whose children are 6 years old or older. The educational attainment of aid-dependent mothers, though improving, remains low. The DHHS survey shows that 40 percent of mothers receiving welfare had failed to complete high school in 1994. In comparison, more than 85 percent of all 25-34 year-old American women had completed high school in that year. About 1 percent of recipient mothers had graduated from college, whereas 23 percent of all 25-34 year-old women have a college degree. Only 15 percent of mothers collecting welfare reported one or more years of college, whereas slightly more than half of all 25-34 year-old women had attended at least a year of college.

Less than 9 percent of the cases included in the DHHS control survey showed evidence of current wage income. Some mothers who report no earnings to welfare offices may nonetheless earn unreported wages or receive irregular labor income that goes unreported. In addition, many women who initially file for assistance benefits have earned wages in the recent past. Over 60 percent of first-time claimants for welfare report work experience within the year prior to filing for AFDC (Pavetti, 1995, p. 33). In the mid-1980s, almost three-quarters of the typical welfare caseload reported *some* employment experience within the past five years (Maynard, 1995, p. 112). Most available evidence suggests, however, that a majority of single women who are long-term recipients of cash assistance do not work and do not have recent work experience. In welfare-to-work experiments conducted in Alameda and Los Angeles Counties, California, for example, only 17-24 percent of the long-term AFDC recipients enrolled in the experiments reported any work experience within two years prior to their entry into the program (Riccio et al., 1994, p. 18). Most of these long-term recipients had received AFDC continuously for at least three years at the time they entered the experiments.

Although there is no definitive study of the labor market experience of single women after they enter the assistance rolls, most studies suggest that a substantial minority of dependent mothers may become employed only after very lengthy periods without work, even when they are enrolled in special training or job placement programs. Daniel Friedlander and Gary Burtless (1995) examined the long-term effects of four welfare-to-work experiments conducted during the 1980s. In the fifth year after women were enrolled in these experiments, the employment rate averaged 38 percent among women who had been enrolled in the experimental welfare-to-work programs and 36 percent among women who had been enrolled in the control group.<sup>1</sup> The findings from welfare-to-work experiments suggest extraordinary efforts will be needed to boost the employment rates of single welfare mothers to rates that are typical among American mothers more generally. For purposes of comparison, about 66 percent of American women who have children under age 18 are employed; 48 percent of never-married mothers are employed; and 69 percent of widowed, divorced, and separated mothers with children under 18 hold jobs (U.S. Department of Commerce, 1996, p. 400).

Another source of information about the job qualifications of welfare recipients is the National Longitudinal Survey of Youth (NLSY). The NLSY is an annual survey of young people who were first interviewed in 1979, when respondents were between 14 and 22 years old. Each year, the survey collects information on educational attainment, employment, and reliance on welfare. About a year after they entered the sample, most respondents completed a cognitive test known as the Armed Forces Qualification Test (or AFQT), which is used to determine which applicants are eligible to enlist in the military. The composite AFQT score is considered a reliable indicator of test takers' general problem-solving ability.

Information about young women's educational attainment and aptitude scores derived from the annual NLSY survey confirms that women collecting cash assistance have serious educational deficiencies. Table 1 shows the educational attainments and aptitude scores of three groups of women, defined by their use of AFDC in the 12 months before their interview at age 25. The least dependent group of 25-year-olds, comprising 92 percent of the sample, received no AFDC during those 12 months. Three percent received benefits during at least 1 but less than 12 months of the previous year. The most dependent 5 percent received benefits in all 12 months.

Whereas only 14 percent of the women who did not rely on AFDC had failed to complete high school by age 25, among those who were most dependent on AFDC the comparable figure was 52 percent. AFDC recipients also performed poorly on standardized tests of ability and achievement. In the most dependent category, 72 percent of the women obtained a score on the AFQT placing them in the bottom quarter of all test takers. Only 12 percent placed in the top half of test takers. Women who are moderately dependent on AFDC achieved better test scores, but their performance on the test was well below the national norm. Only 16 percent obtained a score that placed them in the top half of test takers. Limited education and poor performance on standardized tests greatly restrict the kinds of jobs that most aid recipients can obtain.

*Realistic expectations about employment.* A large minority of welfare recipients can typically be expected to leave the welfare rolls within a year or less after entering the rolls. Many of them will leave welfare to take jobs, while others will leave the rolls because of a change in family composition or some other change that affects their continued eligibility for welfare. Women who remain dependent on welfare for longer periods face a variety of obstacles to finding and holding a job. Many people who are sympathetic to the plight of poor single mothers view these obstacles as insurmountable “barriers” to employment. This viewpoint is unrealistic. Only a minority -- probably a small minority -- of single mothers is prevented from working as a result of an insurmountable “barrier” to employment. It is more sensible to speak of the *costs* of entering employment. If society as a whole or single mothers themselves are willing to pay these costs, paid employment is a practical option for the great majority of mothers collecting welfare. The problem, of course, is that mothers may be unwilling to bear these costs if the reward they receive from working is small. Since most welfare recipients do not have the skills that equip them to hold highly paid jobs, even a relatively minor cost of employment -- such as a \$3.00-per-day bus fare -- may seem to constitute an formidable barrier to employment.

The educational and skill deficiencies of assistance recipients restrict access to most well-paying occupations, but they do not preclude employment altogether. An unskilled welfare recipient, if she is able-bodied and moderately resourceful, can almost certainly find an employer willing to offer her a job if she is willing to accept a low enough wage and an inexpensive package of fringe benefits. In many urban labor markets, for example, jobless workers with few qualifications apply



to temporary employment agencies for short-term work. Although the employment is uncertain and irregular, workers who are diligent and persistent can usually obtain temporary work assignments, at least occasionally, and can often find permanent employment if their job performance impresses a manager who has provided a short-term assignment. Other job opportunities for less qualified workers can be found in low-wage retailing, cleaning services, agriculture, manual labor, and informal child care. With relatively little training, less educated women can work as home health aides.

None of these job opportunities offers promising prospects for a good income or long-term advancement. It is important to recognize, however, that job opportunities exist for applicants who are willing to accept them, a fact confirmed by the job-finding success of unskilled immigrants. Many immigrants enter the United States suffering even worse disadvantages than those of long-term welfare recipients. Immigrants often have less schooling than welfare recipients, and many of them cannot speak English. Immigrants who illegally reside in the United States are not eligible to collect income transfers, except emergency medical aid, so they must rely on their own earnings or contributions from relatives in order to survive. The great majority find jobs, and some unskilled immigrants eventually prosper.

It is less certain that unskilled AFDC recipients could find poorly paid jobs if hundreds of thousands or even millions of them were forced to find jobs within a one- or two-year period. If half of the 3 million adults who currently receive cash aid were removed from the welfare rolls, 1.5 million additional unskilled workers would flood the labor market looking for jobs. Though employers can eventually create enough unskilled positions to employ most of these job seekers, it is unrealistic to expect that new jobs will be created overnight. Most former aid recipients will face a lengthy wait before finding a job. In the long run, however, the skill deficiencies of assistance recipients do not constitute an insurmountable barrier to employment.

Taking into account the practical obstacles to work faced by most single mothers, it is not unreasonable to expect that at least three-quarters of current welfare recipients could contribute to their own support through wage earnings. Nearly all except those with very young children could be expected to work in full-time jobs. In many cases, aid recipients' work experience will turn out

to be intermittent. The U.S. labor market offers few steady jobs to workers who have a serious deficit in skills.

### **Potential Earnings**

The low educational attainment and limited skills of aid recipients restrict the kinds of jobs they can hold. Recipients who find employment often end up in jobs that pay very meager wages, a fact illustrated in Figure 1. The chart shows trends over an eleven-year period in hourly wages received by a sample of one-time AFDC recipients interviewed in the NLSY. To be included in the sample, women had to be between 18 and 22 years old in 1979 and receive AFDC benefits sometime between 1979 and 1981. In many years between 1979 and 1990, fewer than half of the women in this population worked. Figure 1 shows the real hourly wages of working women in the sample whose earnings placed them at three points in the wage distribution -- at the 10th, 50th, and 90th percentiles. (Bear in mind that the calculations include only those women who held a job and had a reported wage.) The top line, for example, shows wages received by women who earned more than 90 percent of the sample of working one-time AFDC recipients but earned less than the top 10 percent of these former recipients. The lowest line traces wage movements among women who earned more than the bottom 10 percent of working one-time AFDC recipients but earned less than 90 percent of working former AFDC recipients. The middle line shows the median wage received by working women who once received AFDC benefits.

From 1979 to 1990 the median real wage of women who once received AFDC rose from \$6.07 to \$6.72 an hour -- an annual wage gain of \$0.06 per hour, or a bit less than 1 percent a year.<sup>2</sup> Near the top of the wage distribution, at the 90th percentile, wages climbed to a respectable level, reaching almost \$12.00 an hour by 1990. However, the great majority of young women who received AFDC in 1979-1981 did not fare as well. The women whose wages placed them at the 10th percentile of working former recipients, for example, saw their wages fall to \$4.26.

The hourly wage figures may be more understandable if they are converted into flows of annual earnings. In 1979, the median wage of \$6.07 received by women who were once dependent on AFDC would yield slightly more than \$12,000 a year for a person working on a full-time, year-round schedule (2,000 hours per year). By 1990 a woman earning the median wage in this sample

could expect to earn \$13,400 if she worked on a full-time, year-round schedule. These “potential” earnings are just 15 percent greater than the poverty line for a family of three. This means that, even in the unlikely event that welfare recipients could all find and retain full-time, year-round jobs, many would struggle with annual incomes that remain depressingly low.

As bleak as this sounds, it probably overstates the wages most aid recipients can expect to earn. The median wage received by former recipients *who actually work* is greater than the wage that *nonworking* recipients could earn if they found jobs. As noted earlier, only about 50 percent of the women who collected AFDC between 1979 and 1981 reported working in a given year after 1981. And only the wages of *working* mothers are reflected in Figure 1. On average, nonworking women had fewer qualifications than those who worked, so if they found jobs most would earn wages that fall below the median wages displayed in Figure 1.

When estimating potential earnings, it is also unrealistic to expect that all single women with young children will be able to work full-time on a year-round basis. Many will choose to work part-time in order to make child rearing more feasible. Others will spend part of the year without jobs as a result of involuntary unemployment, illness, or difficulty in arranging child care. Unemployment is a particular hazard for these women, because many of them will land jobs in which turnover is high.<sup>3</sup>

*Broader labor market trends.* The U.S. labor market in many respects appears quite healthy. Unlike Canada and Western Europe, the United States has seen little long-term trend toward higher unemployment. The number of employed Americans grew by over 30 million since 1980, while the number of payroll jobs climbed more than 35 percent. On balance, the number of jobs climbed faster than the working-age population, indicating that the economy has little problem generating enough jobs to keep potential new workers employed. The economy’s success in generating new jobs has not been matched by a capacity to generate middle-income jobs. Although there has been a substantial increase in the number of jobs which pay \$80,000 per year or more, there has also been a rapid growth in the number of jobs paying \$15,000 per year or less.

The latter trend is particularly relevant to cash assistance recipients, since only a handful can expect to find jobs that pay extremely high wages. The employment prospects of aid recipients were bleak in the 1980s, as we have seen, but their prospects deteriorated after 1989. Overall wage

inequality in the United States has increased since the mid-1970s for both men and women. For men, the rise in inequality meant a significant drop in earnings among workers with limited skills. Until the 1990s, rising inequality among women involved wage stagnation or slow wage growth among the least skilled and sharply increasing wages for the highly skilled. Until recently, women with limited occupational skills did not suffer sizable losses in real hourly or annual earnings. Since 1989, however, less-skilled women have also experienced significant earnings losses.

The effects of rising wage inequality are evident in Figure 2, which shows trends in weekly wages among unmarried mothers who are between 18 and 44 years old.<sup>4</sup> Each bar represents the 1979-1993 change in real weekly earnings at a selected point in the earnings distribution of working unmarried mothers. The chart shows a remarkable pattern of wage divergence over the 14-year period. Real wages sank at the bottom of the distribution, fell slightly in the middle, and grew at the top. Unmarried mothers in the bottom 25 percent of earners saw their wages tumble by between 23 percent and 32 percent, with the largest declines occurring at the very bottom of the distribution.

The jump in earnings inequality has been the focus of much research by economists, who have tried to discover why earnings shrank at the bottom while continuing to grow at the top.<sup>5</sup> Part of the growth in inequality is due to the fact that employers are increasingly willing to reward workers who have more education, skill, and work experience. The flip side, of course, is that the earnings penalty for limited skill is now much harsher. Substantial declines in earnings have occurred among young workers and workers with little education.

The wage developments shown in Figure 2 have important implications for U.S. welfare reform. The great majority of adult assistance recipients are young unmarried mothers who have no schooling beyond high school. Their skills typically prepare them for poorly paid jobs. The wages on these jobs are not only low, until very recently they were declining at a rate of about 1 percent a year. Because welfare has been reformed in a way that forces more unmarried mothers into the labor market, we should expect that the added supply of unskilled workers will push down wages relative to where they would be if the old welfare system had been retained.

In 1993, the full-time gross wage paid to a 25-34 year-old unmarried mother who was a high school dropout averaged slightly more than \$230 a week. This was approximately equal to the poverty threshold for a family containing three members. Without the income supplementation

provided by the EITC and food stamps, most single mothers who are asked to live on earnings this low will be forced, at least occasionally, to consider applying for cash public assistance. In states offering relatively high assistance benefits, the combination of assistance and food stamps can sometimes provide welfare recipients with a higher standard of living than the one unskilled single mothers can achieve through work alone. Of course, when their eligibility for cash benefits is exhausted, they will be forced to rely on their own earnings. In many cases, those earnings will be very meager.

### **What Has Happened So Far? What Will Happen in the Future?**

The federal reform passed in 1996 as well as state-level reforms enacted in earlier years have almost certainly boosted aggregate employment and the labor force participation rate. We can anticipate that welfare reform will increase employment and participation even more in the future. Working-age adults who have relied on cash assistance will be forced under new state programs to search for work, enroll in training programs, or accept workfare jobs. Experience over the past decade suggests these measures will significantly reduce the welfare rolls. In most cases, the employment rates of able-bodied adults enrolled in the programs will increase. Sometimes the increase will occur because state programs will be effective in linking recipients to private job opportunities. In other cases the increase may occur because recipients dislike the added hassle of participating in a work program. They will seek and find alternatives to public assistance, and these alternatives often -- though not always -- will include gainful employment.

To estimate the likely effect on overall employment, it is helpful to consider the number of working-age adults who receive welfare. The focus here is on the AFDC program and its successor program, TANF. In 1994, 5.05 million families received AFDC. Of these, 4.18 million (or 83 percent) contained at least one adult member and 0.32 million (8 percent) contained two adult members (U.S. House of Representatives, Committee on Ways and Means, 1996, p. 479). Figure 3 shows trends in the AFDC / TANF caseload since 1960. As of September 1997, 3.55 million families were collecting assistance payments under AFDC or TANF. Slightly more than 3 million contained an adult member who will be subject to the work requirements under new state laws. For purposes of comparison, this number was 2.2 percent of the number of labor force participants in the

September 1997, 2.3 percent of aggregate civilian employment, and 44 percent of the number of unemployed.

Welfare reform has already affected the labor market status of a couple of hundred thousand former or would-be recipients. The sharp decline in the rolls from their peak in 1994 is at least partly due to state-level reforms that began before Congress passed the federal reform law in August 1996. As indicated in a recent research paper by the U.S. Council of Economic Advisors, a large part of the decline (perhaps 40 percent) may be due to policy reform while much of the remainder is probably due to the improving economy. The change in labor force behavior of the group that is most likely to receive welfare benefits -- currently unmarried or separated mothers who live with their own children under 18 -- is reflected in Figure 4. The top panel in the figure shows a sharp rise in the labor force participation rate of unmarried mothers in relation to that of married mothers who live with their spouse during the mid-1990s. The comparative rise in the employment-population ratio of unmarried mothers, shown in the lower panel, is even more noticeable. The labor force participation and employment-population rates of unmarried mothers began to rise strongly in 1995, and these rates continued to rise at a rapid pace through the end of 1997. The experimental state welfare reform programs enacted before 1996 and the 1996 change in the federal law appear to have caused a significant change in the behavior of unmarried mothers.

If the unemployment rate remains below 6 percent, I suspect that as many as half of the 3 million adults on welfare will move into unsubsidized or workfare jobs over the next five years. Thus, if the labor market remains reasonably tight most of the change in aid recipients' labor force status will occur because of movements out of the labor force into employment rather than into unemployment. This prediction is based on the assumption that most states will eventually adopt tight deadlines ensuring that the great majority aid recipients who collect benefits longer than two years will be forced to accept private-sector or workfare jobs if they want their assistance benefits to continue. A large fraction of states have already adopted such a policy (see Center on Hunger and Poverty, 1998).

Of course, not all of the employment gain will occur right away. At first, we should anticipate that many aid recipients will enter unemployment before finding a job. This may boost the percentage of current aid recipients who are unemployed. The experience of the U.S. job market

over the past three decades suggests, however, that the availability of an extra 1½ - 2 million potential workers will eventually result in added employment for most of them. The net gain in aggregate employment will be somewhat less than the employment gain among parents of needy children.

Additional employment opportunities will probably become available to needy parents as a result of the creation of a relatively small number of workfare jobs and the creation of a much larger number of private or unsubsidized public-sector jobs. Employers will create these jobs in response to the influx of a sizable number of workers who will be available at low wages. In fact, wages in the low-skill job market should be depressed, other things equal, as a result of the entry of former or would-be welfare recipients. The lower wage will make it profitable for employers to offer jobs they would not otherwise have offered. But it will also reduce slightly the participation rate and employment-to-population ratio of low-skilled workers who compete with welfare recipients, for example, secondary family earners (teenagers and wives without recent work experience), less skilled legal and illegal immigrants, and low-skill men.

### **New Policies to Alleviate Working-age Poverty**

Although European and Canadian critics of U.S. policy may not recognize the fact, U.S. policymakers have not stood still in the face of the big deterioration in the labor market position of unskilled workers. The overall direction of policy has shifted significantly since the early 1980s. The Reagan and Bush Administrations left the U.S. minimum wage fixed in nominal terms, lowering its value in relation to economy-wide average wages and reducing its purchasing power. Although the minimum wage has been increased modestly over the past decade, the relative and absolute value of the U.S. minimum wage remains far below its level in the 1960s and 1970s. U.S. tax and transfer programs for the working-age poor have also been changed significantly. Public assistance benefits for the *nonworking* poor have been substantially curtailed, as already noted. But the Reagan, Bush, and Clinton Administrations also created and expanded government programs to help the *working* poor.

The latter policy shift began in the mid-1980s. The 1986 tax reform increased the income threshold where families began to pay positive income taxes, removing millions of poor families

from the positive tax rolls. The EITC was dramatically liberalized in legislation passed in 1986, 1990, and 1993. This income tax credit essentially subsidizes the wage earnings of low-income adults who have child dependents. In addition, the federal government and many state governments established programs to subsidize the child care expenses of former public assistance recipients who left the welfare rolls to enter paid employment. As part of the welfare reform initiative of the 1990s, much more extensive child care assistance has been made available to current and former welfare recipients and (in some states) to working poor parents who have never received public assistance.

In the late 1980s the Medicaid health insurance program was also liberalized to provide insurance benefits on a large scale to low-income children with working poor parents. Up until the late 1980s, this kind of publicly subsidized health insurance had mainly been provided to working-age families containing children only if the families were actually collecting public assistance benefits. (In a small number of cases, low-income wage earners with very low wages were permitted to enroll in the program.) The Medicaid liberalization of the late 1980s and early 1990s meant that for the first time children could be enrolled in the publicly subsidized health insurance program even if their parents had moderate amounts of earnings. Until this reform was implemented, many families lost their eligibility for free health insurance for their children when the family breadwinner left the cash public assistance program and returned to work. In the past few years, some state governments have also established subsidized public health insurance programs for all members of working-poor families, including the breadwinners in the families. The federal government passed legislation in 1997 that offers states generous federal subsidies to establish or enlarge this kind of subsidized health insurance plan.

*The Earned Income Tax Credit.* The most distinctive innovation in U.S. public policy toward the working poor has been the EITC. While most cash assistance is received by people who do not work, the EITC goes only to low-income people who *do* work. The EITC provides as much as \$3,656 in refundable income tax credits to a breadwinner with two or more dependents. For a person earning the minimum wage who works 2,000 hours per year and pays social security taxes, the EITC increases the worker's net annual earnings by 38½ percent. This earnings supplement probably offsets almost all of the reduction in real hourly wages that low-wage workers have suffered over the past two decades.



The idea behind the program is to provide work incentives by increasing the incomes or services available to women who leave the welfare rolls and join the work force. The EITC supplements the wage earnings of low-income breadwinners by providing them with refundable income tax credits. Instead of shrinking as a recipient's earnings grow, the credit rises, at least up to a specified limit. At low earnings levels the credit increases by 34¢ or 40¢ for each extra dollar earned by the breadwinner. Parents who have no wages are not eligible to receive the credit, so the credit provides an incentive for unemployed parents to find work.

The maximum credit is now a little over \$3,650 a year for families containing two or more children. This credit level is achieved when annual earnings reach about \$9,000. When a family's earnings rise above a moderate threshold (about \$12,000 in 1997), the credit is gradually phased out. It is eliminated altogether when a family's income exceeds about \$29,000 a year. (The EITC benefit schedules for families with one child and with two or more children are displayed in Figure 5.) The credit now transfers even more money to low-income families with children than the main cash public assistance program for children. About 19 million families received a credit averaging \$1,470 in 1997. Both the maximum amount of the credit and the total amount of credit paid to low-income breadwinners have increased rapidly during the 1990s (see Figure 6).

It is still too early to assess the overall impact of the EITC on work effort of the poor. Some potential breadwinners who would otherwise be unemployed have been encouraged to take jobs as a result of the credit. By raising the net income a family can receive when the breadwinner goes to work, the EITC can tip the balance in favor of work and against continued joblessness. From the point of view of public perceptions, this is by far the most powerful argument in favor of the program. It is difficult to avoid the conclusion, however, that this employment-increasing effect of the program must be partly offset by the program's work disincentive effects among families earning between \$11,930 and \$29,000 a year. There are more breadwinners in the income range where extra work effort is discouraged than there are breadwinners earning less than \$8,935, who are encouraged to begin working or to work harder. Hence, the EITC may not increase work effort much in the aggregate.

The most powerful economic argument in favor of the EITC is that it raises the net incomes of participating families without causing sizable reductions in their own self-support. In comparison

with other methods of reducing the tax burdens or raising the transfer benefits of the working poor, the EITC has a relatively small work disincentive effect and probably encourages work on balance. Recent empirical evidence suggests the program is actually increasing overall work effort by increasing the hours of work and employment rates of breadwinners with very low wages or no previous earnings at all.

The program is certainly succeeding in transferring large amounts of income to the poor. The substantial increase in generosity of benefits during the 1990s has also dramatically increased the number of pre-transfer poor people who are lifted above the poverty line. The Census Bureau estimates that 4.3 million poor persons were removed from poverty as a result of the EITC benefits they received. This number is a little over 12 percent of the number of people who would be poor if they did not receive EITC benefits. It is also a large increase compared with number of people removed from poverty by the program in the early 1990s, when only 2 million persons (or 5½ percent of the pretransfer poor) were removed from poverty as a result of EITC benefits.

*The distinctive U.S. policy mix.* The United States has adopted a distinctive set of policies to change work incentives for the working-age poor. The minimum wage has been allowed to shrink, making it cheaper for employers to offer jobs to the unskilled (but reducing the attractiveness of employment for the unskilled). In addition, several transfer programs have become much less generous to the *nonworking* (but working age) poor. Other transfer programs have been modified to become much more generous to the *working* poor or to poor breadwinners who leave the public assistance rolls. For many low-income families containing children, the improvements in generosity of Medicaid, state-subsidized health insurance benefits, child care subsidies, and the EITC have more than offset the loss of earnings caused by shrinking real wages. Official U.S. poverty statistics do not reflect this improvement because they fail to account for most of these improvements in benefits.

The policies may be having real economic effects in addition to offsetting the drop in real wages. Poor breadwinners with children may be induced to enter the work force and remain employed, even if they are paid poor wages or must accept jobs offering no fringe benefits. The entry of these workers may even have contributed to the drop in wages among the least skilled. In effect, public transfers or tax credits for the working poor are “subsidizing” employers’ creation of poorly paying jobs. The availability of Medicaid and state-subsidized health insurance for the

working poor has probably affected employers' decisions about whether to offer and how much to subsidize employer-sponsored health insurance plans. Employers may now reason that they do not have to subsidize child dependents' health benefits as generously as they did in the past, especially in low paid jobs. Because the government now offers to provide child dependents' health insurance for free to working poor families, employers are relieved of the expense of providing that kind of coverage to their low-wage employees.

In comparison with Canada and Western Europe, the U.S. combination of policies encourages entry into the job market among low-skilled people with child dependents. But the new combination of policies also permits U.S. employers to create many poorly paying jobs at low cost, and it provides employers an implicit subsidy to do so. Some of the fringe benefits associated with these jobs -- such as health insurance for dependents and inexpensive child care -- are now financed out of the public budget rather than out of company contributions to worker welfare funds or household budgets. The combination of coerced entry into the job market and rapid job creation is almost certainly more consistent with popular American attitudes than the policy combination that prevails in Canada and Europe. Many European countries have favored a combination of policies that imposes high costs on employers and comparatively high marginal tax rates on potential breadwinners who leave public transfer rolls in order to become employed. The European policy combination contributes to higher real wages, but it also tends to produce higher joblessness and slower employment growth. Although this is a policy combination that many European voters clearly prefer, I doubt that it is a combination whose effects would be welcome to U.S. voters. On the whole, Americans seem more tolerant of high levels of inequality and more willing to accept the increases in inequality that have accompanied the economic shifts of the past two decades.

## NOTES

1. The control group consisted of randomly selected AFDC recipients who were not enrolled in the experimental work and training program. See Friedlander and Burtless (1995), p. 88.
2. Wages are measured in constant 1993 dollars using the CPI-U-X1 deflator. For purposes of comparison, among *all* women aged 18-22 in 1979, including both recipients and nonrecipients of AFDC, the median wage climbed fairly rapidly. It rose from \$6.27 an hour in 1979 to \$9.39 an hour in 1990, a wage gain of 4.5 percent or \$0.28 per year.
3. Blank et al. (1995), pp. 39-40.
4. The women are never-married, divorced, or separated mothers who live with unmarried own children who are under age 18.
5. For recent surveys see Levy and Murnane (1992) and Burtless (1994).

## REFERENCES

- Blank, Rebecca M., Gary Burtless, William T. Dickens, LaDonna Pavetti, and Mark C. Rom (1995). "A Primer on Welfare Reform." In R. K. Weaver and W. T. Dickens, eds., *Looking Before We Leap: Social Science and Welfare Reform*. Washington, DC: Brookings Institution.
- Burtless, Gary (1994). "Rising Wage Inequality and the Future of Work in America." In Janet Norwood, ed., *Widening Earnings Inequality: Why and Why Now*. Washington, DC: Urban Institute Press.
- Center on Hunger and Poverty (1998). *Are States Improving the Lives of Poor Families? A Scale Measure of State Welfare Policies*. Medford, MA: Tufts University Center on Hunger and Poverty.
- Friedlander, Daniel, and Gary Burtless (1995). *Five Years After: The Long-Term Effects of Welfare-to-Work Programs*. New York: Russell Sage.
- Levy, Frank, and Richard J. Murnane (1992). "US earnings levels and earnings inequality: A review of recent trends and proposed explanations," *Journal of Economic Literature*, vol. 30 (September 1992), pp.1333-81.
- Maynard, Rebecca A. (1995). "Subsidized Employment and Non-Labor Market Alternatives for Welfare Recipients." In Demetra Smith Nightingale and Robert H. Haveman, eds., *The Work Alternative: Welfare Reform and the Realities of the Job Market*. Washington, D.C.: Urban Institute Press.
- Pavetti, LaDonna (1995). "Who Is Affected by Time Limits." In Isabel V. Sawhill, ed., *Welfare Reform: An Analysis of the Issues*. Washington, D.C.: Urban Institute Press.
- Riccio, James, Daniel Friedlander, and Stephen Freedman (1994). *GAIN: Benefits, Costs, and Three-Year Impacts of a Welfare-to-Work Program*. New York: Manpower Demonstration Research Corporation.
- U.S. Department of Commerce, Bureau of the Census (1996). *Statistical Abstract of the United States, 1996*. Washington, D.C.: U.S. Government Printing Office.
- U.S. House of Representatives, Committee on Ways and Means (1996). *1996 Green Book: Overview of Entitlement Programs*. Washington, D.C.: U.S. GPO.

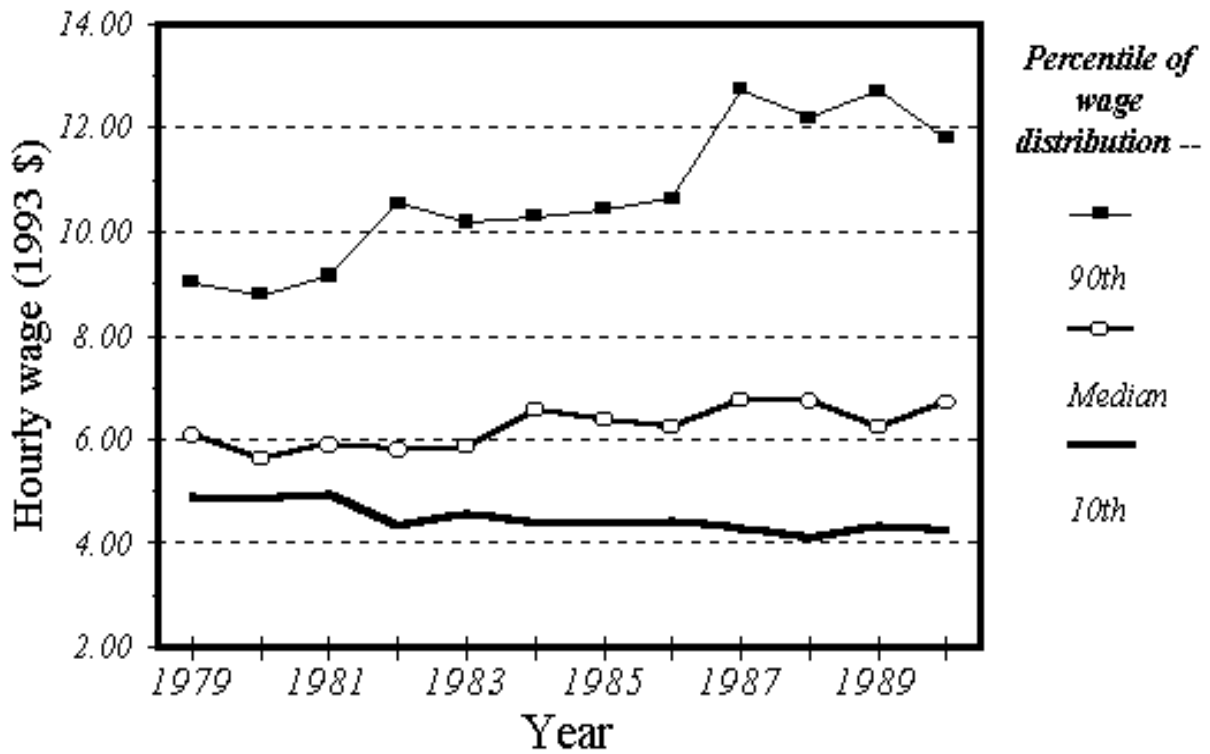
**Table 1.**  
**Educational Attainment and Ability Scores of 25-Year-Old Women,**  
**by AFDC Status**

Percent

	<i>Number of months received AFDC</i>			<b>All Women</b>
	<b>12</b>	<b>1-11</b>	<b>None</b>	
<b>Educational attainment by age 24</b>				
Less than 4 years high school	52	44	14	17
4 years high school	35	48	40	39
1-3 years college	12	8	24	23
4 or more years college	0	0	22	21
Total	100	100	100	100
<b>Composite score on 1980 AFQT</b>				
Bottom quartile	72	52	22	26
2nd quartile	17	33	26	25
3rd quartile	9	14	26	25
Top quartile	3	2	25	24
Total	100	100	100	100

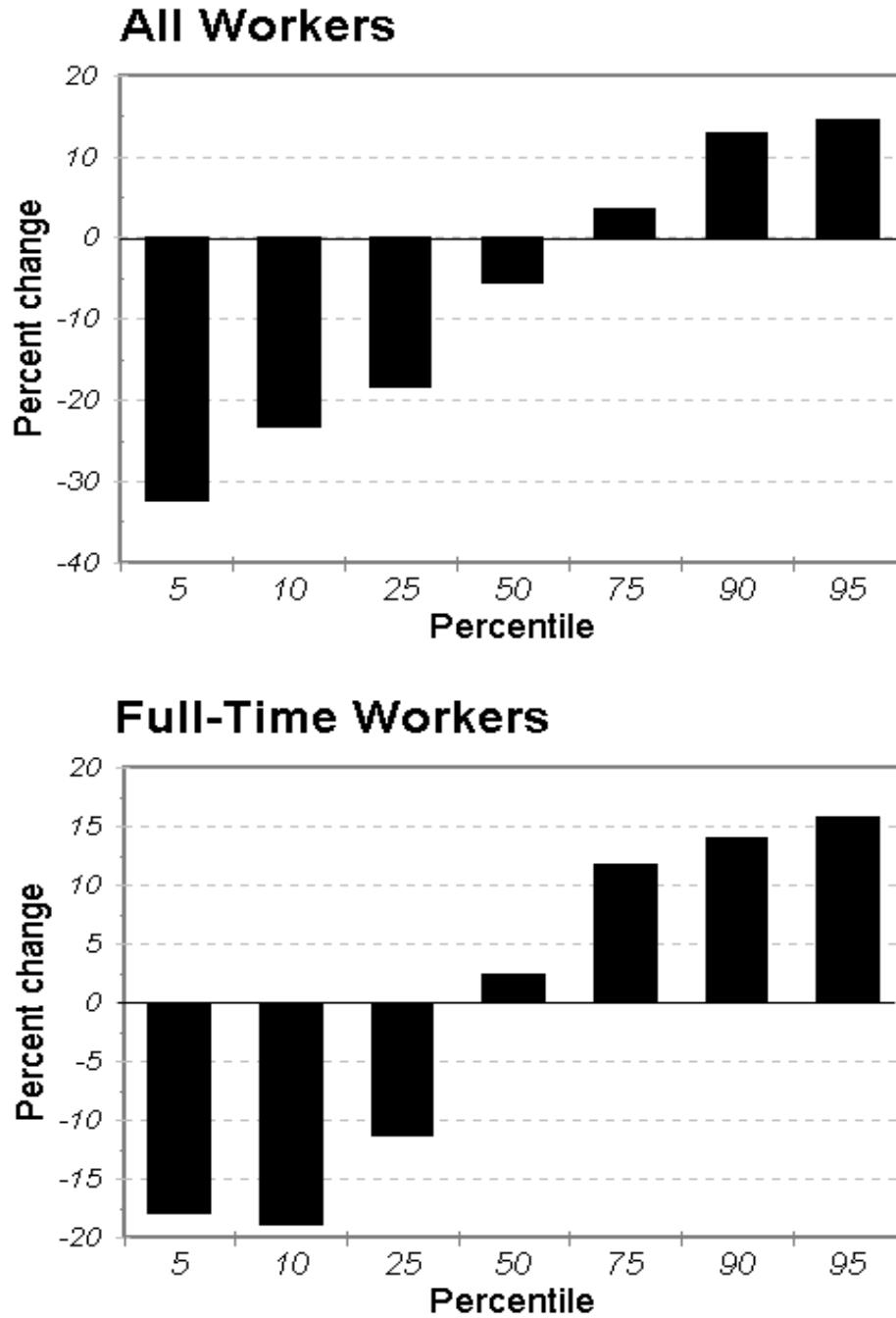
*Source: Author's tabulations of National Longitudinal Survey of Youth (1979-1991).*

**Figure 1.**  
**Potential Earnings, Selected Points in**  
**the Wage Distribution: AFDC Recipients**



Source: Author's tabulations of NLSY (1979-1991).

**Figure 2. Change in Real Weekly Earnings of Unmarried Mothers, 1979-1993**

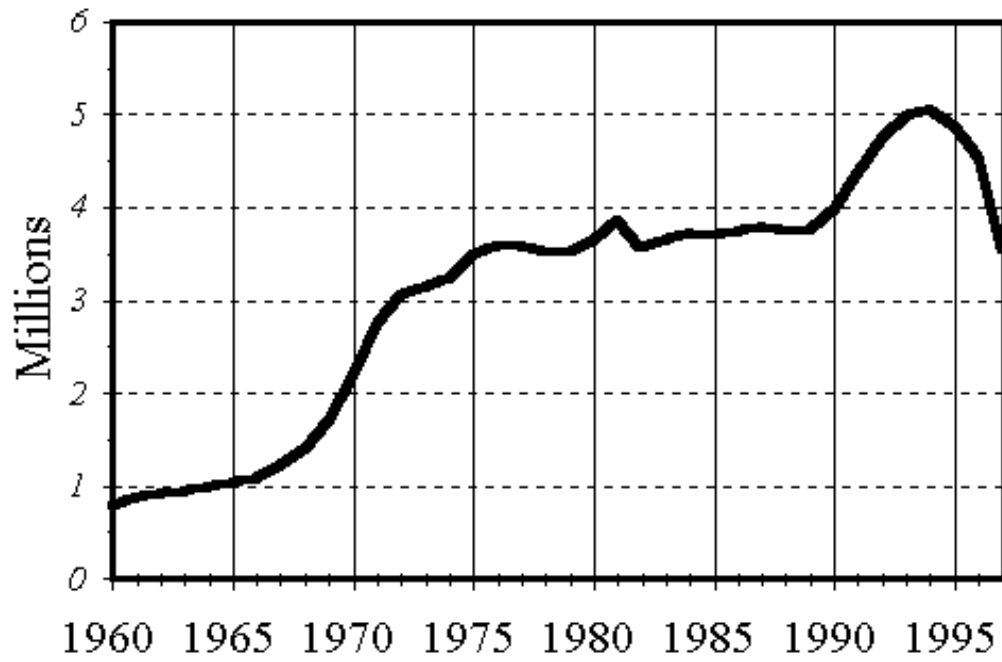


Note: Unmarried mothers included in tabulations are between 18 and 44 years old and live with children under age 18.

Source: Author's tabulations of March 1980 and March 1993 Current Population Surveys.



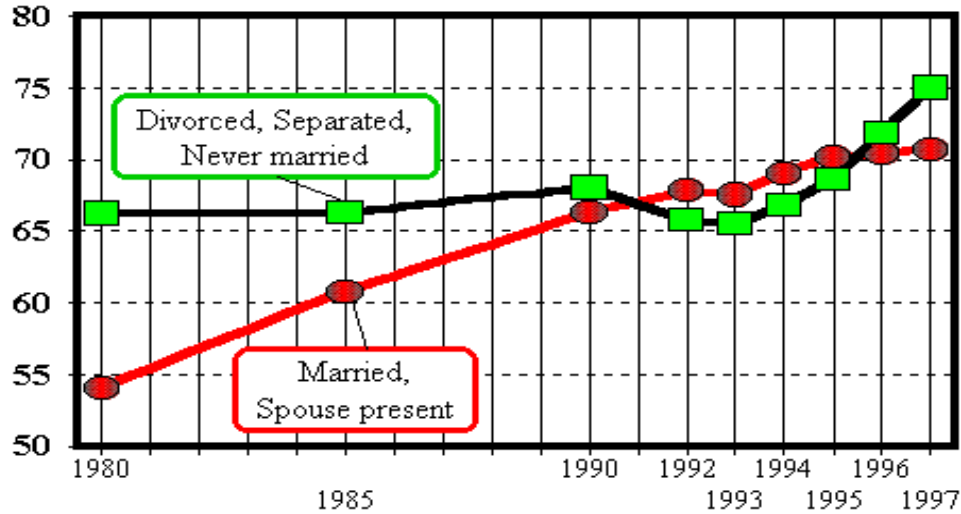
**Figure 3. Number of AFDC Cases,  
1960 - 1997**



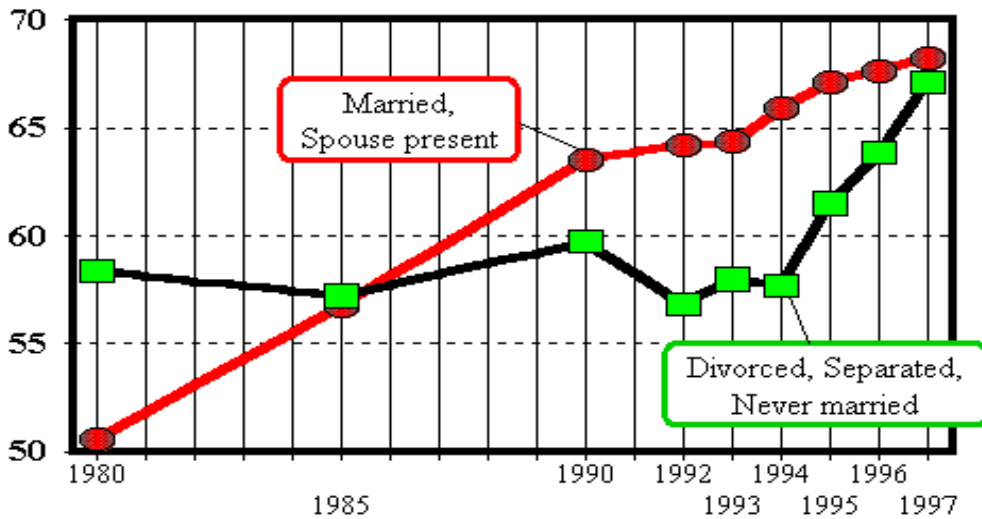
*Source: Department of Health and Human Services.*

**Figure 4. Labor Force Participation Rate and Employment-Population Ratio of Married and Unmarried Mothers, 1980-1997**

**Labor force participation rate (%)**

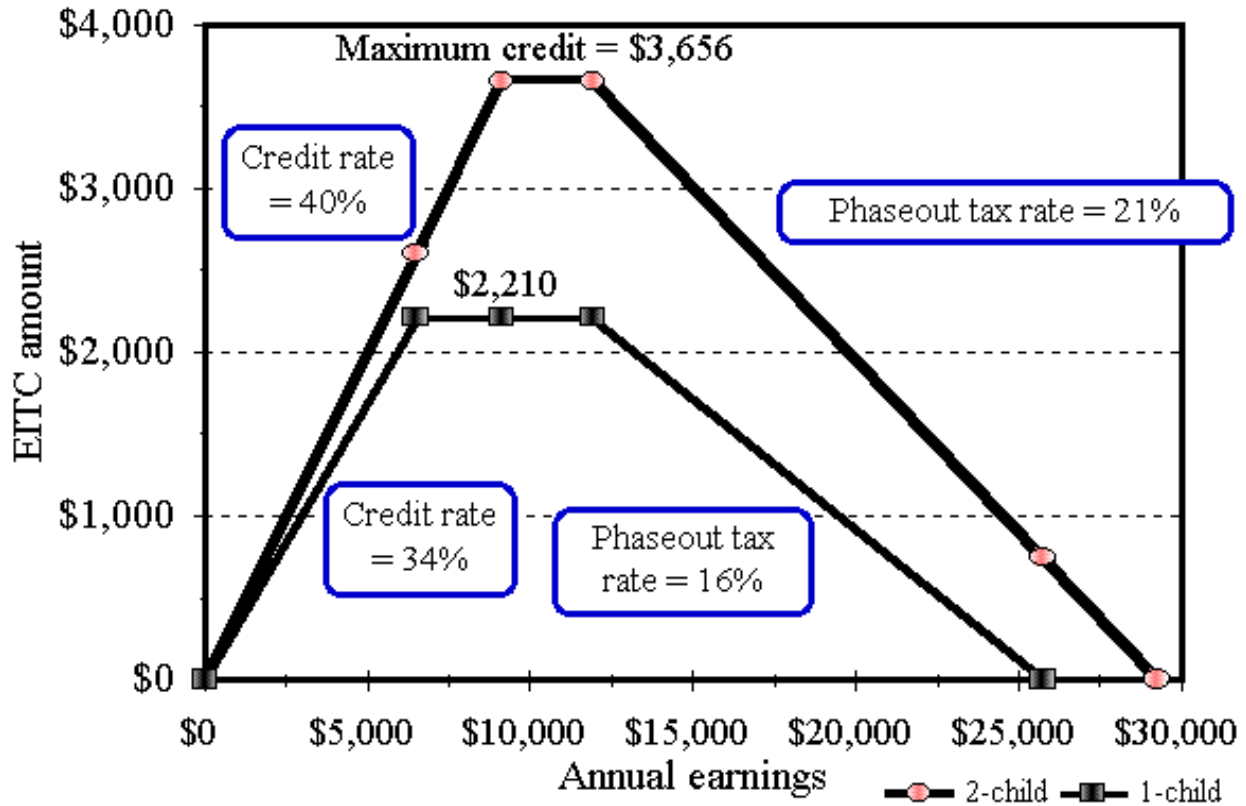


**Employment / Population Ratio (%)**

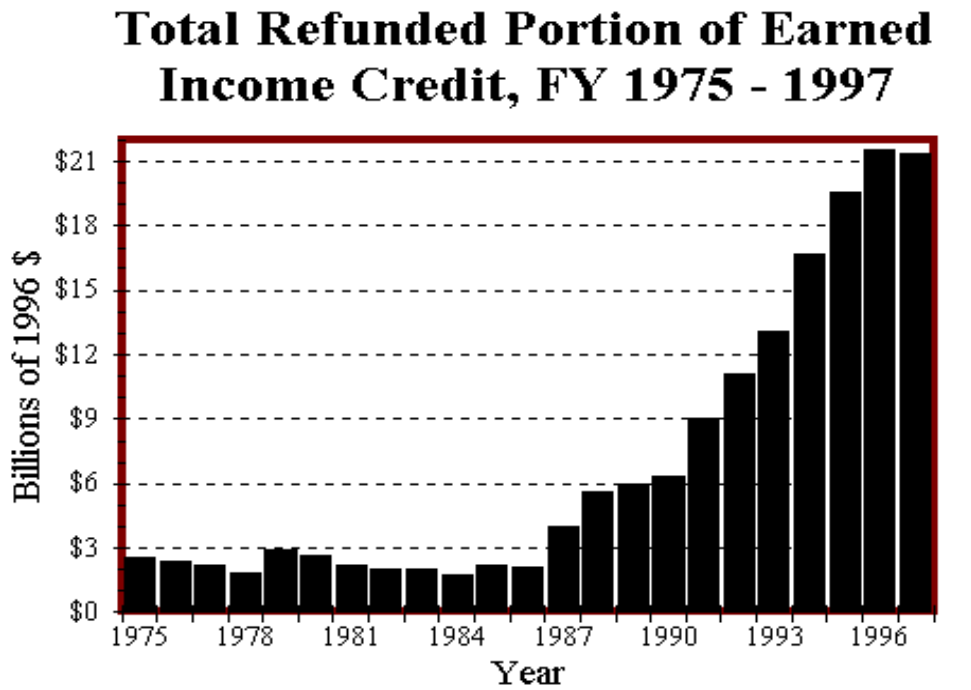


Note: Mothers included in tabulations are at least 16 years old and live with their own children under age 18. "Unmarried" mothers are divorced, separated, and never married.  
Source: U.S. Bureau of Labor Statistics.

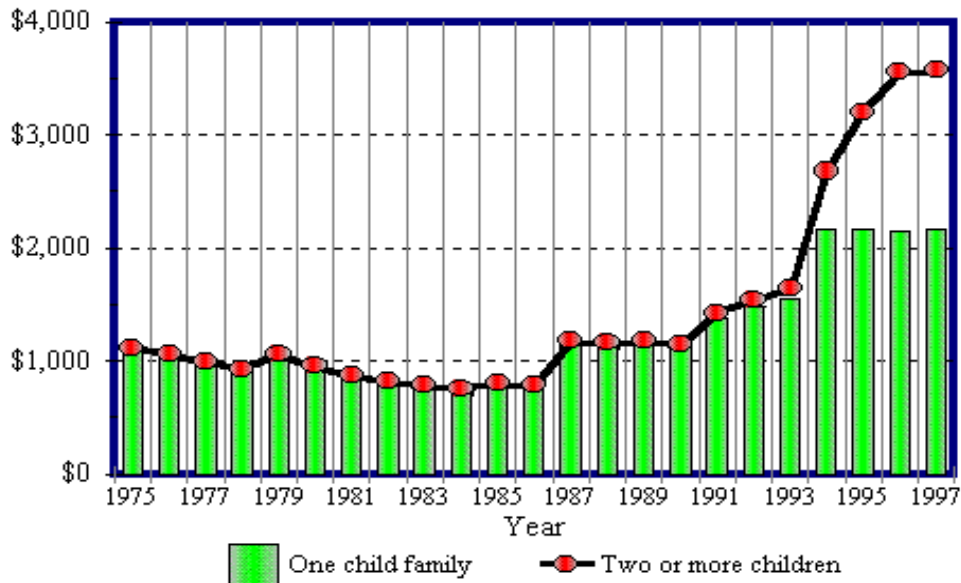
**Figure 5. EITC Schedule in 1997**  
(Schedules for families with 1 and 2 or more children)



**Figure 6. Expansion of the Earned Income Tax Credit, 1975-1997**



**Maximum EIC Refund per Family, 1975-97**  
(Constant 1996 dollars)



Source: 1996 Green Book and Budget of the United States Government, 1999.



CILN Working Papers (downloadable)

wp43 **John Flemming** **John Micklewright**  
Income Distribution, Economic Systems and Transition

wp42 **John Micklewright** **Kitty Stewart**  
Is Child Welfare Converging in the European Union?

wp41 **W Bentley Macleod**  
A Note on the Optimality of Bonus Pay

wp40 **Xin Meng** **Robert G Gregory**  
Impact of Interrupted Education on Earnings:  
The Educational Cost of the Chinese Cultural Revolution

wp39 **Miles Corak**  
Death and Divorce: The Long Term Consequences of Parental Loss on Adolescents

wp38 **Lori Curtis** **Martin Dooley**  
Child Health and Family Socioeconomic Status in the Canadian National Longitudinal Survey of  
Children and Youth

wp37 **Heather Antecol**  
An Examination of Cross-Country Differences in the Gender Gap in Labor Force Participation Rates

wp36 **W. Craig Riddell**  
Canadian Labour Market Performance in International Perspective: Presidential Address to the  
Canadian Economics Association

wp35 **Shelley Phipps**  
Economics and Well-Being of Canadian Children

wp34 **W. Craig Riddell**  
Measuring Unemployment and Structural Unemployment

wp33 **Susan Johnson**  
Automatic Certification or Mandatory Representation Votes? How the choice of union recognition  
procedure affects union certification success.

wp32 **James Andreoni** **Eleanor Brown** **Isaac C. Rischall**  
Charitable Giving by Married Couples: Who Decides and Why Does it Matter?

wp31 **Herb Schuetze** **Peter Kuhn**

Self-Employment Dynamics and Self-Employment Trends: A Study of Canadian Men and Women, 1982-1995

wp30 **Isaac C. Rischall**

The Effect of High School Effort on Future Earnings

wp29 **Isaac C. Rischall**

The Roles of Education, Skill and Parental Income in Determining Wages

wp28 **Isaac C. Rischall**

The Value of a Fresh Start: Earnings Persistence and the Migration of Single Mothers

wp27 **Martin Browning Tom Crossley**

Shocks, Stocks and Socks: Consumption Smoothing and the Replacement of Durables During an Unemployment Spell

wp26 **Heather Antecol Kelly Bedard**

Against All Odds: The Surprising Labor Market Success of Young Mexican Women

wp25 **Heather Antecol**

Why is there Inter-Ethnic Variation in the Gender Wage Gap? The Role of "Cultural" Factors

wp24 **Martin Browning Tom Crossley**

Unemployment Insurance Benefit Levels and Consumption Changes

wp23 **Heather Antecol Peter Kuhn**

Employment Equity Programs and the Job Search Outcomes of Men and Women: Actual and Perceived Effects

wp22 **Thomas F. Crossley**

Firms and Wages: Evidence from Displaced Workers

wp21 **Jennifer Stewart Martin Dooley**

The Duration of Spells on Welfare and Off-welfare among Lone Mothers in Ontario

wp20 **Peter Kuhn Arthur Sweetman**

Vulnerable Seniors: Unions, Tenure and Wages Following Permanent Job Loss

wp19 **Kelly Bedard**

Human Capital Versus Signaling Models: University Access and High School Drop-outs

wp18 **Peter Kuhn Arthur Sweetman**

Assimilation and Economic Success in an Aboriginal Population: Evidence from Canada

wp17 **Martin D. Dooley**

The Evolution of Welfare Participation Among Canadian Lone Mothers From 1973 - 1991

wp16 **Lori Curtis Martin D. Dooley Ellen L. Lipman David H. Feeny**

The Role of Permanent Income and Family Structure in the Determination of Child Health in the Ontario Child Health Study

wp15 **LaDonna A. Pavetti**

A New Social Contract: Moving to a Work-Based Assistance System

wp14 **Gary Burtless**



## The Job Prospects of U.S. Welfare Recipients: Lousier Pay but Bigger Earnings Supplements

wp13 **J.B. Burbidge L. Magee A.L. Robb**  
Cohort, Year and Age Effects in Canadian Wage Data

wp12 **Martyn Andrews Alan Harrison**  
Testing for Efficient Contracts in Unionized Labour Markets

wp11 **Herb J. Schuetze**  
Taxes, Economic Conditions And Recent Trends in Male Self-Employment: A Canada-U.S. Comparison

wp10 **Peter Kuhn**  
Canada and the "OECD Hypothesis": Does Labour Market Inflexibility Explain Canada's High Level of Unemployment?

wp9 **Stephen R. G. Jones W. Craig Riddell**  
The Measurement Of Unemployment: An Empirical Approach

wp8 **Pierre Lefebvre Philip Merrigan Martin Dooley**  
Lone Female Headship and Welfare Policy in Canada

wp7 **Heather Antecol Peter Kuhn**  
Gender as an Impediment to Labor Market Success: Why do Young Women Report Greater Harm?

wp6 **John Myles Paul Pierson**  
Friedman's Revenge: The Reform of "Liberal" Welfare States In Canada and the United States

wp5 **Jeff Borland**  
Earnings Inequality in Australia: Changes and Causes

wp4 **Jeff Borland**  
Union Effects and Earnings Dispersion in Australia, 1986-1994

wp3 **Robert Gregory Boyd Hunter**  
The Macro Economy and the Growth of Income and Employment Inequality in Australian Cities

wp2 **Peter Kuhn**  
Labour Market Polarization: Canada in International Perspective

wp1 **Peter Kuhn A. Leslie Robb**  
Shifting Skill Demand and the Canada-US Unemployment Gap: Evidence from Prime-Age Men

Last updated March 27, 2000