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JOINT COMMITTEE PRINT

WORK, WELFARE, AND THE PROGRAM FOR BETTER JOBS AND INCOME

A STUDY

PREPARED FOR THE USE OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

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LETTERS OF TRANSMITTAL

October 12, 1977

To the Members of the
Joint Economic Committee:

Transmitted herewith for use of the Members of the Joint Economic Committee and other Members of Congress is a study entitled, "Work, Welfare, and the Program for Better Jobs and Income."

This is one of three studies commissioned by the Joint Economic Committee on the subject of welfare reform. These studies are intended to provide information and analysis to the Congress on the important issue of welfare. This study, prepared by Professors Leonard J. Hausman and Barry L. Friedman, focuses on the labor market implications of the Administration's welfare reform proposals, particularly the work requirement, job creation and work incentive components.

The views expressed in this study are those of its authors and should not be interpreted as representing the views or recommendations of the Joint Economic Committee or any of its Members.

Sincerely,

Richard Bolling
Chairman
Joint Economic Committee

October 7, 1977

Honorable Richard Bolling
Chairman
Joint Economic Committee
United States Congress
Washington, D.C. 20510

Dear Mr. Chairman:

Transmitted herewith is a study entitled, "Work, Welfare, and the Program for Better Jobs and Income," prepared by Professors Leonard J. Hausman and Barry L. Friedman, Brandeis University.

The study is the first of three Committee studies on welfare reform intended to provide information and analysis on important aspects of the welfare reform proposal, including a review of its macroeconomic effects and an analysis of its labor market implications.

Drs. Hausman and Friedman have dealt with the latter topic in this paper. It focuses on the program's work incentives work requirements, and job creation components.

This study was conducted under the direction of and reviewed by Tom Cator and Deborah Norelli of the Committee staff.

Sincerely,

John R. Stark
Executive Director

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WORK, WELFARE, AND THE PROGRAM FOR BETTER JOBS AND INCOME

Submitted to the U.S. Congress
Joint Economic Committee

by

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September, 1977

SUMMARY

The Program for Better Jobs and Income (PBJI), the Carter Administration's plan for welfare reform, is the most ambitious effort in recent decades to make welfare beneficiaries work. Previous reforms contained either financial incentives to induce work or at most, regulations to monitor job search. PBJI, however, combines such incentives and regulations with a specially created public job for all those unable or unwilling to accept regular employment. A stronger dose of compulsion now will be mixed with incentives and regulations. At the same time, PBJI offers a consolidated income subsidy program for the entire low-income population as well as many households above poverty lines. Although partially categorical in nature, PBJI thus also represents the most ambitious attempt to offer cash benefits on a sliding scale basis to all those having modest incomes. This study provides an analysis of the effectiveness of financial incentives, monitored search, and compulsory jobs in stimulating work. The following is a section-by-section summary of this paper.

The Two-Tier System

The section begins by explaining the two-tier structure and demonstrates that two tiers exist only at low levels of earnings. At higher levels, the two tiers merge.

In the absence of a program of state supplements to PBJI benefits, female-headed families in a small number of states are likely to get more benefits from the proposed plan than from AFDC. A large number of female-headed families stand to lose benefits if they do not get supplements because AFDC and Food Stamps now offer rather substantial payments. Twenty states currently offer roughly $5,000 or more in annual AFDC-Food Stamps benefits to female-headed families of four with no other income. PBJI will offer $4,200 (in 1978 terms) to such families. Moreover, because of the generous treatment of work-related expenses under AFDC, benefit reduction rates today are exceedingly low, enabling employed female heads to combine substantial earnings with fairly generous welfare benefits. The 50 percent tax rate for all PBJI families with substantial earnings often will raise benefit reduction rates and thus lower benefits below current levels. For the bulk of male-headed families, as well as for almost all filing units without children, even though they will be assigned to the lower tier, PBJI will increase welfare benefits above current levels.

Taken up next is the question of the criteria by which families are assigned to the two tiers. Once the acceptability of categorization is assumed, debate in this area focuses on female-headed families: Should women with children under 3, 6, or 14 be relieved of the responsibility to work? In answering this question, reference often is made to data on labor force participation rates among women. The fact, for example, that a large percentage of women whose youngest child is over 13 are in the labor force does not imply that their earnings are high. So assignment of such women to the lower tier (or category) could have adverse effects if their earnings are low. But while there may be some adverse effects of the two-tier structure, there also may be some gains. Male heads of families with low and modest incomes largely are firmly attached to the labor force, most working full-time all year. Sensitivity to the availability of welfare benefits is slight in this group, but the lower guarantees and tax rates of the lower tier are likely to lessen work disincentives resulting from PBJI. Since this sensitivity is greater among female heads of families, the latter proposition applies with greater force to those women assigned to the lower tier.

The Work Requirement

Work requirements in existing programs like Food Stamps and AFDC/AFDC-UF have not been very successful in getting registrants into jobs. Nevertheless, there do seem to be many who have some difficulty in finding work and who potentially could be influenced by some combination of a job creation program and a work requirement. Unfortunately, evidence is lacking on whether a work requirement will have an extra effect above that that of a job creation program alone. As for the PBJI work requirement, there are numerous loopholes allowing individuals to avoid work. The work requirement can be avoided entirely by anyone who can claim a disability. The attempt to place individuals in private jobs is likely to be similar to existing work tests and is unlikely to be no more successful than these. The attempt to place individuals in newly created jobs will be limited by the number of these jobs available. In the early phase of the program, at least, the number of such jobs may well be inadequate. Moreover, those without children are not eligible for the created jobs. A father in a two-parent family with children who refuses work suffers no penalty, while there is some loss in benefits for a parent in a one-parent family. Only individuals without children lose benefits completely for refusing to accept a job. Yet since the childless individuals cannot receive created jobs, they have a lower probablity of being confronted with a job. Finally, even though the work requirement has significant loopholes, it will be costly to operate. Monitoring the job search effort of all benefit recipients takes resources which might be used more efficiently in other ways.

<u>The Job Creation Program</u>

The job creation program, like any government expenditure, will stimulate employment, and, depending on the position of the economy on its Philips' Curve, possibly also inflation. There is, however, reason to believe that a given expenditure on job creation will differ quantitatively in its macroeconomic effects from the same amount spent on other government projects: more jobs will be created with less inflationary pressure in an appropriately designed job creation program. Unfortunately, exising evidence does not permit an estimate of how big the difference will be.

Perhaps the most serious problems with the job creation program relate to making it effective and efficient. There will be start-up problems in generating an intial supply of jobs. There will be the ongoing problem of maintaining an inventory of jobs to supply a continual flow of new benefit recipients. These new workers must be absorbed without seriously disrupting the efficiency of the production activities. To reach the target population of the Carter Plan, the new jobs should be mainly in relatively labor intensive activities requiring large numbers of unskilled workers. The areas proposed by the Carter Plan, like home care services for the aged and disabled, seem consistent with this objective. There is a problem that newly created jobs could displace existing jobs, public or private. Related to the displacement problem is that of union concern. Unions are concerned with low wage program participants displacing higher wage union labor. Displacement can be avoided if the jobs are created in new areas of production. What is new may differ between localities. It is essential that local job creation agencies be aware of union and other local concerns in developing new jobs. Ultimately, the success of the job creation program will depend on the local agencies and the imagination and skill they can bring to the job creation process.

Coordination of the Welfare Programs

PBJI calls for a partial consolidation of the existing welfare system. The plan leaves uncoordinated an array of remaining transfer and tax programs. This failure to attend adequately to the coordinated design and management of existing programs may result in serious problems for PBJI as well as in missed opportunities for the new welfare system.

Tentative plans have been developed for the coordination of the program of state supplements with the basic PBJI plan. The state supplement program is quite sure to preserve benefit levels for current welfare beneficiaries only in the first year of PBJI. After that, the level of state supplements will depend, as AFDC/AFDC-UF and total SSI benefit levels do now, on the responses of states to an array of economic and political forces.

A potentially serious problem for PBJI is that high cumulative tax rates may result from its interaction with other tax and transfer programs. Unspecified plans to reform Medicaid and the federal income tax will have a critical effect on the seriousness of this problem.

A missed opportunity to use the various components of the multi-program welfare system to serve better its conflicting objectives is illustrated in a discussion of income accounting. The Food Stamp program, for example, offers an opportunity to place a program with a short accountable period alongside of one with a long accountable period. This allows for a mix of responsiveness to sudden need and low costs in the two program system that could not be accomplished in a system with one program.

I. INTRODUCTION

Work effort among welfare beneficiaries has become the principal concern of those designing welfare reform legislation. Heightened political interest in the work avoidance problem coincides, ironically, with sharply declining rates of growth in the AFDC/AFDC-UF and Food Stamp programs and with research findings that the problem is of limited importance among welfare beneficiaries. Indeed, the work disincentives of Unemployment Insurance now may create a more serious problem than those of the two welfare programs.[1] Nonetheless, political pressures mount on planners and legislators to do more to make sure that all who "can" and "should" work do so . This is seen as a way to reduce welfare rolls.

Since the early sixties, various federal administrations have responded to the growth of AFDC and other welfare programs with proposals to spur the work effort of recipients. In 1962, the government financed manpower and other social services for AFDC recipients and allowed for the deduction of work expenses from their labor income to encourage them to work. In 1967, changes in the AFDC program provided substantial "disregards" of labor income to assure recipients a financial gain from work and required work registration of "appropriate recipients. In the early seventies, work registration

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1 Recent research on the impact of the level of UI benefits and the number of weeks for which such benefits are available on the probability of becoming and staying unemployed is summarized and evaluated in Finis Welch, "What Have We Learned From Empirical Studies Of Unemployment Insurance?" presented at the Symposium On The Economics Of Unemployment Research, University of Pittsburgh, April 8, 1976.

requirements were added to the Food Stamp program and expanded to cover all AFDC mothers whose youngest child was of school age. Now the Carter Administration's welfare reform plan appears as the most ambitious effort yet to promote work in the context of an income maintenance plan. The plan combines financial incentives to work, a work registration requirement, and a substantial job creation program.

This paper reviews evidence on the nature and extent of work problems in the low-income population, using as a vehicle for the discussion the basic elements of the Carter Plan, The "Program for Better Jobs and Income" (PBJI). This plan calls for a two-tier benefit structure, with assignment of those who are expected to work to the lower tier. In addition, a work registration requirement attempts to place those who are expected to work in private sector jobs. As a last resort, a special job creation program is intended to offer placements to one adult in every family with children when regular employment is not available. The bulk of the paper is devoted to an analysis of the effectiveness of work stimulation programs in the context set by PBJI.

A secondary interest of the paper is the coordination of welfare programs. Attention has been focused recently on the multiplicity of welfare programs. Concern has arisen since they offer simultaneously several benefits to given families, make for high combined benefit reduction rates, and result in administrative duplication and inefficiency. The response of the Carter Plan to this concern is the proposed consolidation of three welfare programs, AFDC/AFDC-UF, Food Stamps, and SSI.

Unfortunately, a partial consolidation of welfare programs does not remove substantially the problems posed by several coexisting welfare and tax programs. Housing and medical programs, as well as income and social security taxes, remain to provide problems of coordination that are both managerial and more fundamental in nature. After taking up the work issue, the paper deals with the question of whether the multiplicity of programs per se is the real source of the coordination problem in the current welfare system. Beyond that, the paper considers the proposition that the multiplicity of programs offers an advantage in satisfying the several conflicting objectives of welfare.

This paper is divided into five sections. Section II considers the proposed two-tier system, comparing it to the existing system of tax rates and guarantees, discussing the categorization procedures necessary to carry it out, and finally evaluating whether anything is gained by two tiers rather than one. Section III discusses work requirements, reviewing the effectiveness of previous work tests, considering the nature and extent of work problems among low-income people, and tracing the possibilities for continued work avoidance through the proposed procedures. Section IV discusses the job creation program, considering its macroeconomic effects and evaluating it at the implementation level in terms of its target effectiveness and efficiency. Section V takes up the matter of program coordination, examining both the problems and opportunities offered by the existence of many programs.

II. The Two-Tier Benefit Structure

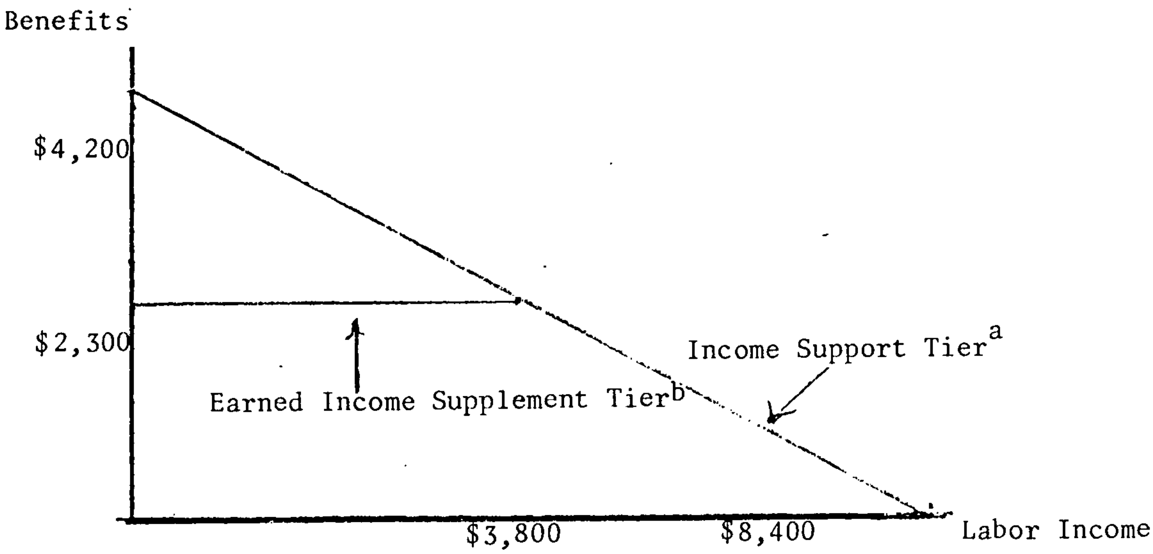
This section begins in Part A by providing greater detail on the two benefit schedules and their variants. The generosity of the schedules is assessed in Part B of the section by comparing the net benefits offered by PBJI with those of existing programs. The section in Part C considers the categorization problem, the criteria by which filing units will be assigned to each of the two benefit tiers. It concludes in Part C by evaluating the advisability of instituting a two-tier categorical system.

A. The Basic Benefit Schedules

Figure 1 contains the two basic benefit schedules for a four person filing unit, the unit used in all illustrations in this paper. The upper tier is the income support tier, while the lower schedule is the earned income supplement tier. The guarantee or basic benefit on the income support tier is $4,200 in 1978 terms. This schedule has a constant 50 percent tax rate on labor income, so benefits fall to zero when labor income reaches $8,400, the "breakeven" level

FIGURE 1

Basic Annual Benefit Schedules for 1978 For Four Person Filing Units



a) The benefit formula on which this schedule is based is:

$$B = 4200 - .50Y$$

where B is the net annual benefit for the filing unit, and where Y is the filing unit's income. The $4,200 basic benefit breaks down into $1,900 for the first adult, $1,100 for the second, and $600 for each of the two children.

b) B = 2,300 for Y $3,800; and

B = 4,200 - .5Y, for $3,800 Y $8,400

of earnings.[2]

The earned income supplement schedule in Figure 1 has an annual guarantee of $2,300. The tax rate on labor income varies with the level of earnings. It is zero for the first $3,800 of annual earnings, and 50 percent thereafter.[3] Notice that the two tiers coincide above $3,800 of earnings. This allows a filing unit with a person who works full-time all year at the minimum wage to have total benefits equal to those of filing units on the income support tier. Figure 1 thus makes a very vital point with respect to the two tier system: the tiers differ only at earnings below $3,800. The last proposition must be modifed in the case of the disabled. Filing units with such persons in them receive an added $550 per year making the income support schedule for them more generous throughout

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[2] The tax rates on income from capital or private transfers are not considered in this paper. Breakeven levels of income or benefit cut-off points, therefore, are always points at which labor income reaches a certain amount. Tax rates on income from public income transfers are considered briefly in the section on program coordination. Also, it should be noted that where child care costs are deductible, the breakeven level will rise by the amount of the deduction.

[3] The range of earnings over which the tax rate on labor income is zero commonly is called a "disregard." The disregard on the lower tier in PBJI always is $3,800. This is because the guarantees on the upper and lower tier always differ by $1,900 which is the guarantee for the first adult in a household assigned to the upper tier; and because the upper and lower tiers always must coincide before benefits on the lower tier begin to decline with rising earnings. Since the tax rate on earnings on the upper tier is 50 percent and the initial difference in benefits on the two schedules always is $1,900, the schedules always coincide at $\frac{1,900}{.5} = \$3,800$ of annual earnings.

its length. Since such units still face a constant 50 percent tax rate on income, the breakeven level is $9,500 and the schedule lies above the regular income support schedule at all levels of income.

A feature modifying both schedules for female-headed families is the deductibility of child care expenses. Child care expenses of up to $150 per month per child for no more than two children are deductible from labor income in calculating PBJI benefits. Every dollar of child care expenses deducted from income raises benefits by 50 cents over what they would have been in the absence of the deduction. Thus, this deductible also raises the breakeven level for those claiming it. For those women claiming the maximum deduction of $3,600 per year, the breakeven level rises from $9,400 to $13,000 on both tiers. A noteworthy point is that this deductible thus expands the population of eligible female-headed families from those whose labor incomes are below $9,400 to those whose incomes are up to $13,000, providing they incur child care expenses.

B. Generosity of Benefit Schedules

One measure of the generosity of the Carter Plan is whether the level of benefits will be higher than that received under current plans. The comparison between existing and proposed programs turns out to be very important since it will be shown that many groups will suffer a decline in benefits under PBJI unless the decline is offset by state supplements. The comparisons in this section are made on the assumption that state supplements are zero. The provisions in PBJI for such supplements are discussed in Section V.

Comparing generosity between the two plans is complicated. The Carter Plan is proposed as a substitute for AFDC/AFDC-UF, Food Stamps, SSI, and, if enacted, possibly even for general assistance for four broad groups: female-headed families with children; aged, blind, and disabled adults; childless couples and single individuals. It is essential to distinguish these groups since their treatment differs both under existing programs and under the Carter Administration proposals. The case of female-headed families will be considered in some detail in order to illustrate the difficulties in making comparisons between programs.

1. <u>Female-Headed Families With Children</u>

Some female-headed families with children who have low to moderate incomes receive currently neither an AFDC nor a Food Stamp benefit. If their income is above the AFDC guarantee level, even if it is below the breakeven level, they cannot begin to participate in AFDC.[4]

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4 Families may start to receive AFDC benefits only if their incomes fall below state guarantee or cost standards. They can continue to receive AFDC benefits if their labor incomes rise above the guarantees but stay below breakeven levels of income. This distinction arises because the "30 and 1/3" disregard under AFDC applies to labor income only after a family has established eligibility for the program.

Since most of these families will become eligible for benefits under PBJI, their entire benefit is a gain, whether they are assigned to the upper or lower tier. For those who now receive no AFDC but partial Food Stamp benefits, the gain will be less.

The comparisons are more complicated for families who currently receive AFDC and Food Stamps. The easiest case is that of a family with no labor income. Its AFDC and Food Stamp benefits are equal to the sum of the AFDC guarantee and a fraction of the Food Stamp guarantee. The total benefit, the "cumulative guarantee," is somewhat less than the simple sum of the guarantees because of the way in which the two programs are coordinated.[5] Table 1 presents the annual guarantees by state for four-person female-headed families in July 1976. The states are arranged in ascending order by the size of the cumulative guarantee. Note that the cumulative guarantee is below $3,000 per year only in one small state, Mississippi, and is $4,200 or less per year in but twenty states, including Mississippi.

Remember that $4,200 is the upper tier guarantee for 1978 -- not 1976 -- in the PBJI. Then for the sake of comparison, call the states with current cumulative guarantees of $4,200 or less the low guarantee states; in these, female-headed families with no income will gain. The remaining 30 states can be labeled the high guarantee

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In particular, the Food Stamp program defines income to include AFDC benefits and then reduces Food Stamp benefits by roughly 30 percent of AFDC benefits. The cumulative guarantee, then, is the AFDC guarantee plus the Food Stamps guarantee minus 30 percent of the AFDC guarantee.

TABLE 1

AFDC AND FOOD STAMP BENEFITS FOR
FOUR PERSON FAMILIES
JULY 1976

(In Dollars)

State	AFDC	Food Stamps	Total
Mississippi	720	1836	2556
South Carolina	1404	1656	3060
Tennessee	1584	1584	3168
Alabama	1620	1584	3204
Arkansas	1680	1548	3228
Texas	1680	1548	3228
Georgia	1776	1548	3324
Louisiana	1896	1500	3396
Florida	2040	1428	3468
Missouri	2040	1428	3468
Arizona	2376	1350	3732
North Carolina	2400	1356	3756
New Mexico	2472	1356	3828
Kentucky	2820	1212	4032
Montana	3024	1140	4104
Maryland	2904	1212	4116
Indiana	3000	1140	4140
Ohio	3048	1140	4188
West Virginia	2988	1212	4200
Nevada	2988	1212	4200
Wyoming	3240	1068	4308
Colorado	3312	1068	4380
Maine	3336	1068	4404
Oklahoma	3408	1068	4476
Delaware	3444	1068	4512
Nebraska	3528	996	4524
Virginia	3732	924	4656
Washington D.C.	3768	924	4692
Illinois	3804	924	4728

State	AFDC	Food Stamps	Total
Utah	3996	852	4848
South Dakota	3996	852	4848
Idaho	4128	852	4980
New Hampshire	4152	852	5004
Kansas	4368	744	5112
New Jersey	4272	852	5124
Iowa	4272	852	5124
Rhode Island	4308	852	5160
North Dakota	4440	744	5184
Pennsylvania	4476	744	5220
California	4548	744	5292
Vermont	4548	744	5292
Massachusetts	4620	744	5364
Minnesota	4620	744	5364
Washington	4620	744	5364
Michigan	4836	636	5472
Connecticut	4860	636	5496
New York	5064	528	5592
Wisconsin	5088	528	5616
Oregon	5196	528	5724
Alaska	4800	1356	6156
Hawaii	6168	876	7044

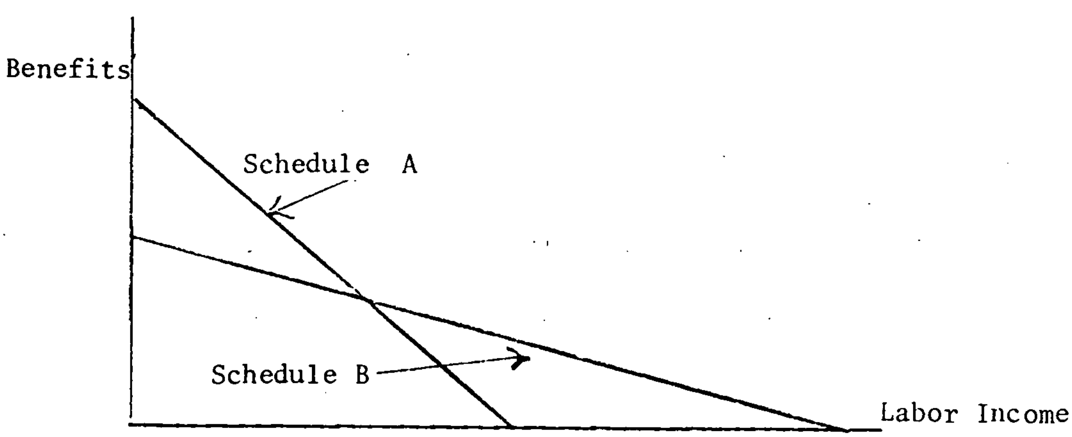
Source: Office of Income Security Policy, Department of Health, Education, and Welfare, Washington, D.C., 1977.

states; their female-headed families with no income will lose without state supplementation. Note that although the low guarantee states have less than half of the general population, they certainly have half of the poor and near-poor population. At the same time, participation in AFDC among the poor in these states is much lower than in the other states. If one assumes that the AFDC-Food Stamp cumulative guarantee will rise between 1976 and 1978 by 10 percent on the average, then 6 of the 20 states just labeled low guarantee states in Table 1 would be high guarantee states by 1978. Under this assumption female-headed families with little or no labor incomes are gainers in only fourteen states.

For a family with labor income and receiving AFDC, the task of comparison is complicated by the need to consider not only guarantees, but also tax rates in gauging generosity. Consider the two benefit schedules in Figure 2.

FIGURE 2

Illustrative of Benefit Schedules That Cross



Schedule A with the higher guarantee is more generous than Schedule B at low levels of income, but not at high levels. This is because Schedule A also has a higher tax rate. The figure illustrates that at relatively low incomes, the relative generosity of benefit schedules depends only on the guarantee, but at higher income levels, the schedules could cross because of differences in tax rates. In considering families with labor income, it is thus necessary to distinguish those with relatively high or low earnings: for those with low earnings, tax rates can be ignored in comparing generosity, but not for those with higher earnings.

Parts A and B of Table 2 summarize the gains or losses from the Carter Plan for female-headed families based on labor income and the cumulative guarantee under the existing AFDC and Food Stamp programs. Female-headed families will be assigned to the upper (income support) tier of the Carter Plan if they have young children and to the lower (earned income supplement) tier if the children are older. Part A of Table 2 presents the comparison for those assigned to the upper tier and Part B for the lower tier. Tax rates are not shown in the tables. They will make a difference in relative generosity only for those in the second column (high income) of each table. They will be discussed explicitly in the text.

An illustrative comparison can be made for a filing unit from Mississippi in box (1) of Table 2. Its AFDC-Food Stamps cumulative

TABLE 2

Gains or Losses from the Carter Plan for Female-Headed Filing Units

Part A

Income Support (Upper) Tier

Current State Cumulative Guarantee	Labor Income Low	High
Low ($4,200)	(1) gain	(2) gain
High ($4,200)	(3) loss	(4) loss

Part B

Earned Income Supplement (Lower) Tier

Current State Cumulative Guarantee	Low	High
Low	(5) loss	(6) no change
High	(7) loss	(8) loss

guarantee is $2,556 in 1976. On the upper tier of the Carter Plan, its guarantee is $4,200 in 1978. (Tax rates under the existing and proposed systems are inconsequential here because labor income is assumed to be low.) The family clearly comes out ahead under the new plan. Similarly, any filing unit in box (1) will benefit from the proposed system.

Filing units in box (3) will lose under the new system without state supplementation because their current guarantees exceed $4,200. Only if states supplement the federal benefit of $4,200 will they not lose under the new system. Note from Table 1 that the loss could be large since several states have cumulative guarantees in 1976 exceeding $5,000. Hawaii's is over $7,000.

Continuing with the low income column but now for a filing unit assigned to the lower tier, consider a unit from Mississippi in box (5) of Table 2. It loses under the new plan. Its current cumulative guarantee is $2,556, while its new guarantee is $2,300. This type of unit would be one in which there are no young children. Of course, units assigned to the lower tier are supposed to be offered specially created jobs. It is obvious that their total income -- benefits plus earnings -- often will exceed current benefits if they get a job, but benefits alone will fall.

Since Mississippi has the lowest cumulative guarantee of any of the states under the existing system, and since a unit assigned to the lower tier loses even there, then certainly such units in the high guarantee states -- those in box (2) -- will lose benefits under the Carter Plan. This result can be altered only if some or all of the states offer state supplements to filing units on the lower tier.

Moving on to those with labor incomes high enough that tax rates affect relative generosity (second column of Parts A and B of Table 2), it is necessary to consider explicitly the effect of differences in tax rates. Unfortunately, tax rates in AFDC are not known in many states. Moreover, the cumulative tax rate of AFDC and Food Stamps is difficult to calculate. Nevertheless, several pieces of evidence on tax rates do allow some general conclusions, assuming still that there is no state supplementation. In any case, those in the second columns of the tables -- boxes (2), (4), (6), and (8) -- constitute a minority of AFDC units, perhaps 15 percent of the caseload at any one point in time.[6]

As shown in Figure 3, those in box (2) of Table 2 will be on the income support schedule which, by definition, has a higher guarantee than any AFDC-Food Stamp guarantee in this category; they typically will face a lower cumulative tax rate under the Carter Plan than under the AFDC-Food Stamp schedules.

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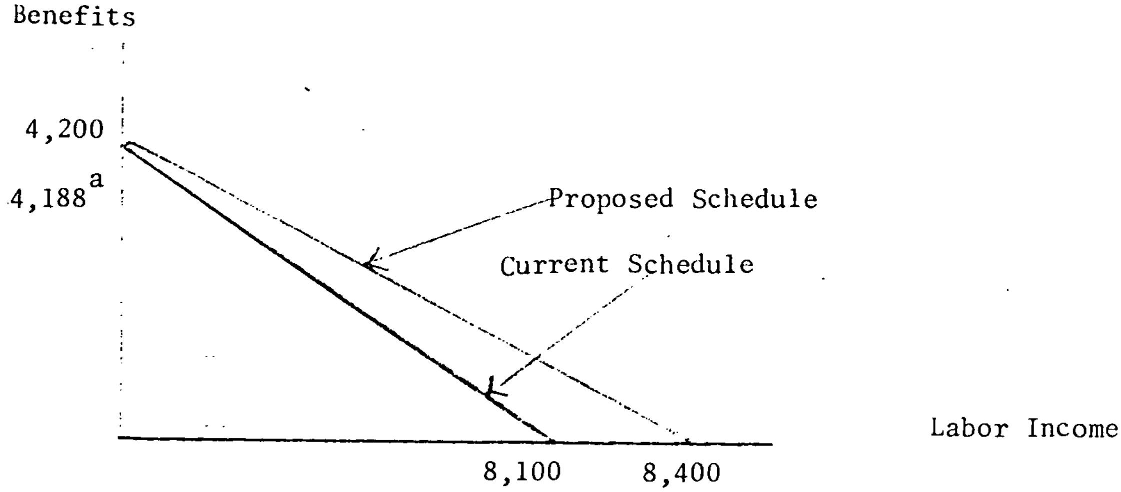
6 The exact figure has been in the neighborhood of 15 percent at least since 1961. Data on this are available periodically from the national survey of the AFDC population conducted by the National Center for Social Statistics in the Department of Health, Education, and Welfare.

FIGURE 3

Comparison of Benefit Schedules Under Existing and Proposed Systems For Filing Units in Box (2) of Table 2



a/ A guarantee of 4,188 is used for an illustrative state in this category. As noted in the text, it happens to be Ohio.

The difference in benefits between existing and proposed systems in box (2) typically will be small, however, because cumulative AFDC-Food Stamp tax rates are surprisingly low. In Ohio, for example, the effective AFDC tax rate is roughly 30 percent. The effective tax rate in AFDC is so low because of the exceedingly generous treatment of "work expenses" under that program. They are defined so broadly that when they are deducted from earnings almost no earnings are left to reduce AFDC benefits.[7] Since the Food stamp tax rate is

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[7] In AFDC, work expenses actually are not deducted from earnings. A credit in the form of higher benefits is given to recipients in an amount equal to such expenses.

A review of data on individuals in the surveys mentioned in the previous footnote reveals that work expenses often apparently are defined to equal gross earnings.

For the most recent estimates of how AFDC benefits decline with earnings, given how work expenses rise with earnings, see: Robert M. Hutchens, "Changes in AFDC Tax Rates," 1967-1971, Journal of Human Resources, forthcoming.

roughly the same 30 percent, the cumulative tax in Ohio is slightly greater than 50 percent.[8] Given that the AFDC Food Stamps guarantee in Ohio in 1976 was $4,188 and that the tax rate was 52 percent, the breakeven level of labor income in Ohio was $8,100, not far below $8,400. So the gain in benefits under the new system will range from negligible to slight in box (2), the gain being greater the lower the existing guarantee and the higher the existing tax rate.

In box (6) of Table 2, there often will be no change in benefits because, as shown in Figure 4, above $3,800 of annual labor income the tax rate on the lower tier is the same 50 percent that it often is under AFDC-Food Stamps. For those in box (6) with labor incomes of less than $3,800, the new system will result in a loss of benefits. Again, this will be the case unless state supplements maintain current benefits.

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[8] In simplified form, the benefit formulae for AFDC and Food Stamps are:

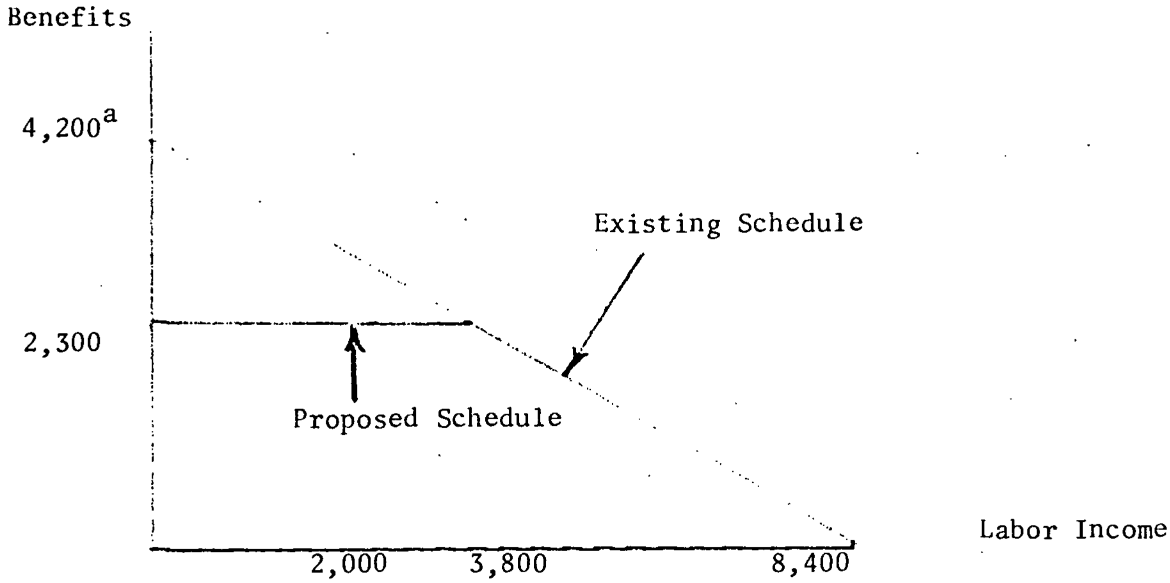
$$B_A = G_A - T_A(Y - S) + W_A$$

$$B_F = G_F - T_F(Y - W_F - B_A)$$

Where the B's are net benefits under AFDC and Food Stamps, respectively, the G's are the guarantees, the T's are the tax rates on earnings, the S is a set-aside, and the W's are work expenses. When B_A and B_F are summed, the cumulative benefit formula or schedule is obtained. Proper manipulation of terms in this formula yields a cumulative tax rate of $T_A + T_F - T_AT_F$. If $T_A = .3$, and $T_F = .3$, then the value of this cumulative tax rate is .51.

FIGURE 4

Comparison of Benefit Schedules Under
Existing and Proposed Systems For
Filing Units in Box (6) of Table 2



a/ By construction, 4,200 is the highest cumulative guarantee in a low guarantee state in Table 2.

Filing units in boxes (4) and (8) of Table 2 are likely to lose substantial amounts of benefits under the proposed system, unless state supplements maintain existing benefit levels. Guarantees under the existing system in boxes (4) and (8) are, by definition, above guarantees under the proposed system. Moreover, cumulative tax rates under the existing system often are lower than under the Carter Plan.

The average effective tax rate in AFDC in California is 16.6 percent; in New York, it is 25.7 percent; in Pennsylvania, it is 32.3 percent.[9] Again, this is because of the generous treatment accorded "work expenses" under the current AFDC program. These three states today have roughly 30 percent of the national AFDC caseload. In the first two of these states, the cumulative AFDC-Food Stamp tax rate is well below 50 percent, while in the third it is only slightly above 50 percent. With existing guarantees higher and tax rates lower, breakeven levels of income will be well above those in the Carter Plan. Existing benefit schedules will lie above those of the Carter Plan for these groups unless, of course, state supplements alter the proposed schedules.

2. Male-Headed Families With Children

Male-headed families with children in the low and moderate income population can be divided into several major categories according to their current welfare status: 1) those on AFDC as incapacitated fathers and on Food Stamps; 2) those receiving AFDC-UF and Food Stamps; 3) those combining General Assistance and Food Stamps; 4) those receiving only Food Stamps; and 5) those not in receipt of any benefits. The bulk of male-headed families with children who

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[9] Hutchens, *op. cit.*

would receive aid under the Carter Plan fall into the last three categories.

Males heading AFDC-Food Stamps families as incapacitated fathers undoubtedly would qualify for the income support tier. Their labor incomes typically will be low. In the low guarantee states, their financial status will improve because their guarantees will rise. In the high guarantee states, they will lose without arrangements for state supplements.

Filing units in the second category of male-headed families have low labor incomes while on AFDC-UF because of the limitation in that program on the number of hours they may work and remain eligible. For them, too, the comparison between the existing and proposed systems depends principally on the guarantees. Since these units largely are in high cumulative guarantee states, and since they will be assigned to the earned income supplement tier, their net benefits will fall.[10] Their total incomes, earnings plus benefits, will not fall if they are offered and accept specially created jobs on a full-time basis.

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10 Less than 20 percent of all AFDC-UF cases are in the low guarantee states, as these are defined in Table 1. These cases are in 4 of the 28 states that have the AFDC-UF program. Moreover, all four states have cumulative guarantees between $4,000 and $4,200. Therefore, all AFDC-UF cases assigned to the lower tiers will experience a fall in their guarantees and, probably, in the net benefits. (U.S. Department of Health, Education, and Welfare, Public Assistance Statistics, January, 1977, Table 5.)

For the bulk of male-headed families with children, those in the three remaining categories, benefits will rise slightly under the new system. This is because either guarantee will rise, or average tax rates will fall slightly, or both. For such families, most of whom have regular labor incomes, benefit increases will be the same whether these families are assigned to the upper or the lower tier. Again, this is because the two tiers coincide above $3,800 of annual earnings.

3. The Aged, Blind, and Disabled

The guarantee in SSI for single individuals in July 1975 was $2,134 whereas the Carter Plan proposes a guarantee of $2,500 in 1978 terms for such persons; for couples the two figures are $3,200 and $3,750, respectively. Thus, single individuals and couples now qualifying for the Supplemental Security Income program either as aged, blind, or disabled persons, would receive increases in benefits in the 28 states, all listed in Table 3, which do not supplement the basic federal benefits plus roughly 12 other states which do supplement SSI. Whether persons in the remaining 10 states benefit from the Carter Plan depends upon decisions by states regarding their supplements.

4. Childless Couples and Single Individuals

Single individuals and couples without children who do not qualify for SSI would experience increases in benefits under

TABLE 3

SSI Benefits for the Aged and Disabled
Living Independently in July 1975

Annual SSI Guarantees (In Dollars)

State	Aged Individual	Aged Couple	Disabled Individual	Disabled Couple
Arizona	1896	2844	1896	2844
Arkansas	1896	2844	1896	2844
Delaware	1896	2844	1896	2844
Washington, D.C.	1896	2844	1896	2844
Florida	1896	2844	1896	2844
Georgia	1896	2844	1896	2844
Indiana	1896	2844	1896	2844
Iowa	1896	2844	2112	3276
Kansas	1896	2844	1896	2844
Kentucky	1896	2844	1896	2844
Louisiana	1896	2844	1896	2844
Maryland	1896	2844	1896	2844
Mississippi	1896	2844	1896	2844
Missouri	1896	2844	1896	2844
Montana	1896	2844	1896	2844
New Mexico	1896	2844	1896	2844
North Carolina	1896	2844	1896	2844
North Dakota	1896	2844	1896	2844
Ohio	1896	2844	1896	2844
South Carolina	1896	2844	1896	2844
South Dakota	1896	2844	1896	2844
Tennessee	1896	2844	1896	2844
Texas	1896	2844	1896	2844
Utah	1896	2844	1896	2844
Vermont	1896	2844	1896	2844
Virginia	1896	2844	1896	2844
West Virginia	1896	2844	1896	2844
Wyoming	1896	2844	1896	2844
New Hampshire	1896	2844	1896	2844
Illinois	1896	2844	1896	2844
Alabama	1896	2844	1896	2844
New Jersey	1896	2844	1896	2844
Maine	1896	2844	1896	2844
Michigan	1896	2844	1896	2844
Oregon	1896	2844	1896	2844

New Hampshire	2040	2844	2040	2844
Illinois	2100	2844	2100	2844
Alabama	1896	2904	1896	2904
New Jersey	2184	3000	2184	3000
Maine	2016	3024	2016	3024
Michigan	2040	3060	2040	3060
Oregon	2184	3133	2184	3133
Hawaii	2100	3180	2100	3180
Pennsylvania	2136	3204	2136	3204
Minnesota	2268	3300	2268	3300
Washington	2328	3324	2328	3324
Idaho	2652	3432	2652	3432
Oklahoma	2220	3492	2220	3492
Rhode Island	2268	3552	2268	3552
Nebraska	2700	2700	2700	2700
Connecticut	3500	3648	3000	3648
New York	2628	3756	2628	3756
Wisconsin	2736	4104	4200	8400
Nevada	2556	4116	1896	2844
Alaska	2820	4140	2820	4140
Colorado	2220	4440	1968	3936
Massachusetts	3228	4920	3108	4728
California	3108	5856	3108	7008

Source: "Supplemental Security Income for the Aged, Blind, And Disabled: Summary of State Supplementation and Medicaid Decisions," Bureau of Supplemental Security Income for the Aged, Blind, and Disabled, Social Security Administration, #ISS-12-100, Revised on August 12, 1975.

the new program in the vast majority of cases. Such persons now may receive aid under the Food Stamp or state General Assistance programs. Under Food Stamps, the guarantee in July 1977 is $624 per year for a single individual and $1,128 for a couple, whereas under the Carter Plan the figures are $1,100 and $2,200, respectively, in 1976 terms.

C. Criteria for the Assignment to the Two Tiers

Politically, categorization has great appeal. In comparison to a system of uniform treatment for all, the cost of a single cash transfer program is lower when one group receives more favorable treatment than another. In addition, value considerations may lead to a designation of one group as more deserving, or, in some cases, deserving of a different kind of treatment. Yet beyond cost and values, it is sometimes attempted to justify categorization on the basis of its effects on behavior. If it is desired that the groups behave differently, the treatment of each category can be specialized to induce the desired behavior pattern. Thus one test of a categorization system is whether it is effective in inducing the intended differences in behavior between groups.

No matter what combination of value and effectiveness criteria is used to evaluate the results of a categorical system, the dividing lines between categories will be determined largely by value consideration. Yet even here Kesselman and Rosow have shown that some behavioral considerations can assist in determining the categories.[11] This part will consider the assignment to categories in the Carter Plan while Part D will discuss the effectiveness of the differential treatment provided by the two tiers.

Under the Carter Plan, assignment to a particular tier (or category) depends on whether one of the adult heads in a filing unit is expected to work. For male-headed filing units with children, assignment to the lower tier is automatic because the male head is expected to work. Only if the male head can establish a disability will the filing unit be placed on the upper income support tier. (When the worker in the family cannot find a job within a fixed time, the unit may also be moved up to the income support tier.) For filing units with a female head, assignment to the upper tier will be automatic for those with some children who are under 14. Those who have some children under 6 are not expected to work, but those women whose youngest child is between 6 and 13 are expected to work part-time. If the latter women refuse an available job, their families are assigned to the lower tier. The aged and disabled are not expected to work, so they are assigned to the upper tier.

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11 Jonathan R. Kesselman, "A Comprehensive Approach to Income Maintenance: SWIFT," Journal of Public Economics, Vol. 2, 1973, pp. 68-69; Jerome W. Rosow, "Work Requirements and Work Incentives in Welfare Reform," Proceedings of the Industrial Relations Research Association, 1972, pp. 431-433.

Filing units containing no children and where the adults are neither aged nor disabled will be assigned to a lower tier.

A social consensus seems to exist on allowing the aged, the disabled, children who are in elementary or secondary school, and mothers of the latter in two parent households not to work. Equally clear is a general agreement that non-aged, non-disabled male heads with children should seek and accept work along with male or female adults having no child care responsibilities. Disputes arise, once categorization and work requirements are desired, only with regard to women heading one-parent households with children: Should such women with children under 3, under 6, under 14, or even under 18 be exempted from the requirement to seek work?

The dispute is resolved differently by the major existing transfer programs for low income families. The Food Stamp program exempts from its work registration requirement all mothers with children under 18 and still in school. The AFDC program, by contrast, exempts only women with children under 6. Under AFDC, however, a regulation that suitable day care be available to women with children who are 6 or older before they are required to accept work or training often results in the de facto exemption of a broader group because of limited availability of such services.

Kesselman and Rosow have suggested that the labor force behavior of various groupings of women in the general population be used as a guide in categorizing women. They argue that extensive participation in one demographic group makes it difficult to exempt the welfare poor within that group from having to work.

Whether one accepts their argument or not, it is interesting to consider the extent of labor force participation of females within several demographic categories. Part A of Table 4 presents data indicating that women with children work less if they have husbands present than if they do not, no matter what the ages of their children may be. Another unsurprising finding is that women without husbands in their homes work less the younger their children. Somewhat surprising, though, are the facts that over two-thirds of women without husbands whose children are between 6 and 17 are in the labor force; so are over three-fifths of husbandless women with one or more children between 3 and 5 and none younger. The trend in labor force participation of women, shown in Part B of Table 4, is fairly steadily upward. Unfortunately, the available data do not give finer breakdowns within the group of women whose children are all between 6 and 17. Undoubtedly, the participation rate for women who have children between 6 and 13 and none younger is somewhere between 61.1 percent and 71.7 percent, while that for women none of whose children are under 14 is somewhat greater than 71.1 percent.

With participation rates so high -- and rising -- some might argue for a work requirement to apply to women with children of 6 and over, if not 3 and over. Longitudinal data suggest even

TABLE 4

Part A

Percentage of Women in the Labor Force by Presence and Age of Children [1]

Presence and Age of Children	Married, Husband Present	Other Marital Status [2]
Mothers with children		
Under 18 years	44.9	64.7
6 to 17 years only	52.3	71.7
Under 6 years	36.6	56.3
3 to 5, none under 3 years [3]	41.9	61.1
Under 3 years	32.7	50.5
Women without children under 18 years	43.9	64.9

1 Ever-married women, 16 years of age and over
2 Includes widowed, divorced, and married, husband absent
3 May also have older children

Part B

Labor Force Participation Rates of Mothers

	Husband Present				Other Marital			
	1950	1968	1971	1975	1950	1968	1971	1975
With children 6 to 17 years only	28.3	46.9	49.4	52.3	63.6	67.8	67.6	71.7
With children under 6 years	11.9	27.6	29.6	36.6	41.4	47.6	47.8	56.3

Sources: Jerome M. Rosow, "Work Requirements and Work Incentives in Welfare Reform," Proceedings of the Industrial Relations Research Assocation, 1972, p. 432; and Allyson Sherman Grossman, "The Labor Force Patterns of Divorced and Separated Women," Monthly Labor Review, January 1977, p. 51.

higher participation rates than do cross-sectional (point-in-time) data.

There is, however, a serious limitation to these data as a guide to policy under the two tier system. Although many women without husbands work, the number of hours they work and their rates of pay also need to be known before the data can be used in guiding assignments to the two tiers. There may be a crucial difference in the hardship imposed by a categorical program which only obligates a woman to make some contribution to her support and one which requires full-time work. There could be serious adverse effects for those who can work only part-time or part-year from assignment to the lower tier. Thus the empirical basis for categorizing women currently does not exist.

D. The Gain From the Two Tier Benefit Schedule

The categorization process assigns filing units to one of the two benefit tiers, a process of added significance in that the work requirement is applied only to those on the lower tier. Thus an evaluation of whether the categorization process is effective in stimulating work effort must consider both the effectiveness of the work requirement and the consequences for work of the two tier benefit schedule. Section III will take up the work requirement while this part will concentrate on the benefit schedules. The question to be considered is whether the two tier benefit system will result in more work effort than a uniform one tier system for all, say the proposed upper income support tier.

1. The Incentives to Work Provided by the Two Tier System

Recall the two tiers for a family of four in Figure 1. The notable feature of these two schedules is that they coincide for annual labor incomes in excess of $3,800. If a person works full-time at a minimum wage of $2.65, his labor income will be $5,300, within the range of coincidence. Thus a difference in treatment does not exist for full-time full-year workers, working at or above the federal minimum. The two tier benefit schedule matters only for those not working or who work part-time or part-year.

Table 5 summarizes the gains to a family if the head works. If a person does not work all year, the benefit to this four person family on the lower tier is $2,300 (line 4). On the other hand,

TABLE 5

The Gain from Work for a Four Person Family

	Lower Tier	Upper Tier
1. Labor Income of Head (annual, full-time at minimum wage)	$5,300	$5,300
2. Benefit While Working	$1,550	$1,550
3. Total Income (1+2)	$6,850	$6,850
4. Benefit If Not Working	$2,300	$4,200
5. Net Gain From Work (3 minus 4)	$4,550	$2,650

if he were to work full-time at the minimum wage with income of $5,300 the benefit is $1,550, providing the family with a total income of $6,850. The family gains $4,550 if the head works full-time as opposed to not at all. Now suppose the family had been assigned to the upper tier. If the person did not work all year, his family in this case would receive $4,200 in benefits (line 4). Yet if he worked full-time, his benefit would be the same as in the previous case, or $1,550, providing a total income again of $6,850. Thus if the family is on the upper tier, the gain from full-time work is only $2,650. A gain of $4,550 associated with the lower tier is certainly much greater than that of $2,650 associated with the upper tier. The question is whether the difference is large enough to make a difference in work effort.

Actually the differential incentive to work is exaggerated by the figures in Table 5. Table 5 shows the gain from full-time full-year work as opposed to no work. However, many people work at least part of the year. If a person chooses not to work, it may well be only for a matter of weeks or months, while the person does work for the rest of the year. For example, if the person is considering whether or not to work for half a year, the respective gains will be approximately half of those appearing on line 5. The differences in incentives provided by the two tiers is less impressive in absolute terms the shorter the period of time under consideration.

In order to evaluate whether the difference in incentives between the tiers is likely to matter in terms of behavior, two sorts of evidence are relevant. Since the difference in tiers matters only for those who do not work full-year full-time, data on the extent of work under the current welfare system will be considered. Then evidence on how responsive work effort is to incentives provided by the welfare system will be considered.

2. The Current Extent of Work

Both females and males heading families in the low-income population work extensively under the current welfare system, although the attachment to the labor force of the male heads obviously is much greater. According to data from the Michigan Panel Study of Income Dynamics, two-thirds of women who headed low-income families at some time during the five-year period 1967-1972 worked at some time during the period. Among women who headed low-income families throughout the same five-year period, 77 percent worked at some time.[12] Another study utilizing the Michigan data has demonstrated, however, that such female heads generally do not work 2000 hours per year. Employed white women heading families with children averaged 1,044 hours of work in 1971. Their black counterparts averaged 1,231 hours of work in that same year.[13] Since their wage rates were low,

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12 Work and Welfare Patterns in Low Income Families, June 1975, p.76

13 Frank Levy, "How Big Is The American Underclass," unpublished paper, University of California, School of Public Policy, December, 1976, pp. 38-39.

average annual earnings in both groups were in the neighborhood of $1,500.

Equally demonstrable is the fact that male heads of low-income families work extensively. A small set of numbers makes the point dramatically. Eliminating the disabled from the population of non-aged male heads of low-income households, 90 percent of such non-white males and 97 percent of whites worked during 1971. The non-white males who worked averaged 1,842 hours and the whites who worked averaged 2,103 for the year.[14] The Carter Plan, of course, extends the availability of welfare far beyond the low-income population. Hours worked per year certainly are greater in the near-poor than in the poor population, so it can be shown that work effort is considerable in the population covered by the Carter Plan.

While it is clear that male heads of low-income families work, on the average, full-time full-year in spite of the fact that reasonably generous benefits are available to them, it cannot be forgotten that there is substantial long-term unemployment in the general population, some of which must occur in the low-income population. Data on this, reviewed in Section III, underline the fact that in this section the data are on average amounts of work

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[14] Ibid.

effort. Some people do not work for long periods of time or several periods during the year. With non-white male heads, there is room for more hours worked. It is unknown, however, whether the shortfall from 2,000 hours per year for this group is based on voluntary or involuntary factors. Among female heads, few are working full-time all year, but the potential for greater work effort is difficult to estimate. Such women undoubtedly need to time carefully their hours of work, both among hours of the week and weeks of the year. Whether there is room for much effect from assigning those who have school age children to the lower tier, therefore, is difficult to tell.

It may be concluded that there may be a difference between tiers for large numbers of females since so many of them do not work full-time full-year. However, only a relative small proportion of males do not work full-time full-year. It is only for these that the difference between tiers might matter.

3. <u>Impact of Welfare Benefits on Work Effort</u>

Work effort in the low-income population is extensive though a welfare system offering modestly high benefits for all types of families already is in place. As of July 1972, the average female-headed family with three children could receive $3,442 annually in cash and food benefits, and Medicaid benefits typically were added on to that amount. Male-headed families with a mother and two children could receive on the average $2,431 in cash and

and food benefits and also often could add Medicaid benefits. Of course there is substantial variation around these averages which are weighted by the distribution of the poverty population.[15]

Evidence on the sensitivity of work effort on the part of welfare beneficiaries to the generosity of welfare programs comes from two types of sources. The public is most familiar with the four negative income tax experiments. A substantial body of evidence also has been developed using data from non-experimental sources. Two consistent themes emerge from both types of studies. The first is that for a given change in the guarantee or tax rate, male heads of families exhibit the smallest labor supply response and wives the greatest response. Female heads of families have an intermediate response, but are more like the married women than like the male heads in their labor supply response. The responses to a large change either in the guarantee or in the tax rate are substantial in percentage terms mainly for married women. It is they, apparently, who are looking for opportunities to exit from the labor force and who use transfer programs to facilitate that exit. Male heads of families are firmly attached, by and large, to the labor force, and welfare programs seem to jar that attach-

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15 U.S. Congress, Joint Economic Committee, Subcommittee on Fiscal Policy, "Welfare In The 1970's: A National Study of Benefits Available in 100 Local Areas," in Studies in Public Welfare, Paper No. 15, July 22, 1974, pp. 4-5.

ment only for a few. The second theme is that for all three groups responses are greater the lower a family's income normally is. Thus, while responses for male heads as a whole are small, they are yet smaller for males whose incomes normally are, let's say, $5,000 per year as opposed to $1,000 per year. Importantly, many more male heads of families are concentrated at the $5,000 level than at the $1,000 level.

Illustrative responses, in terms of declines in hours of work per year, to a $1,000 increase in general welfare benefits may prove instructive. The average male head of a family would work 34 hours per year less than his virtual full work-year. The average married woman would work 143 hours less per year than her usual 650 hours per year. The average female head would work 101 hours less than her usual 950 hours per year.[16] At lower levels of family income, the three responses are greater; at higher levels, they are smaller than those indicated here.

Illustrative responses to a change in the tax rate follow the same patterns. A given decrease in the net wage resulting

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16 These results come from the Seattle-Denver Income Maintenance Experiment. The early results of this experience appear in: M.C. Keeley, P.K. Robins, R.G. Spiegelman, and R.W. West, "The Labor Supply Effects and Costs of Alternative Negative Income Tax Programs: Evidence from the Seattle and Denver Income Maintenance Experiment, Part II, National Predictions Using the Labor Supply Response Function." Center for Study of Welfare Policy, Stanford Research Institute, Research Memorandum #39, May 1977.

from the application of a tax rate to the gross wage induces the greatest decline in hours worked for married women, a smaller decline for female heads of families, and a still smaller decline for male heads of families. Again, the responses are greater at lower levels of family income than at higher levels to a given change in the net wage.

In general, then, there are responses to differences in benefit schedules, but they are not large. Responses are larger, however, for those with lower normal incomes. Many of those with lower normal incomes will have incomes in the range where the two tiers differ. Moreover, many female workers, who also have larger responses, will be in the region of differences between tiers. Thus given the types of people who will face a difference in tiers, existing evidence suggests that work effort will be somewhat greater if they are placed on the lower rather than the upper tier, but the difference will not be a large one.

III. The Work Requirement

A concern with work plays a central role in the Administration's proposals. The aim of the work requirement is, first, to place an individual in a regular job, and, failing that, to employ him in a publicly created job. Indeed, the proposed procedures to place a person in a regular job appear to be very similar to existing work tests in the Food Stamp and AFDC/AFDC-UF programs.

Yet, recent studies of existing work tests have been unable to detect significant success in getting registrants back to work.[17] In Part A, this section will consider reasons why existing work tests are unlikely to succeed. In Part B, it will consider evidence on the kinds of work problems that exist among low-income individuals. In Part C, it will consider the procedures of the PBJI work requirement in some detail in order to detect routes for continued work avoidance.

A. Existing Work Tests

Some recipients of Food Stamps, AFDC/AFDC-UF, and Unemployment Insurance are registered at the Employment Service (ES) where the respective work tests may be applied. Although the standards differ by program, basically registrants are those expected to search for better jobs.[18] In the Food Stamps work test, a recipient is

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17 Robert Evans, Jr, Barry L. Friedman, and Leonard J. Hausman, The Impact of Work Tests on the Employment Behavior of Welfare Recipients unpublished monograph submitted to the U.S. Department of Labor, May, 1976; David W. Stevens and V. Christine Austermann, Equity and Efficiency Considerations in the Unemployment Insurance Work Test: An Analysis of Local Office Administrative Practice, unpublished monograph submitted to the U.S. Department of Labor, October 1975; David W. Stevens, Assisted Job Search for the Insured Unemployed, Kalamazoo, Michigan: The W.E. Upjohn Institute for Employment Research, January 1974.

18 In the Food Stamps program, registrants are the unemployed or part-time workers (under 30 hours) except for those who are under 18, over 65, single parents of children in school, caretakers of disabled persons, enrolled in schools of training, or not able-bodied. In the case of AFDC/AFDC-UF, registrants are non-workers as well as those employed whose earnings are so low that they are eligible for benefits. Exemptions include the mother of children under 6, children under 16 or enrolled in school, the caretaker of a disabled person, the wife of a registrant, a person too old to work (no fixed age), ill or incapacitated, or too remote from a WIN project.

registered when the local welfare office submits a form on his behalf to the ES office without any action taken by the registrant himself. The ES office may call in the registrant to pressure him to intensify his job search by questioning, by requesting proof of search, as well as inquiring into his response to job offers. It may also offer assistance in search, like providing job listings and job referrals. After being registered for one month, registrants are expected to accept available jobs that are within their "major or general field of experience." If a registrant fails to cooperate in search or refuses to accept a job offer, the ES may recommend that the welfare office terminate Food Stamp benefits.

The work test under AFDC/AFDC-UF differs somewhat by state. For example, the New York program requires personal registration by recipients, and, during a recent period, mandatory bi-weekly check pick-up at the ES. At these times recipients were pressured to search and accept job offers in the same ways as in the Food Stamp work test. The California requirement is distinctive in that registrants are required to initiate search on their own and report frequently on that search to the ES. There are, however, several restrictions on the type of work to which AFDC/AFDC-UF registrants in all states may be referred. The job must be within the registrant's "capability" and a reasonable commuting distance from his residence; the wage must exceed a certain minimum; if a question is raised by a registrant, it must be verified that a variety of Federal employment laws are not violated.

Several weaknesses are apparent in existing work tests. First, the ES offices do not have jobs at their disposal that registrants can be required to accept. The ES can make referrals, but even referrals do not necessarily lead to job offers. Thus, although the ES can require a registrant to accept a job offer, the registrant must first obtain that offer. If a registrant does not want to work, he can search enough to satisfy the requirements of the work test -- whether under Food Stamps or AFDC/AFDC-UF -- but he can do it in a way to assure that he receives no offer. It follows that when the supply of jobs is limited, a work test cannot have a strong effect; many registrants who could be influenced cannot be placed in jobs, while registants who do not want to work can avoid jobs while remaining in compliance with the work test rules. It is notable that the PBJI proposal seeks to overcome this serious difficulty by creating public jobs if necessary.

A second weakness of existing work tests is the limited extent of enforcement. Enforcing work tests is only one of the varied responsibilities of ES offices. Full enforcement of a work search test would require staff resources far larger than ES offices can devote to the task. Since job search is likely to be an on-going process, especially for those with difficulties in finding jobs, the ES office must have frequent contact with registrants to provide an effective combination of pressure and assistive services. Nevertheless, a study of work tests in five cities found that in the Food Stamp work test in Fort Worth only 34 percent of male registrants were called into the ES office even once.[19] It is true that in the AFDC/AFDC-UF work test in San Diego 84 percent of males were called in once, but even there 65 percent had frequent contact. There are clearly substantial differences in the extent of enforcement between cities and between types of work tests. Yet, even in a city like San Diego, where enforcement appeared more extensive, the ES staff claimed that they lacked the resources for a fully adequate effort. It appears that the administrative cost of a stringently enforced work search test would be very high, requiring a level of staffing well beyond what ES offices currently provide. Even if the form of the work test were different, costs could be high. For example, in a work test where the enforcer had a supply of jobs and could place registrants directly in those jobs, the cost of frequent contact with registrants might be avoided, but new costs would arise. Maintaining an inventory of jobs adequate to employ a varying inflow of new registrants will involve some costs. In addition,

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19 Evans, Friedman and Hausman, op. cit., Table 3-1, p. 40.

administrative costs rise the more stringent the work test since registrants may try harder to evade the work test or insist on the right to due process and appeal.

A third weakness in work tests is that the rules may be avoided or evaded. For example, a non able-bodied person is exempt from existing work tests, but there is some subjectivity in establishing able-bodiedness. Some registrants may avoid the work test by claiming a disability. As another example, there is a possibility that individuals pressured by the Food Stamp work test in one location simply may move to a new county and establish eligibility again. It takes time before the work test can affect them.[20] In general it should be expected that the stronger the provisions of a work test, the greater may be the efforts of registrants to avoid or evade them. It must be assumed that all the forms of avoidance have not yet been discovered, but they will certainly show up as time elapses.

B. <u>Work Problems and Work Tests</u>

This section will consider various types of work problems and their susceptibility to treatment by an effective work requirement.

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20 In the Evans, Friedman, Hausman study, a survey of registrants was conducted. Many of the addresses available to the ES were out of date. It is possible that some registrants moved for evasive reasons, but this argument is conjectural.

Given a class of individuals who are expected to work, a work requirement is intended to affect several parts of this target population differently. For those currently working full-time, it is intended as a deterrent against quitting work. For the remainder of the target population it is intended to increase work effort. Thus, part-time workers may be pressured to seek full-time work. Those out of work, whether searching or not, will be pressured to take jobs. To evaluate a work requirement, it is necessary to consider how well it performs the functions of deterrence and of increasing the amount of work.

As for the deterrent effect on workers, research on existing work tests do not evaluate it, concentrating instead on effects on those not working. In principle the deterrent effect on current job-holders should be stronger, the harsher the penalties of leaving work. Work test provisions are applied directly only to those out of work. For a person out of work, the harshness or penalty of the work test depends on how strong the pressure is to do something not desired -- like working when the individual does not want to work. In other words, the deterrent effect on job-holders depends on how strong the direct effect is on those out of work. Since it is much more difficult to study the deterrent effect than the direct effect,[21] previous researchers had a two

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[21] The principal difference is that the population for studying the direct effect is more readily identifiable than for the indirect effect, making sampling easier. The population subject to the direct effect consists of those registered at the ES office so that a list of names is available. In contrast, the population affected by the indirect effect could include all workers. On the other hand, many workers have little chance of ending up on welfare. One needs to identify the population of workers at some risk of going on welfare and then sample from it.

part strategy: direct effects would be studied first, and if these were found to be significant, deterrent effects could then be examined. Since direct effects were found to be so small, there was little gain in investigating deterrent effects. A new work test could be more stringent and, if so, it could have a deterrent effect. However, the strength of the effect could only be guessed. Of course, if a new work requirement is introduced, it would be interesting to see if there is an impact effect on the transition rate from jobs to unemployment or to being out of the labor force altogether.

Caution is needed in evaluating the direct effect on those out of work since a new work requirement could have different features than existing work tests. Rather than rely on studies of existing work tests, it may be possible to learn more by examining some relevant pieces of information on the behavior of those out of work. One type of evidence comes from examining work experience over time: Few individuals never work. For example, in the New Jersey Graduate Income Experiment only 3 or 4 percent of the male heads never work. Moreover, these non-workers seem to be characterized by health problems.[22] Studies of welfare experience have similarly found that the majority of recipients of transfers do not receive them permanently, but rather move back and forth between

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22 Barry L. Friedman and Leonard J. Hausman, Work and Welfare Patterns in Low Income Families, unpublished mongraph submitted to U.S. Department of Labor, June 1975, Table III-1-A, p. 74.

work and welfare and under some programs also mix work and welfare at the same time as well as serially.[23] The importance of these results is that spells out of work -- even for transfer recipients -- are usually temporary. The question to consider is not whether a work test can make a person work, but whether it can shorten his spell out of a job: He is likely to return to work sooner or later even without a work test.

Recent work on unemployment spells has begun to delve into the endpoints of a spell. The beginning of a spell is related to the probability of separation from employment and the end to the probability of return to work. The direct effect of the work test, of course, aims at increasing the probability of returning to work. It is thus instructive to consider some of the conclusions of Marston on the relative importance of these factors in explaining overall unemployment:

> "The comparisons just discussed establish employment separations of one kind or another as the common factor linking unemployment rates among teenagers, non-whites, and women. Employed women drop out of the labor force, employed non-whites become unemployed, and employed teenagers do both in copious flows. The difficulty of both unemployed workers and labor-force entrants

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23 B. Harrison and M. Rein, <u>Some Microeconomic Relationships Between Work and Welfare</u>, Department of Urban Studies and Planning, MIT, mimeo, 1976; Lee Rainwater and Martin Rein, <u>Sources of Family Income and the Determinants of Welfare</u>, Joint Center for Urban Studies of MIT and Harvard University, May 1976.

in finding a job contributes substantially to unemployment rates among nonwhites. Except for this group, the probabilities of leaving unemployment play only minor roles."[24]

"...cyclical run-ups in unemployment rates stem from a very different set of flows than do enlarged unemployment rates associated with disadvantaged demographic groups. In a recession the problem is finding a job, not just for labor-force entrants but also for job losers and leavers. But the disadvantaged groups in average labor markets primarily have difficulty keeping their jobs, and except for new entrants seem not to have much more difficulty than do othersin finding a job."[25]

While these results do not undermine the argument for a work test, they do show that the problems to be treated by a work requirement are not the most important ones associated with employment. The relatively unfavorable unemployment experience of the most disadvantaged -- nonwhites, women, and teenagers -- results primarily from a higher probability of leaving a job rather than from a low probability of getting a new job once unemployed. Of course, a job separation could result from a voluntary quit rather than an involuntary layoff. A work requirement cannot affect layoffs, but it is intended to deter quits. Indeed, the data from manufacturing firms show a quit rate much higher than the layoff rate. However, as Marston points out,

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24
Stephen T. Marston, "Employment and Instability and High Unemployment Rates," Brookings Papers on Economic Activity, 1976:1, p. 184.

25
Ibid, p. 188.

most quitters either take new jobs immediately or else leave the labor force. When one considers only the unemployed, those laid off far exceed the quitters.[26] Thus, unless the work requirement has a strong deterrent effect, it will have little impact on the job separation side of unemployment which quantitatively is the more important side.

The Marston results do not rule out completely the effectiveness of a work requirement. First, his results are concerned with explaining the higher unemployment rate of disadvantaged demographic groups. What he finds is that difficulty in finding jobs does not explain the difference in unemployment rates. Difficulty in returning to work may be a problem, but if so, it is common to all groups, not just the disadvantaged. Second, the Marston results reflect the average experience of heterogeneous demographic groups. However, the targets of a work requirement are not the average individuals, even among the unemployed. The work requirement is aimed primarily at those most reluctant to work. The Marston results do not offer an estimate of how many of these there might be.

Reluctance to work is probably often temporary and may not show up as absence from the labor force.[27] Rather, it may appear

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26 Ibid, p. 191. Based on data from March 1973.

27 Given the expectation of work associated with transfer programs, individuals are likely to claim they are searching for a job even if they hope not to work for a while.

as a prolonged spell of unemployment. There are some data on the number of individuals with long durations of unemployment in the Employment and Training Report of the President. Unfortunately, these data are not available separately for the target population of a work requirement, but it is provided for males, certainly a major component of the target population. For example, in 1976 with male unemployment averaging 3.96 million, 36 percent of these were unemployed 15 weeks and over while 21 percent were unemployed 27 weeks and over. Restricting attention to the 3.03 million over age 20, the two percentages are 41 and 25 respectively. In addition to those long-term unemployed, some of the reluctant ones may be able-bodied individuals out of the labor force altogether. Thus, even among males, there is a sizable number of individuals out of jobs with work problems. Yet those reluctant to work may account for a limited fraction of the problem cases. Inability to find a job can lengthen a spell just as well as a reluctance to work.

A work requirement in conjunction with a large scale job creation program will almost certainly reduce the number of problem cases since the employment program can expand job opportunities. Work requirements alone in the existing system do not seem to have much impact on the unemployed. It is reasonable to ask what the marginal effect of an effective work requirement could be in the presence of a jobs program. If the reluctance to work is a relatively minor cause of lengthy unemployment, the marginal contribution of a work requirement will be small. Unfortunately, data do not exist currently

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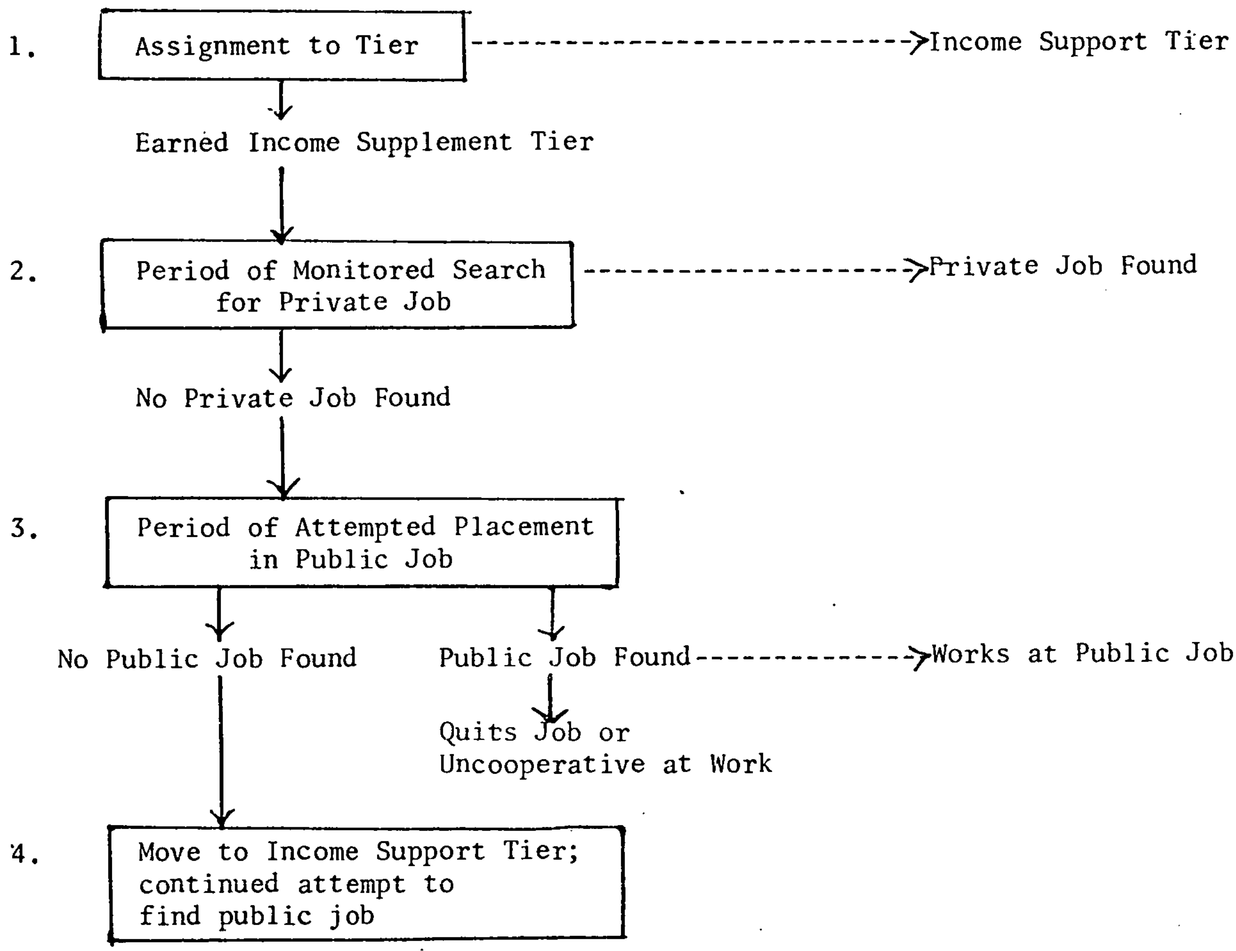
to evaluate the extent of reluctance to work among those without jobs. It is thus possible that many individuals do exist who are potentially susceptible to the pressures of a work requirement. The question remains as to whether a work test can be designed that will effectively exert pressure to work. The next section takes up the specific case of the work requirement in PBJI.

C. The Carter Work Requirement

This section will consider the potential for loopholes in the work requirement in PBJI. The work requirement is introduced in the proposal through the two-tier system. The income support tier provides benefits largely to those not expected to work, while the work requirement largely will be applied to those on the lower earned income supplement tier. Women heading families where the youngest child is between 6 and 13 are assigned to the income support tier but are expected to accept part-time work. The effectiveness of the work requirement will depend on the rules to be followed as well as on the administrative procedures to be used, matters that have not been fully elaborated yet. Nevertheless, the major steps in the procedure have been indicated and may be represented in Figure 5 for all those except women heading families and expected to work part-time.

FIGURE 5


1.
Assignment to Tier
Income Support Tier
Earned Income Supplement Tier
2.
Period of Monitored Search for Private Job
Private Job Found
No Private Job Found
3.
Period of Attempted Placement in Public Job
No Public Job Found
Public Job Found
Works at Public Job
Quits Job or Uncooperative at Work
4.
Move to Income Support Tier; continued attempt to find public job

These steps presumably will be administered by a local employment and training agency. The items in boxes indicate procedures of the agency while the other items indicate results or individual responses to those procedures. Arrows to the right indicate final outcomes while arrows pointing down lead to additional steps of the work requirement procedures. This section will consider the procedures in each of the four boxes plus a fifth step in the form of an appeal procedure available to an individual. The discussion will seek to identify areas of individual or administrative discretion at each step which could provide opportunities to avoid work.

1. <u>Assignment to Tier: The Determination of Who Is Expected to Work.</u>

A critical step in the proposals is to make an initial assignment of each filing unit to one of the tiers. The conceptual problems in constructing categories have already been discussed in Section II C. This section assumes that the categories have already been constructed and considers the possibilities of movements between them. Since the income support tier offers higher benefits at zero and low levels of earnings, individuals not working very much would prefer it to the earned income supplement tier. PBJI would assign filing units to the lower tier based on demographic characteristics that are hopefully unalterable to keep people from shifting upward. The proposals would restrict the upper income support tier to the aged, blind, disabled, and single parents with children at least one of whom is under 14. Those units with at least one member expected to work and assigned to the lower earned income supplement tier include two-parent families, single-parent families with children none of whom are under 14, single individuals, and childless couples. Female heads of families whose youngest child is between 6 and 13 are assigned to the upper tier but will be switched to the lower tier if they refuse a part-time job. Examining these categories, there are two areas where families could change their category in order to move onto the income supplement tier: a) a two-parent family with young children could become a one-parent family; b) some individuals might have themselves reclassified as disabled. A third but more remote possibility, of course, is that childless persons could become parents.

a. The Splitting of Two-Parent Families

The welfare reform proposals provide an incentive for two-parent families to split, similar to that under AFDC. Consider, for example, a two-parent family of four, with at least one young child and where neither parent works. This family is assigned to the earned income supplement tier where its proposed benefit is $2,300. If the husband then leaves, the resulting one-parent family of three becomes eligible for the income support tier and a proposed benefit of $3,600, a clear gain. Moreover, the separated husband himself may be eligible for benefits on the earned income supplement tier for as much as $1,100 if he cannot find a job. In other words, there is a strong incentive for the family to dissolve. If it dissolves, in the view of the welfare agency, the gain to the remaining three person family is $1,300 plus the father's $1,100 or $2,400. The gain is smaller to the extent that either parent works, since the difference between tiers narrows with earnings, and to the extent that the separating parent incurs rent costs. Thus the gain from family dissolution is accompanied by an incentive not to work. As noted, there is a cost in splitting as well as the gain, so not all families will choose to avail themselves of the incentives to split. There is no way to estimate in advance how many will. As long as one and two-parent families are on different tiers, this loophole will encourage family and work behavior contrary to the intentions of the policy-makers.

b. The Discretionary Element in Disability

Another possibility for moving between tiers arises because the disabled are on the upper income support tier. If a person can be reclassified as disabled, he can move to a more favorable treatment. The problem is that many disabilities are difficult to evaluate. A person with a bad back or who cannot bear emotional stress has a genuine problem. In some circumstances the problem might prevent work while at other times the same individual would be able to work. The individual will need to be examined by a doctor to establish that the problem is a disability. However, if the person really does not want to work, he often can arrange to be examined when the problem is most acute so that the doctor will observe the disability.

Although there is no proof yet, there is a tentative indication that this type of procedure is growing rapidly under the disability insurance program. For example, the number of individuals under 65 claiming disability benefits under OASDHI rose from 1.2 million in 1966 to 2.7 million in 1976. It more than doubled.[28] There was no other independent indication of increasing bad health. It is at least a plausible hypothesis that some of the growth in disability claimants represent a voluntary attempt to take advantage of an attractive government program. The PBJI two-tier system risks creating a similar epidemic of disability among welfare recipients.

2. Procedures for Monitoring the Search for Private Sector Jobs

The Carter proposals envisage requiring those required to work to register with an employment and training agency. That agency will seek to find private sector jobs for the registrants, providing counseling or training, if necessary, to qualify them for the jobs.

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28 Social Security Bulletin, May 1977, Table M-12, p. 44.

Although the tools to accomplish this objective have not been spelled out yet, it is a reasonable presumption that the procedures used within the employment and training agencies will be similar to those used in the current work tests. Placing registrants in private sector jobs may require frequent monitoring of their search efforts, but, equally important, assistive services like counseling and perhaps training will be needed. Monitoring and counseling are provided to some extent in existing work tests and training is provided as well under the WIN Program. As for the actual servicing of registrants in employment and training agencies, past experience should be a guide to how effective this component of the program will be. As already discussed, current work tests do not seem to be especially effective and WIN training programs also have achieved only limited success in getting trainees into lasting jobs.[29] Basically, there is little reason to believe that this component of the new program will place more registrants in private jobs than current programs do. It is conceivable that the effectiveness of these programs could be increased with greatly expanded staffs

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29 Pacifica Consultants, "The Impact of WIN II: A Longitudinal Evaluation," unpublished monograph submitted to U.S. Department of Labor, September 1976.

or, more likely, with a technological change in the process of delivering assistive services. There is no indication in the PBJI proposal that such innovations are imminent.

An individual who does not want to work can easily get through this step of the work test without a job. He can cooperate with the process by getting job interivews, but he can behave in a way that will insure that he will not be hired. Thus, the reluctant worker should emerge from step two in full compliance with the work requirement and without a job. Step two will last for eight weeks before the individual is moved on to step three to be placed in a public job.

3. Procedures for Placement in Public Service Jobs

If a private sector job cannot be found within the specified time, the jobs program will attempt to assure access to a public service job or training slot. Since even a public job may not be immediately available to suit the needs of the individual, the process of placing him in a public job also may take time. Indeed, it remains to be seen whether enough public jobs will be created with skill requirements suitable for the registrant population. Problems in job creation will be considered in Section IV. There is a real possiblity that individuals will pass through step three without receiving a public job. It is thus convenient to consider two cases: a) the employment agency has enough jobs for all registrants, b) the agency does not have enough jobs and must ration them among registrants. Of course, both the numbers of available jobs and of registrants will vary over time so that the same agency may move between the two cases.

Case A: Enough Jobs For All Registrants

The individual can be placed in a suitable public job without difficulty. All jobs will pay the minimum wage or slightly more, but several different kinds of jobs are likely to be available. Therefore, the employment agencies will need some guidelines on what constitutes suitable work.

The most important concern at this stage is what happens if the person rejects the offered job. If the person is single or part of a childless couple, benefits are lost. A mother whose youngest child is between 6 and 13 receives benefits on the upper tier and would now be moved down to the lower tier. At present the proposals include no penalty for a person who refuses to work in a family with children assigned to the lower tier. Similarly, for the latter persons there appear to be no penalties for quitting a public job, or for accepting it but not cooperating in doing the work. There is a difference here between existing work tests and the PBJI work requirement for two-parent families and the one type of one-parent family. Existing work tests always contain a penalty for non-compliance -- usually termination of benefits --

although the penalty is rarely imposed in practice. In contrast, benefits under the PBJI proposal are not to fall below the level of the earned income supplement tier even in the case of non-compliance in order not to harm the children in the family. Thus, the reluctant worker can pass through this stage, too, without a job. He is no longer in compliance with the rules, but his family is not deprived of benefits on the lower tier.

Case B: Rationing of Jobs

If there are not enough jobs for all registrants, the employment agency will need rules for rationing the limited supply of jobs. Recent efforts at job creation have always been limited in scope. There has usually been a greater demand for jobs than the number available. Apparently large numbers of unemployed persons would like to work. Thus, the easiest approach to the rationing problem would be to assign jobs to volunteers. If the demand for jobs is still too great, there could be random selection among volunteers or else rationing on a first come first served basis. This approach, of course, eliminates the work requirement for all practical purposes. It has the advantage for public employers that volunteers are likely to be more efficient workers than those pressured into jobs. Moreover, there is probably a natural tendency for the employment agency to move toward this approach -- no matter what the formal rules -- because it is easier, because of pressure from the public employers to do so, and because the agency will look better the more successful placements it makes. In this case again, the reluctant worker emerges without a job, and probably still in compliance.

4. Moving Up To The Income Support Tier

The proposals would not keep a two-parent family and the particular type of one-parent family on the lower earned income supplement tier indefinitely. If neither a private nor a public job can be found after a given period of time, such families would be moved up to the income support tier. Presumably, there would be a fixed period of time for finding a public job just as there is for searching for a private job. However, if a job is made available after these two periods, the family will be returned to the lower tier. In the cases of these families, a penalty for non-compliance would appear only at this later stage.

This step of the proposal is attractive as a matter of fairness. Nevertheless, it does reduce the incentive to work provided by the two-tier system. If an individual prefers not to work and if he can avoid the pressures to work long enough, his family's benefits actually will be increased. As the discussions of steps two and three indicated, it may be possible to reach step four by design. The individual can comply with any search requirement of step two, but in a way that will insure that he receive no job offer. Avoiding a public job in step three is more of a gamble. However, it was argued that public jobs may tend to go first to those most eager forthem. Depending on the number of public jobs available, the probability may be fairly high of avoiding work through step three and thus reaching step four.[30]

5. Procedures of Appeal

The PBJI proposal does not specify any appeal procedures. In principle, such procedures might be necessary to guarantee due process to registrants. However, since the steps of the work requirement involve no penalties for many persons, these individuals will have little to appeal. An individual might be dissatisfied with his assigned public job, but it is not clear that an appeal procedure is required for this problem.

In contrast, for those for whom there is a penalty in the work requirement, the appeal procedure could be important and frequently

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30 The expected annual benefit to the individual who wants to avoid work can be represented symbolically. Let L represent the annual guarantee on the lower tier and U the guarantee on the upper tier. Let t represent the fixed length of time (as a fraction of a year) until the individual is allowed to move to the upper tier. Then benefits received on the lower tier amount to tL. For the remaining fraction (1-t) of the year, benefits will be (1-t)U if the individual is not offered a public job so that he remains in full compliance. On the other hand, if the individual is offered a job but rejects it, his benefits for this part of the year will be (1-t)L. Let p represent the probability that the individual will be offered a job. Then the expected benefit for the entire year is $tL + p(1-t)L + (1-p)(1-t)U$. The formula shows that for given L and U, the expected benefit from avoiding work is larger the smaller t and the smaller p. Assuming random assignment to jobs, the probability p is the ratio of the number of jobs available to the number of registrants.

used. To the extent that appeals succeed in reducing penalties, they could become a device that increases the ease of avoiding work. In any case, they could become a device for delaying work.

6. The Work Requirement: Conclusions

A work requirement rests on a moral principle; those who deliberately avoid work do not deserve welfare payments. Given this principle, the need for a work requirement arises in the presence of a welfare system covering the working poor. In such a program, benefits depend only on an individual's income, not on his motivation or moral qualities. The work requirement is needed as an extra screening device for deservedness.

The discussion of Section III B indicated that there could be many work avoiders, but the number is unknown. Externally, a work avoider is not readily distinguishable from a person out of work because he is unable to find a job. While the latter is considered deserving, the former is not. Thus, the work avoider will try to conceal his true motivation in the presence of a work requirement. On the other hand, the discussion of this section showed that the PBJI work requirement is a relatively inefficient screening mechanism. The work avoider can pass through step two undetected and has a chance at concealing his motivations even through steps three and four. Even if he is detected, he faces relatively little punishment. A more stringent work test might increase the probability of detection, but even so, enforcing penalties could remain difficult.

In addition to its screening functions, a work requirement in PBJI may provide counseling and assistance in job search during step two, while training on a public job may be offered in step three. However, the monitoring and assistive functions of the work requirement are likely to conflict. Because of the need to monitor all registrants, job search assistance will be spread thinly and given to many who have no intention of benefiting from it. The limited resources of the employment agencies could be used more effectively if concentrated on those who really wanted help. Similarly, if reluctant workers are forced into public jobs, they are likely to create discipline problems. The public employment program is likely to operate more efficiently and to offer better job experiences to workers if participation is voluntary. Thus, the assistive services that PBJI will link to the work requirement would be more effective if offered on a voluntary basis. The moral or political concern with screening deservedness is thus likely to produce a program of only limited usefulness in both monitoring and assisting.

IV. Job Creation Program

Although guaranteed job programs have received wide attention recently, the Carter proposals have opted for a more limited version of job creation. Basically, minimum wage jobs are to be created largely for parents assigned to the earned income supplement tier; these jobs are limited further to only one parent in each family. It is estimated that as many as 1.4 million jobs could be needed for this program at an unemployment rate of 5.6 percent. Section A of this part will consider the macroeconomic effects of a job creation program. Section B will consider some administrative problems in running it related to efficiency, displacement, and relations with unions and private employers.

A. Macroeconomic Effects of a Public Employment Program

Any government expenditure is likely to affect GNP, the level of employment, and the price level. The extent of effect on any one of these three is usually assumed to depend on the position of the economy on its Philips Curve. The chief appeal of a job creation program is that it may affect these variables in a more favorable way than other forms of government expenditures: a given level of expenditure on job creation may create more jobs with less inflationary pressure.

Several arguments are used to demonstrate the advantages of a job creation program.[31] First, expansions in production are likely to produce inflation because of bottlenecks due to limitations in

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[31] For fuller discussion see Martin N. Bailey and James Tobin, "Direct Job Creation, Inflation and Unemployment," presented at Brookings Conference on Direct Job Creation, April 7-8, 1977.

in capital capacity. If the new jobs are created in relatively labor-intensive activities, strains on capacity leading to inflation may be smaller. Public works projects may be useful in creating jobs countercyclically. However, because of their heavy capital requirements, they pose an inflationary threat as an economy approaches full employment. On the other hand, public service employment with its lower capital requirements would contribute less to inflationary pressures. In addition, since less of the expenditure is needed for equipment, there will be a larger direct affect on employment.

Second, wage inflation appears to be more sensitive to unemployment among advantaged workers -- experienced, well-educated, prime age, married, white males -- than among others. To the extent that this is true, a job creation program directed at disadvantaged workers will be less inflationary than one including the advantaged. This means that a guaranteed job program offering a job to all has greater inflationary potential than a limited program where jobs are available mainly to disadvantaged workers. Apparently employers prefer to hire advantaged workers so that wage inflation begins whenever an excess demand for these workers emerges, even though many other workers remain unemployed. The tendency not to hire the latter group may be reinforced by the minimum wage law if employers assume that disadvantaged workers

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have low marginal productivities -- below the minimum wage. Indeed a job creation program with jobs paying the minimum wage could help to offset possible unemployment which may be caused by the minimum wage. At the same time, its coverage would be restricted to the neediest, since the pay of more advantaged workers tends to exceed the minimum wage.

While the first two arguments were concerned with the direct effects of a job creation program on employment and inflation, government expenditures also have an indirect multiplier effect. It is sometimes argued that a given expenditure on job creation will have a larger multiplier effect and thus will stimulate indirectly output and employment more than other types of government expenditures. The reason is that the low income individuals who will receive their earnings from the job creation program are believed to have a marginal propensity to consume higher than average. They will thus spend a larger fraction of their new earnings, giving rise to a larger multiplier effect. Of course, a larger multiplier, while advantageous in depressed times, increases the risk of inflation in a period of expansion.

The above arguments all suggest that a given expenditure on job creation can have a greater potential for stimulating employment than the same expenditure on other types of government projects. However, evidence on the quantitative importance of this difference is not yet complete. It is premature to assume that the difference is large. There is, moreover, one further complication in judging the macroeconomic effects of a job creation program. While the above arguments discussed the effects of a given level of expenditure on job creation, in fact the expenditure will vary since it depends on the fluctuating number of individuals who will participate in the program.

Basically, the participants in a job creation program can come from three sources: 1) from unemployment, 2) from out of the labor force, 3) from existing private jobs. In deciding to shift out of one of these categories into a public job, the individual must balance the benefits of the public job against the costs of making the move. The attractiveness of a public job depends on its wage rate as well as its other characteristics like the type of work and the expected stability of the work. As for the costs, the unemployed worker would forego the possibily better job that might be found through prolonged search; the person out of the labor force must give up leisure; the worker in a private job must give it up. Thus for the unemployed worker especially, the costs of shifting will depend on the state of the economy. He is most likely to find a better job through search when the economy is thriving and numerous jobs are available. However, since the various elements of benefits and costs are difficult to measure and since individual responses to them are difficult to predict, there could be large errors in predicting the extent of participation in a voluntary job creation program.

PBJI seeks to reduce the uncertainty in program scale by limiting participation. Largely, parents in families eligible for benefits on the lower tier -- and then only one parent in the family -- are eligible for the created jobs. For these individuals participation is to be compulsory if a private job cannot be found, although, as indicated in the previous section, the program may not succeed in creating enough jobs. Even with these limitations, program scale will depend on the attractiveness of the created jobs as well as on the state of the economy. If the public jobs paid too high a wage, working parents might give up regular jobs to qualify for benefits and later for a public job. The higher the level of unemployment, the more parents will qualify for benefits. Thus, even in the Carter Plan, there will be some variability and some uncertainty in program scale.

Indeed there is one part of the job creation program which heightens the uncertainty. While newly created jobs are to pay the minimum wage, about 725,000 jobs now included in the CETA Program and paying an average wage of $3.60 an hour are to become part of the jobs program for parents. These jobs will be combined with 725,000 newly created jobs under the Carter Plan to yield the total of 1.4 million. The existence side by side of similar jobs paying different wage rates could create undesirable incentives as well as equity problems. The higher the wage rate on public jobs, the more people will give up private jobs to move into public ones. With the mixture in wage rates, it is only a gamble that a person would receive a high wage, but it is a gamble some individuals might be willing to take. To avoid this problem, presumably, some mechanisms will be needed to reduce wages on existing jobs down to the minimum level without hurting existing holders of these jobs.

B. Problems in Administering a Public Employment Program

There have been a number of job creation programs in recent years like the various titles of CETA, the supported work experiments, and the 1976 public works program. Although all of these have been small compared to the proposed job creation in PBJI, they provide information on the problems in creating public jobs. The administration of the supported work experiments has been monitored particularly carefully to see what lessons can be learned.[32] A variety of mechanisms have been used to create jobs. CETA has relied heavily on existing government agencies; the supported

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[32] See Peter Kemper and Philip Moss, "The Efficiency of Targeted Job Creation: Conjectures Based on the Early Supported Work Experience," presented at Brookings Institution - Institute for Research on Poverty Conference, "Public Service Employment, Supported Work and Job Guarantees: Analytic Issues and Policy Implications," March 18, 1977. See also, Lee S. Friedman, "An Interim Evaluation of the Supported Work Experiment," Policy Analysis, Spring, 1975.

work experiments have created a series of new, small organizations, each producing a particular service or product; public works are constructed by private builders under contract from local governments. This section will consider several types of difficulties that have arisen under these forms of job creation: a) start-up and timing problems, b) targeting of jobs to the poor and disadvantaged, c) displacement, d) acceptability to unions.

1. Timing and Start-Up Problems

Previous job creation programs have been relatively small with more than enough takers for the limited number of new jobs. These programs did not create enough jobs to employ the entire target populations. In order to make the work requirement more effective, it is apparently the intention of the Carter proposals to create enough jobs so that parents out of work and in the target population can be employed.

Since new individuals will continually become eligible for public jobs over time, the program will have to maintain an inventory of suitable jobs sufficient to meet the fluctuating needs of this large population. There are similarities to the management of the inventory of an output. There is a penalty to a firm in not having an adequate inventory in that the profit from the sale of a unit is lost. The analogous penalties from not providing enough jobs are that individuals will go without work and after the specified period will have their transfer benefit increased to the income supplement tier, raising transfer costs. Analogous to the inventory storage cost of a firm is the cost of holding a job open which may be needed in the public production process: there can be a loss in productive efficiency from filling jobs at unpredictable times. While the inventory management of a private firm is understood, there is little experience with managing an inventory of jobs. There is inadequate evidence to judge whether the process signficantly interferes with the production process.

Of course, the job creation process will start gradually. Initially there will not be enough jobs; the job inventory management problem will arise only after an adequate supply of jobs is developed. Some of the difficulties in creating enough of the right kinds of jobs are discussed in the next three sections. One additional start-up problem arises if new job creation enterprises are needed. The tentative evidence from the supported work experiment suggests that in some of the newly created enterprises, efficiency increased markedly over time.[33] This apparently reflects the process of learning on the job, not only by the regular enrollees, but also by supervisors.

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33 Kemper and Moss, op cit., p. 23.

2. Targeting of Jobs to the Poor and Disadvantaged

The type of program matters greatly in how well jobs will suit the needs of the target population. For example, a public works program will create jobs largely for construction workers. This excludes most women and benefits mainly those who already have some construction skills. More generally, revenue sharing may create new jobs. But the jobs are likely to require a variety of skills not found among the target population. While revenue sharing will create jobs to perform new tasks of highest priority to State and local governments, few of the jobs may be suitable to the poor and disadvantaged. The distinguishing feature of public employment, for example Title II of CETA, is that the jobs aim at employing the neediest; while hopefully useful, this may not serve the highest output priorities.

The difficulties in creating enough jobs for the disadvantaged are illustrated by the experience of the Economic Stimulus Package in providing public service jobs for the poor or those out of work at least 15 weeks. The Wall Street Journal reports that "in Houston, only two job seekers in ten can qualify for the program. Only 155 of of 700 jobs in Dallas have been filled." [34]

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34 Labor Letter, Wall Street Journal, July 19, 1977, p. 1.

The supported work experiment, which was targeted at the most disadvantaged, provides some useful tentative findings on fitting workers to jobs. Labor intensive, low-skill projects with few start-up costs, like painting, parks maintenance, and building maintenance, were most efficient. Less efficient were material-intensive or equipment-intensive projects, like tire-recapping, furniture refinishing, furniture manufacturing, gas station work, and Christmas tree sales. The more inefficient projects required relatively more supervision and at times even ran the risk of inexperienced workers destroying or damaging the equipment. Even skills such as reading or having a drivers' license could limit the ease of placing a worker. Yet although low skill projects were needed, some of these failed also because they were too unattractive to motivate the workers.[35]

3. Displacement

There has been growing interest in the effect of federal grants on state and local expenditures. Do the federal grants add to state and local expenditures or do they simply displace previous

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35 Kemper and Moss, op.cit. pp. 24-26.

expenditures, allowing the sub-national governments to continue their old spending levels, financed now by federal money? Do the new federal grants allow a net expansion in state and local government employment,or do workers under the new grants displace workers previously paid out of state and local funds? A review of results in the area by Fechter leads him to conclude that "for long-run programs operated as lump-sum grant programs the displacement rate would range from 55 to 75 percent for total expenditures and from 60 to 90 percent for wage bill expenditures." [36]

Reviewing more recent results specifically for public employment programs rather than for grants in general, Wiseman concludes that the displacement rate over approximately three quarters is no higher than 40 percent.[37] He also points out that the displacement rate tends to be relatively low when a program starts and increases thereafter. In addition, displacement may be lower under CETA than under previous programs since there is more awareness of the problem of displacement and a greater attempt to police against it. Still,

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36 Alan Fechter, Public Employment Programs, Urban Institute, February 1976, p. 19.

37 Michael Wiseman, "Public Employment as Fiscal Policy," Brookings Papers on Economic Activity, 1:1976, p. 90.

recent, unpublished studies of Titles II and VI of the CETA program have found displacement rates of 25 to 35 percent.

The evidence from the supported work experiments is again instructive. The newly created enterprises had to avoid antagonizing existing powerful producers or agencies in order to survive. They had to be concerned with displacement primarily in the private sector. Kemper and Moss characterize the markets where these enterprises appear to have the best chances of success as those with low barriers to entry, where other suppliers are relatively small firms, are less likely to use unionized labor, and use relatively little capital. The other suppliers tend to have little market power and there is a high turnover of firms.[38] The enterprises frequently operate in subsectors of larger industries like construction where they concentrate on painting, housing rehabilitation, demolition, de-leading, and sealing of abandoned buildings, areas apparently of little interest to large contractors and skilled craft unions. Moreover, the buildings are usually in low income neighborhoods. Thus to be successful, these enterprises either seek areas where they do something new -- in which case there is no displacement -- or where the displacement effect on individual producers is relatively

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38 Kemper and Moss, op. cit. p. 36.

small. Carried over to the government sector, displacement effects are likely to be smaller the greater the concentration on developing new areas. Furthermore, new agencies may more successfully avoid diversions of funds to existing activities, although careful guidelines may also help prevent displacement at the agency level.

4. Acceptablity to Unions

Unions are concerned with the problems of displacement both in the public and the private sectors since union jobs could be lost. In addition they are concerned with indirect effects on labor markets like downward pressure on wages as a result of public employment programs. Such effects, of course, differ with the kind of program. For example, if public works projects are built by private contractors, they hire the kinds of workers they need at competitive wages. Employment may be increased and the pressure on wages would be upward if anything.[39] In contrast, unions fear that a program mandating low or minimum wage jobs could induce firms or agencies to replace relatively high wage union labor with low cost minimum wage workers.

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Public works projects do not necessarily increase employment much, since contractors may continue to rely primarily on existing employees. For example, consider the report of James C. Hyatt, "Public Works Grants Help Baltimore a Bit, the Jobless Very Little," The Wall Street Journal, July 21, 1977, p. 1. Under the Local Public Works Capital Development and Investment Act of 1976, the expected cost for each new directly created job would be about $14,000. In Baltimore the actual cost turned out to be about $36,000 since far fewer new workers were hired than expected.

In the supported work experiment, liaison was established with local union leaders either informally or by placing them on the boards of local Supported Work organizations. Some projects were ruled out; some were limited in scope; some involved agreements to hire union supervisors.[40] The union response to specific projects varied considerably across cities, but union input was essential in finding politically feasible projects.

5. Conclusions on Job Creation

Public works programs may be useful in fighting cyclical unemployment, but it is difficult to target the created jobs toward the poor and disadvantaged. To succeed with these, labor intensive, low skill projects will be needed with a limited number of higher skill jobs. Such jobs are also less costly to create, requiring less capital equipment and materials. To avoid displacement and more particularly to minimize union opposition, the created jobs should seek new areas where there is room for new production without pushing existing firms or workers out. The supported work experiment showed that it is possible to find such areas in a

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40 Kemper and Moss, op. cit., p. 39.

relatively small scale program. Not only was the program small, but the planning and administrative staffs were imaginative and skilled in initiating new projects that could succeed. That part of Title VI of CETA under which special projects managed by non-profit organizations are financed also has demonstrated the possibility of finding new areas of production.

The Carter proposal calls for a much larger job creation program than any now in existence. The proposed jobs -- in areas like home services for the elderly and the ill -- appear to involve activities suitable for the target population. While there is some variety, skill requirements are generally low. Many of the jobs tend to have relatively limited needs for sophisticated equipment, being in more labor-intensive lines of production. The major difficulty is that the implementation of the program -- the actual creation of jobs -- must take place on the local level. The success of the program will require a high level of imagination and skill in all the local job creation offices, both to initiate new activities and to gain community acceptance for those activities. It should be expected that many difficulties will appear in the early phases of the program with wide differences in effectiveness between localities. The big test will be whether administrative mechanisms can be developed to allow the program to function smoothly in most locations.

V. Coordination of Welfare Programs

The Carter Plan devotes insufficient attention to the coordination of the existing multi-program welfare system. It proposes only the consolidation of the AFDC/AFDC-UF, SSI, and Food Stamp programs. Currently, though, particular families often are simultaneously eligible for housing and medical assistance as well as for two of the above three programs. Simultaneous eligibility for several benefits presents both opportunities and problems in attaining the several conflicting objectives of the welfare system. This section of the paper considers two types of program coordination that could be effected in a welfare reform plan, one relating to the design of the programs and the other relating to their management. Coordination in design and management could realize great cost savings and also enable the welfare system to meet the various and often conflicting goals of its component programs more effectively. The opportunities resulting from careful coordination often are overlooked and have been again in PBJI.

A. Coordination in Design

1. State Supplements

a. General Problems

The section on the two-tier structure emphasized repeatedly the significant role of state supplements. State supplementary payments can be looked upon as a distinct welfare program, just as distinct as is the Section 8 Housing Assistance program. Failure to coordinate state supplements with the two-tier structure may undo the work incentives it seeks to create. On the other hand, state supplements allow for differences in benefits between states, reflecting differences in the willingness to promote redistribution. As of the writing of this paper, provisions in the Carter Plan for state supplements have not been finalized. The material in this part therefore is based on the incomplete details made available when PBJI was announced on August 6, 1977.

An additional function of state supplements is to protect current welfare beneficiaries, in whole or in part, against losses in income once a uniform national base of payments is legislated. It is, of course, difficult to protect all current welfare beneficiaries against some losses in benefits. This is because some welfare beneficiaries who have high labor incomes now get benefits in states that have both high guarantees and low tax rates. Even though their earnings are high, the current benefits of such people can be substantial. The 50 percent tax rate on the upper portion of both tiers of the Carter Plan is likely to reduce their benefits. If state supplementation were viewed as the device to protect benefit levels of current beneficiaries, full protection would be possible only by a state supplement system that contained both high guarantees and low tax rates. But states would find that costly and unappealing. To be politically acceptable in high guarantee states, supplementation plans will often provide only partial protection for current beneficiaries. If full protection is desired, a grandfather clause can be introduced that assures current beneficiaries that, as long as their incomes do not rise, their benefits will not fall below current levels. Of course, this type of scheme offers only short-term protection to current beneficiaries.

One further problem arises in the design of state supplements, since they could reduce the differential incentives of the two-tier structure. The treatment of these problems in PBJI will now be considered.

b. <u>Provisions in PBJI to Preserve Current Benefit Levels</u>

The tentative plan for the state supplement program to some degree attempts to preserve both current benefits and the two-tier structure. On the income support tier, the federal government will finance 75 percent of the first $500 of state supplementary payments and 25 percent of further supplements, until the sum of federal and state guarantees comes up to a family's poverty line. Thereafter, there will be no federal matching for supplements. States may supplement benefits above poverty lines and receive

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federal funds on a "hold harmless" basis for such supplementation only for families currently on welfare. Once these families leave the welfare rolls, they and all other families coming onto the welfare rolls can receive benefits above poverty lines only from State and local sources.

On the earned income supplement tier, federal matching funds on a 75 percent basis are available only for the first \$274 of state supplements. (A \$500 supplement on the upper tier is equal to 10.6 percent of \$4,200. Similarly, a \$274 supplement on the lower tier is 10.6 percent of \$2,300.) Above \$274, no federal matching funds are available except, again, to hold harmless states when they continue current welfare beneficiaries at their current benefit levels.

The question is whether states will partially or fully protect beneficiaries against losses in benefits by offering these supplements. To answer this question one must understand the fiscal relief offered states by the Administration's Plan. In the first year of the plan, each state is assured a 10 percent reduction in current expenditures on "welfare," i.e., the sum of its payments under AFDC/AFDC-UF, SSI, Emergency Assistance, and General Assistance. Each state also must expend in the first year of PBJI 90 percent of such welfare expenditures by contributing 10 percent to each family's basic PBJI benefit and, possibly, by offering some state supplements. They can spend less than 90 percent, and thus get more than 10 percent in fiscal relief, only if the sum of their contributions to basic federal benefits and to state supplements up to current benefit levels are less than 90 percent of current welfare expenditures. In this event, their fiscal relief is the difference between 90 percent of present welfare outlays and the (smaller) sum just mentioned.

Returning to the basic question, in the short term, current welfare beneficiaries are likely to be protected against cuts in benefits by the various rules on fiscal relief in PBJI. According to the calculations of the Office of Income Security Policy in HEW, high guarantee states are likely to receive fiscal relief in excess of 10 percent of current outlays even if they supplement all current beneficiaries up to current benefit levels and all new beneficiaries up to current levels (or to the limit allowed for federal matching, whichever is lower). Such states actually will forego fiscal relief if they fail to supplement basic federal benefits up to current levels -- because they will not be entitled to fiscal relief exceeding 10 percent if they don't make the supplementary payments. In the remaining states, the re-quriement that states spend 90 percent of current outlays in the first year is likely to assure that state supplements raise total benefits to current levels.

How combined federal-state benefits compare with current benefits after the first year of the Administration's Plan depends upon the response of states to two financial incentives. On the one hand, fiscal relief will be greater the lower the supplements. States could use their potential relief either to finance supplements or to cover other state functions. On the other hand, the federal government is changing its matching rate. Currently, the federal government pays between 50 and 83 percent of any change in AFDC/AFDC-UF payments; and states finance entirely state supplements under SSI, unless the cost of doing so goes so high to make the state eligible for "hold harmless" payments from the federal government. The hold harmless clause holds, however, only if state supplements per recipient do not make total benefits per recipient exceed some pre-existing level. The upshot of this second aspect of the financing formula is that states will be less encouraged at the margin than they are now under AFDC/AFDC-UF to increase benefits above any given level, but more encouraged at the margin to increase SSI benefits.

Exactly how states will respond to the indicated financial incentives as well as to the political pressures generated by the new system cannot be predicted at this point. It is important to note, however, that total benefits will be set under PBJI exactly as they are currently: by states responding to an array of economic and political factors. States right now are not compelled to pay any particular level of benefits.

c. <u>Provisions to Preserve Two-Tier Structure</u>

The two-tier structure is preserved by including in the federal PBJI plan provisions constraining both guarantees and tax rates in the state supplement program. By constraining tightly both the total guarantee and the total tax rate on the lower tier, the work incentives that it generates are preserved. The constraints on the guarantee and tax rates on the income support tier are not nearly as effective in preserving its work incentives. The result of the different constraints is likely to be a more decidedly categorical Federal-State program containing generous benefits and weak work incentives for those on the upper tier and much more modest benefits and stronger work incentives for those on the lower tier.

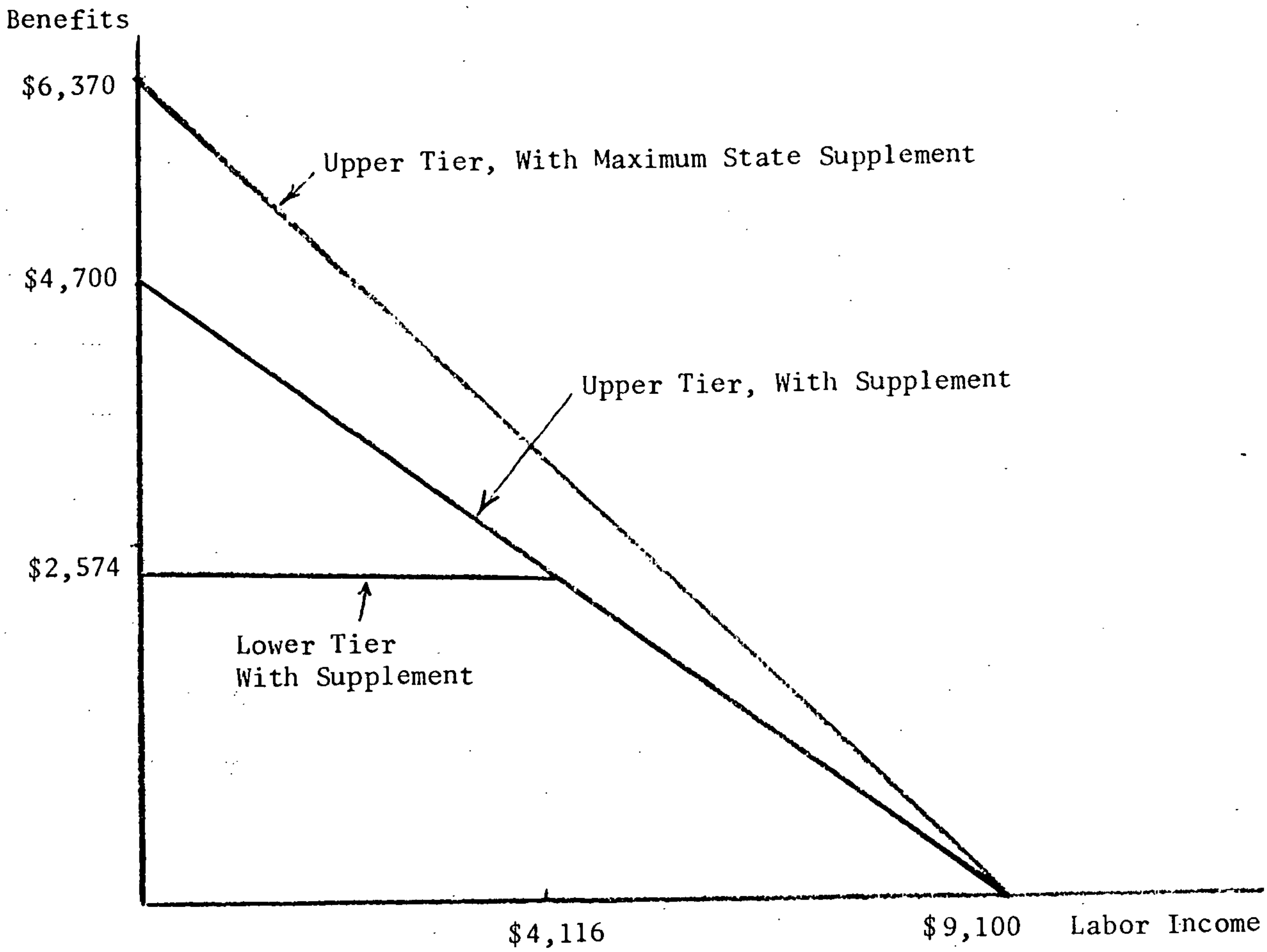
An example of how the state supplement program preserves the two-tier structure is instructive. Assume that a state offers a supplement of $500 on the income support tier. It then is compelled to offer a supplement of $274 on the lower tier. Thus, the total guarantee on the upper tier is $4,700 while on the lower tier it is $2,574. Another provision in the plan calls for the combined federal-state benefit on the upper tier to break even or phase out at $9,100, the point where a family is presumed to begin paying federal income taxes in 1981 if anticipated federal tax reform is effected. If a $4,700 guarantee is phased out at $9,100 of income, the (constant) tax rate is 51.65 percent. As illustrated in Figure 6, the upper and lower tiers merge at $4,116 of annual earnings, if benefits on the upper tier are reduced until the two-tiers or schedules intersect. Thereafter, a 51.65 percent tax rate applies on both tiers. The two-tier structure is preserved in this instance.

As noted, guarantees exceeding $2,574 on the lower tier will not be federally subsidized beyond this point, except to protect current beneficiaries against losses in benefits. If guarantees rise above $4,700 on the upper tier, the tax rate will equal the guarantee divided by $9,100; but it never may exceed 70 percent, which is what the tax rate would be if the total federal-state guarantee reached $6,370, as depicted also in Figure 6. If the total guarantee exceeds $6,370, then the breakeven level must rise above $9,100.

In sum, the tentative plan for the state supplementary program does not insure people against losses in benefits in the long run, but it provides regulations and incentives for states to maintain supplements at a level that preserves existing amounts for the near term. By offering states only a 25 percent matching rate on supplements exceeding $4,700, the Carter Plan strongly indicates the Administration's preference to limit differences between states. Lastly, by requiring proportionate supplements on the two tiers, the Carter Plan assures the coordination of the PBJI and the state supplement programs in a way that preserves the incentive structure of the two-tier system.

FIGURE 6

Cumulative Guarantees and Tax Rates With State Supplements to PBJI Benefit Schedules



2. Cumulative Tax Rates on Earnings

In the debate over the Family Assistance Plan, a major stumbling block was the problem of high "cumulative tax" rates: several benefit and tax programs taken together result in very small increases in disposable income when earnings rise, both because benefits decline and taxes rise as income increases. PBJI does consolidate some programs. The tax rates on labor income in the federal component of the Carter Plan are 50 percent on the upper tier and a combination of zero and 50 percent on the lower tier. However, when state supplements are included, tax rates may rise to 70 percent and to zero and 52 percent respectively. There is an additional problem of high cumulative tax rates because of how the Medicaid and housing programs as well as social security and income taxes would interact with PBJI in the absence of reform in these programs. The existence of these benefit and tax programs may mean that, for people in filing units with labor income of over $3,800(or $4,116 in states that offer supplements), tax rates could far exceed 50 percent.

At this point, there is substantial uncertainty about whether the Carter Plan will create a problem of high cumulative tax rates for large numbers of people. No plan has been specified to address the problems caused by the Medicaid program. Similarly, no plan has been specified to change the personal income tax so that its tax threshold coincides with the breakeven level of PBJI.

The Carter Plan anticipates a specified extension of the Earned Income Tax Credit to counteract the impact of Social Security taxes. Given the appropriate changes, some of the problems in this area could be avoidable. The potential problems and possible solutions are briefly indicated below.

a. Medicaid

Consider first the impact of Medicaid benefits on cumulative tax rates. Currently, Medicaid benefits remain constant as earnings rise as long as the family qualifies for AFDC/AFDC-UF. However, when earnings pass the AFDC breakeven level (or rise past 100 hours under AFDC-UF),the family loses all Medicaid benefits. In over half of the states, a Medicaid program exists for the medically needy, those among the poor and near-poor not receiving cash assistance. Having this component of Medicaid means that families losing eligiblity for AFDC/AFDC-UF still may be able to get on the Medicaid program. Yet, for many families the AFDC-Medicaid rules create a "notch." The "notch," a large sudden drop in benefits associated with a small change in earnings, often involves the loss of the equivalent of major medical and dental insurance -- easily worth more than a $1,000 per year in many states. When PBJI is implemented,if eligiblity for Medicaid is based on eligiblity for PBJI,then the notch problems is extended over a larger population than it affects today. The work incentive problem could be serious. Practically,there will be no alternative to universal eligibility for Medicaid among PBJI beneficiaries if Medicaid is not changed, for Medicaid administrators could not long sustain a distinction among PBJI beneficiaries that gave Medicaid to those who had received AFDC/AFDC-UF but not to other PBJI beneficiaries.

Press releases accompanying the Carter Plan suggest that a national health insurance program of some kind will resolve the problem of the Medicaid notch. It should be noted that any technique that preserves benefits and eliminates the Medicaid notch will raise either implicit or explicit tax rates. The notch could be eliminated by making families at all income levels eligible for full Medicaid benefits. The high cost of this undoubtedly would result in a rise in federal income tax rates. Alternatively, making welfare beneficiaries contribute partially to their medical expenses means including a more or less steep benefit reduction rate in Medicaid. This approach raises tax rates all along the basic benefit schedules of the Carter Plan.

There simply is no way to avoid the problem in a reform of Medicaid of added tax rates unless this benefit program is scaled down or eliminated. If added positive taxes are not to be concentrated exclusively in the non-welfare propulation, they must begin below the breakeven level of the Carter Plan. If they do, though, cumulative tax rates for the welfare population will rise to unacceptably high levels. Lowering the tax rate in the

Carter Plan would reduce cumulative tax rates for the welfare population, but doing so would raise the breakeven level of income and the cost of this program. Such an increase in the cost of the welfare program could be financed, in turn,only by an increase in tax rates for the non-welfare population. Clearly, the tax rate problem posed by the simultaneous existence of a generous medical care program results in difficult dilemmas even for the Carter Plan. The solution is likely to be costly, a matter completely ignored to date.

b. Housing and Other Welfare Programs

Federal housing programs present problems similar to those of the Medicaid program, although participation in housing programs is not nearly as extensive as it is in Medicaid. Even so, however, roughly 1 in 13 filing units receiving PBJI benefits will be eligible for benefits under various federal housing programs. In each of these programs, the tax rate on cash income is 25 percent. Given the fact that PBJI excludes from taxable income such housing benefits and given the tax rate in housing program on cash income -- including PBJI benefits -- housing programs will add roughly 13 percentage points to the basic 50 percent tax rate in the Carter Plan.

Other welfare programs also will add to cumulative tax rates for PBJI beneficiaries. Basic Educational Opportunity Grants and income-conditioned day care programs at the state and local level offer two examples. Since many PBJI families will receive state supplements and thus experience higher tax rates from that program, cumulative tax rates for many families on labor income could reach high levels.

c. Positive Taxes and The Earned Income Tax Credit

In addition to the high cumulative tax rate that may result from the simultaneous reduction of several benefits, the work incentives of PBJI beneficiaries may be dulled by social security and personal income taxes. The social security tax rate now is close to 6 percent on the first $16,500 of annual earnings. Federal personal income taxes for a family of four begin to be paid at a 14 percent rate at $6,200 of annual income. Most states and even some cities also have personal income taxes. Frequently, state personal income taxes have marginal rates of 5 percent in the neighborhood of $5,000 to $7,000 of annual income.[41] Together, these three or four tax programs will add significantly to the 50 percent basic tax rate in the Carter Plan or to the combined rate of 52 to 70 percent involving the state supplement tax rate.

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[41] Advisory Commission on Intergovernmental Relations State and Local Finances: Significant Features, 1967 to 1970, Washington, D.C. November 1969, Table 40. This source is somewhat dated, but it suggests the general level of state personal income tax rates in the relevant range of income.

Several options exist for the coordination of the various tax programs in the area of welfare. One approach is the partial or full reimbursement of taxes resulting from making them deductible in calculating welfare benefits. Under AFDC, taxes often are fully reimbursed in this manner. This prevents positive taxes from adding to the cumulative tax rate, but obviously makes AFDC or any substitute income subsidy more costly. A second approach is re-imbursement through another program. The Earned Income Tax Credit (EITC) is a reimbursement technique that applies broadly, but it carries the problem of being a benefit program that itself begins to phase down at a rate of 10 percent of gross earned income above $4,000 of annual earnings. While it more than offsets social security taxes at very low levels of earnings, it adds importantly to cumulative tax rates above $4,000. This level is roughly where the tax rate rises to 50 percent on the lower tier. A third approach involves cutting positive personal income taxes in the lower and moderate income ranges.

The Carter Plan currently either anticipates or calls for a combination of all three alternative approaches to preclude mounting cumulative tax rates. First, social security taxes are to be offset to the entry point of the federal personal income tax system by an expanded EITC. For those entering regular as opposed to specially created jobs, the new EITC will offer a 10 percent credit on the first $4,000 of annual family earnings, a 5 percent credit on earnings between $4,000 and the tax entry point, after which the (roughly $650) tax credit will phase down at a 10 percent rate. Secondly, federal personal income taxes are to be eliminated entirely below $9,100 of annual family income in an anticipated tax reform measure. Thirdly, in the few states that will have combined PBJI and state supplement guarantees exceeding $6,380, and thus will have breakeven levels of income exceeding $9,100, social security and federal personal income taxes will be reimbursed through the new welfare program. The costs of the latter two reforms has not been published at this date. They are likely to be substantial. Lastly, no provisions have been made to offset state and local income taxes.

d. Summary

High cumulative tax rates may well plague the Carter Plan as they did the Family Assistance Plan. At a minimum, all families with incomes above $3,800 will face a 50 percent benefit reduction rate under PBJI and some combination of state and local income taxes, the latter typically combining to add 5 percentage points to the 50 percent rate. A sizable proportion of PBJI beneficiaries automatically will face an added tax rate of between 2 and 20 percentage points from the state supplement program. Next, unless the Medicaid program is reformed it will contain a severe notch. If it is reformed, since benefits will not be cut very much, it is likely to call for higher personal income taxes or an income-conditioned contribution rate like that contained in the Food Stamp program. Further, the expanded EITC program must be passed if social security taxes are not to add to the cumulative rate by more than 1 percentage point above $4,000 of earnings. Lastly, a costly reform in the federal personal income tax is necessary to raise by roughly three thousand dollars the tax entry point. Clearly, dealing with the cumulative tax rate problem could be costly. Yet the problem itself will be serious under the most favorable assumptions about future legislation. It could be fatal to PBJI under less optimistic assumptions.

3. Income Accounting

A highly controversial design problem in the Carter Plan is that of the accountable period in its income accounting system. The accountable period is the length of time for which income is measured in determining benefits for the current period.

A longer accountable period cuts costs in effect by taking income from some better periods and assuming its availability in other periods. At the same time, a longer accountable period reduces the responsiveness of the plan to sudden change in income.

An example of the conflict between costs, responsiveness, and horizontal equity, a third objective of welfare programs, clarifies the problem. Consider a teacher who is not paid for the summer months. The teacher could claim to have an income of zero and attempt to qualify for welfare benefits during the summer. If there were no assets test in a welfare program, and the program was only interested in looking at the teacher's income for July in determining the benefit for that month, the teacher could qualify for benefits. If the teacher's annual income was $18,000, that would appear preposterous under almost any plan. To prevent the teacher from getting benefits, the accountable period could be stretched out to include months in addition to July. This stretching of the accountable period could be either retrospective or prospective. In either event, the teacher's income from other months would be lumped together with that for July.

Under these circumstances, the teacher probably would not get any benefits during July or any other month. Lengthening the accountable period in this instance obviously would cut costs. It also would enhance equity among families. Another family whose income was zero in July as well as in the eleven preceding months now would not get the same benefit for July as would the teacher's family. Quite appropriately, it would get more than the teacher's family. There is a risk, however, in lengthening the accountable period. Families whose total incomes drop unexpectedly from rather high levels and who have not planned well for bad times could not qualify for benefits very quickly under a long accountable period. It is this risk that converts many people into advocates of short accountable periods. Inevitably, then, in determining the accountable period in welfare programs, there is a conflict among the goals of having responsiveness to sharply falling incomes, horizontal equity defined for a period such as a year, and cost minimization. Any method that cuts costs will lengthen the accountable period, but lengthening the accountable period reduces responsiveness for filing units whose incomes have been relatively high and fall suddenly.

The Carter Plan proposes a six-month accountable period. It implies no delays in getting benefits for families whose monthly incomes are below an annual rate of $8,400 (or $9,100 in states with state supplements of $500). Still, even though long accountable periods such as the one in PBJI do not hurt the chronically poor, long periods usually are eliminated from welfare plans. In part, this is because organized labor often wants short accountable periods to facilitate access to welfare for strikers who have suddenly falling income.

Fortunately, the existence of two benefit programs allows one way out of the conflict among responsiveness, equity, and costs. One welfare program can have a long accountable period while another contains a short one. This approach allows for the attainment of some balance among the competing goals.

Consider the possibility of a multi-benefit welfare system in which the basic federal welfare plan, the Carter Plan, for example, had a relatively high guarantee, moderate tax rate, and long accountable period. This program could keep costs down by a few billion dollars per year with an accountable period of six months rather than of one month. To offset partially the weakness of a long accountable period with respect to responsiveness, a housing assistance program could be devised (or the Food Stamp program could be retained) in which participation was very widespread. This program could have a low guarantee, a very low tax rate, and a very short accountable period. It would be very responsive and cover a large group of people. The cost of responsiveness in this would be kept down by the fact that the guarantee would be small. The multi-benefit system now would achieve a more even mix of responsiveness, equity, and low cost.

The Carter Plan contains an emergency needs program to achieve the responsiveness foregone by having a long accountable period. The unfortunate aspect of such a program is its inevitable arbitrariness. There also may be greater difficulty in controlling cost under a program which above all must be flexible. A formal structure in which two or more programs are designed to achieve conflicting objectives is likely to be more controllable.

B. Management Coordination

Only in recent years has there been substantial concern with the management of welfare programs. Quality control programs to minimize error rates have been instituted in several programs. In spite of the potential returns, the Administration's Plan insufficiently emphasizes improved management of the broader welfare system. One area where coordinated management would reduce costs is suggested below.

All public welfare and "social insurance" programs test for and thus monitor income or substantial components thereof. Presently, each program independently tracks income and, where relevant, assets. Given the inherent difficulty of the tasks, efforts should be made to coordinate this monitoring process by common electronic data processing.

Errors arise in making welfare payments when recipients inaccurately report relevant information and when agencies, even given accurate information, make errors in calculating entitlements. On the recipient side, the problem is that they either willfully or accidentally report income inaccurately. On the agency side, the problem is that there is a limited capacity to monitor income and assets. Recipients, after all, may be required to have perfect understanding of the differences in the information being sought by several different agencies. Agencies are required to track income in a population in which income fluctuations may be both frequent and substantial and in which income often accrues from employers who make minimal efforts at record-keeping. The problems in administering assets tests also are complex. The valuation of assets is difficult. Locating them is equally challenging. In the first instance, an agency must estimate the worth of a home or a diamond ring. In the second, it must discover where other assets, like savings accounts, are located.

The tasks of monitoring income and assets in the low-income population are so difficult that they are probably carried out in very uneven fashion under existing programs. In some cases, limited attention by management to these tasks may be entirely deliberate and appropriate in the current welfare system. Given limited management resources, should not the Medicaid program attend more carefully to errors, including fraudulent ones, in physicians' billings rather than to errors in recipients' reporting of income? The return per management dollar may be much greater when devoted to the former task. Even in cases where attention is paid to monitoring income, as it is in AFDC, error rates in some jurisdictions can be very high.

To monitor income and assets accurately some centralized management mechanism is needed. Offices need not be consolidated, but data collection and processing must be. This requires the spread of computerized record-keeping. AFDC, SSI, Food Stamps, Medicaid, and each of the five or more major federal housing programs now must carry out similar tasks, often for the same filing units, with very limited resources. Under the existing or proposed systems, centralized data processing probably would result in sizable economies. If the Internal Revenue Service finds the task of income monitoring challenging, it is doubtful that the various welfare and insurance programs all can execute means or income tests very effectively. The Carter Plan calls for more frequent reporting of labor income among those on PBJI and undoubtedly, when implemented, will utilize advanced data processing techniques. Efforts should be made, however, to incorporate a broader range of programs in common data processing systems.

Prior to effecting centralized information systems, some changes in the nature of programs may be desirable, although perhaps not necessary. For example, definitions of income vary among welfare programs. Often this variation is for good purposes, as when a program may exclude from income a student's earnings to encourage his continued enrollment. Often, however, the differences may be accidental and may serve no important purpose. A major task, then, of welfare reform should be a movement towards coordinated management and more carefully coordinated design.[42]

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42 A recent study on coordination in design is: George J. Carcagno and Leonard J. Hausman, "A Legal And Economic Analysis of Policy Recommendations To Improve The Existing Multi-program Welfare System," a monograph submitted to the Social and Rehabilitation Service, DHEW, June 1977.

VI. Conclusion

Although problems in the Carter Plan have been emphasized, in some respects it would make very important improvements in the welfare system. Perhaps its most significant feature is the extension of a nationally uniform benefit schedule to the working poor, with and without children. The Food Stamp program currently provides such coverage on a national basis, but the treatment of the working poor under AFDC-UF is highly uneven. In both AFDC and AFDC UF, assets tests, tax rates, and guarantees differ greatly between states, making for great disparity in eligibility standards and benefit levels. AFDC-UF is not even offered in 32 states. The Carter proposals will provide for greater equity in eligibility standards. While in the short run benefit levels may be affected by state supplementation schemes, national standards for guarantees and tax rates will provide a rational basis for future alterations in benefit levels. For the sake of these accomplishments, the Carter Plan deserves serious consideration.

This paper has emphasized problems in the plan or problems that the plan has overlooked. One broad problem area is that of program coordination. Although the Carter program will consolidate three programs (AFDC, Food Stamps, and SSI) into one, several other programs will remain separate. Section V argued that a multiplicity of programs in itself is not a difficulty if the programs are suitably coordinated. Thus, a mechanism is needed to limit the cumulative tax rate. Income accounting periods can be coordinated to deal with multiple objectives in timing. Perhaps the most significant area for coordination is data collection and storage. Gathering extensive data on income or assets can be costly. To repeat the same operation several times in different programs is wasteful. Modern computer technology provides a basis for sharing information between programs while otherwise retaining separate management. It is essential that the new consolidated program develop a computerized system of record-keeping and then create networks for other programs to draw on the same system.

Perhaps the area of greatest public interest is the work requirement. The argument of Section III indicated that the effectiveness of the work requirement alone, as opposed to the job creation program, will be slight. In particular, a person who wants to avoid work will often succeed. Yet, the proposed work requirement is not a harmless or costless way to achieve a political objective. It will take sizable resources at the employment agencies to maintain contact with all registrants, even if the monitoring activities are performed perfunctorily. These same resources offering assistive services to those most eager to find work could be more productive in getting people into jobs. Similarly, the job creation program, although it is likely to be expensive, could succeed in putting many to work and even providing useful job experiences in some cases. However, if it is joined to the work requirement and must accept reluctant workers, its efficiency may be seriously impaired. Thus, although a work requirement is politically attractive, it may actually hurt the chances for increasing work effort if it is linked to assistive services, training, and job creation. In strictly pragmatic terms, the work requirement will probably achieve relatively little, while using up resources that could promote work effort more effectively if used in other ways. A work requirement and welfare reform really should not go together if one judges the cost-effectiveness of the work requirement. Yet, if it is the political price necessary to achieve welfare reform, the benefits of the whole welfare reform package are likely to outweigh the costs of the work requirement.

Much can be done to improve the adequacy and equity as well as the efficiency of the welfare system. The Carter welfare reform proposals take some important steps in this direction, although much remains to be done. The Carter work requirement, although politically attractive on the surface, will be a source of inefficiency. There are several areas where increased coordination of programs could produce important benefits. The need for reform is not new; hopefully the time of its realization is approaching.