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# Is Welfare Reform Succeeding?

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**Abstract**

Welfare Reform and the Earned Income Tax Credit have apparently caused a dramatic increase in the labor force participation rates of single parents. Between the first quarters of 1994 and 1998, labor force participation rates rose 25.4 percent for never-married women caring for children, rose 15.5 percent for mothers separated from their spouse and rose 4.9 percent for divorced single mothers. By contrast, unmarried individuals and separated and divorced women who were not caring for children lowered their rates of participation in the labor market. The rise in the labor force participation rates of single parents between 1994 and 1998 increased the labor force by 1,111,000. The total increase in the labor force due to changes in participation rates was 1,178,000. Thus, single parents, who accounted for only 6.2 percent of the labor force in 1994, were responsible for almost all of the increase in the overall labor force participation rate between 1994 and 1998. This unanticipated increase in labor supply may be one of the reasons why wage inflation has been so moderate since 1992. The EITC and welfare reform have increased the level of output that is consistent with non-accelerating inflation and may have even shifted the NAIRU, though probably not by much.

## **Is Welfare Reform Succeeding?**

**by John H. Bishop**

The Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) represents a radical change in the strategy and tactics of the thirty-three year old War on Poverty. While in-kind transfer programs were changed only slightly, the federal government no longer guarantees that non-working able-bodied adults who care for children will get cash assistance. AFDC was turned into a block grant and the states now decide how to administer it. The federal government instead guarantees low wage parents cash assistance only when they work ( in the form of the Earned Income Tax Credit and hiring tax credits) and subsidizes work expenses (child care and transportation) and certain forms of consumption (medical care, food and housing). What have been the effects of this dramatic change in welfare policy?

### **The Old Welfare System**

Under the old welfare system non-working heads of families with children were **entitled to** cash assistance from state administered programs and states were **entitled to** federal reimbursement of 50 to 78 percent of their spending on welfare. Highly prescriptive federal regulations focused on protecting recipients of Aid to Families with Dependent Children, the primary income-tested cash assistance program for working age adults, from arbitrary or discriminatory behavior by local welfare administrators. States were free, however, to decide how generous their program would be. The entitlement to federal matching money was intended to induce states to be more generous than they might have been if state and local taxes had been the sole source of funding.

Funds for training welfare recipients for jobs, by contrast, came to states and localities as formula-based block grants. Small performance bonuses were given to training programs that served many clients at very low cost per client. States and localities spent the federal dollars earmarked for training welfare recipients, but seldom supplemented federal welfare-to-work training money with state tax dollars. Training programs for welfare recipients were never funded at a level that would have made it possible to make participation mandatory for all clients. The different rates of marginal federal subsidy at different policy margins had a predictable effect on the way welfare was administered. States where advocates for the welfare population had political clout, saw the open ended offer of federal matching money as a way to bring federal dollars into the state and designed generous programs with lax work and

eligibility requirements. States where welfare recipients had little political clout chose to be incredibly stingy. In Mississippi, the maximum AFDC payment for a three person family was only \$4.00 a day during the 1990s. Hardly any state devoted significant state resources to training welfare recipients. Federal job search assistance mandates were not widely and effectively implemented.

### **The New Welfare System**

Over the course of the 1990s a very different welfare system has been developed. Federal entitlements to Supplementary Security Income (a small cash assistance program for the elderly and the disabled), Food Stamps and Medicaid were retained largely unchanged, but the cash assistance program for working age adults, AFDC, was renamed Temporary Assistance to Needy Families (TANF) and turned into a block grant. The grant must be used to assist the poor but the means of providing help—the mix of cash, vouchers, training, child care, workfare, etc.-- is a state decision. To assist mothers moving into jobs, recipients were guaranteed one year of transitional Medicaid coverage and 14 billion dollars was allocated for child care. Federal regulation of eligibility determination was transformed from a system designed to enforce individual entitlements to one designed to induce states to help and urge welfare recipients find work. Under the new federal law, recipients must work after two years on assistance and states are allowed to impose work requirements earlier if they wish. Recognizing that many states lacked the administrative capacity to immediately impose work requirements on everyone, a phase in period was devised. In 1997 states had to have 90 percent of their 1994 two-parent case load and 25 percent of their single-parent caseload in work or off the rolls. By the year 2002, states are required to have 50 percent of their 1994 single parent case load in work, in approved training programs or off the roles. A billion dollars will be available between 1999 and 2003 for performance bonuses to reward states that meet or exceed these goals.

Families who have received assistance for five cumulative years (or less at state option) will be ineligible for cash aid under the new law. States are permitted to exempt up to 20 percent of their caseload from the time limit and they have the option of providing non-cash assistance and vouchers to families that reach the time limit using Social Services Block Grant or state funds. States are required to continue spending at at least 80 percent of FY1994 levels. Within that constraint, states may choose to be either more or less generous than before and reap the savings or pay the additional costs of their changes. Clearly, state and local welfare administrators now face very different incentives. The TANF grant can be used in

many different ways, so moving welfare recipients into work and off cash assistance increases the flexibility of program administrators and increases the resources available for transition services for the remaining clients .

While non-working family heads no longer have a federally enforced entitlement to cash assistance, families with at least one working adult are **entitled to very generous earnings supplements** and their employers are **entitled to generous wage subsidies**. The earnings supplement program, the Earned Income Tax Credit, was first established in 1975 and later expanded in 1986, 1990 and 1993. In 1996 families with two children were eligible for a refundable tax credit equal to 40 percent of the first \$9000 of annual earnings. Once family earnings exceed \$12,000, the tax credit begins to phase out at a 20 cents on the dollar rate disappearing entirely when family income exceeds \$29,000. The EITC cost the treasury nearly 26 billion dollars in 1995, six billion dollars more than AFDC in that year.

The second program is the Welfare-to-Work Tax Credit. **Employers** who hire long-term welfare recipients after January 1998 **are entitled to a tax credit** of 35 percent of the first \$10,000 in wages in the first year of employment, and 50 percent on the first \$10,000 in wages in the second year. Putting the effects of the two tax credits together, after tax credit earnings of a family leaving welfare can now be 2.15 times employer wage costs in the first year and 2.8 times employer wage costs in the second year.

### **The Debate over the Feasibility of Work not Welfare**

**Are there enough low skill jobs?** During the 1995-96 welfare reform debate, some of the opponents of proposals to impose work requirements and time-limits on all welfare recipients predicted that the policy would founder on a lack of jobs. It was pointed out that in 1994 five and a half percent of the nation's population received AFDC benefits. In many cities a third of the population was on welfare. How were jobs to be found for all these people?

The economists who took the other side in this debate argued that in the flexible American labor market the number of jobs open to welfare recipients would grow as the supply of willing workers expanded. They pointed out that illegal aliens speaking little English are able to find work. The labor market, they argued, has handled large increases in the supply of unskilled labor in the past—sudden arrivals of large numbers of refugees from Cuba and Vietnam and seasonal variations in the supply of student labor. Lack of jobs for welfare recipients was not going to be a general problem, they predicted. The problem will be that the jobs will have low wages and offer few promotion opportunities. Most long-term welfare recipients will not be able to get and keep a job that pays enough, by itself, to bring a 3 or 4

person family out of poverty (Burtless 1995). However, when one takes account of supplementary assistance available from EITC and in-kind transfer programs, a full-time job is sufficient to bring almost all families out of poverty. This implies that success in pushing welfare recipients into full-time jobs will not obviate the need for Medicaid, child care assistance, rent subsidies, Food Stamps, the EITC and tough enforcement of child support awards.

**Do most recipients lack the cognitive skills necessary in the information economy?** Skill requirements were rising and most welfare recipients lacked the skills that employers were demanding. Welfare recipients want to work, it was claimed, the problem is that employers don't want to hire them even when offered large subsidies. Work (as opposed to job search) requirements would be feasible only if the government became the employer of last resort. That was impractical because of high costs and opposition from public sector unions.

The fact that most job growth occurs at the top of the occupational hierarchy is a problem, but not an insurmountable one. Rapid increases in the total number of unskilled jobs is not essential because turnover is high in entry level jobs, so new hiring is constant. Most high and intermediate level jobs are filled by people moving up from below, not by new college graduates. This starts a chain of vacancies that may eventually generate an entry level opening for poorly educated workers who lack a history of steady employment. The key is to keep the overall job market tight, so that skilled workers who have temporarily taken jobs as waiters or sales clerks can find jobs that better match their skills. When they move up, openings are created in entry level jobs that welfare recipients can compete for.

**Do most recipients lack the soft skills necessary to get and keep jobs?** When asked why men in the neighborhood couldn't find jobs, a black employer in Chicago said:

"Attitude. Poor Attitude. I'm very vocal on that. They lazy, a lot of them. You know, when you trapped, you realize you're trapped, but if you don't try to do something about it yourself, then you'll always be trapped. If you get into a welfare mode you becomes a slave - I'm going to work. It's an attitude problem, that's all I can tell you and I've known, I been around them. I know what's happening." [quoted in William Julius Wilson, *When Work Disappears*, 1996]

How common are these attitudes? Are they immutable? Or are they a consequence of the poor quality of the jobs open to them and the availability of alternative means of support. "Work not Welfare" advocates argued that most welfare recipients want to work, but since they

are not qualified for a “good” job and they have welfare to fall back on, they quickly become dissatisfied with the unskilled jobs they can get or hold out for a “good” job and remain unemployed. To employers, their lack of enthusiasm for the low wage jobs they are qualified for looks like an attitude problem.

The Work-not-Welfare approach to this problem is a) to make work more attractive, b) to provide lots of transition assistance and training in appropriate workplace behavior and c) to tell able-bodied welfare recipients that cash assistance is temporary and even temporary assistance is contingent on actively seeking work, being in training or doing a workfare job. Employment in unskilled jobs is made more attractive by continuing Medicaid coverage for a year and by providing child care subsidies, transportation assistance, earnings supplements (EITC) and welfare to work tax credits. This combined with work requirements, time limits and training in job search techniques and work habits, advocates predicted, would induce recipients to intensify job search, accept jobs that were previously unacceptable and try harder to keep supervisors happy. Employment rates of single parents will increase.

**The Ineffectiveness of Past Reforms:** Another source of skepticism about the feasibility of work replacing welfare as the primary source of income for female heads with limited education was the failure of past welfare policy changes to budge the employment rates of female family heads. Robert Moffitt (1992) constructed a time series of employment rates from 1968 to 1987 and concluded:

“the most surprising feature...is the extreme inelasticity of the labor supply of female heads, for employment rates and hours of work of female heads have been extraordinarily stable over the entire period despite major changes in benefit levels, benefit reduction rates, benefit-earnings ratios and unemployment rates....This...does not augur well for the prospect of increasing work effort by any change in benefits or benefit reduction rates...(p. 13).”

For example, between 1967 and 1972 the proportion of female heads on AFDC rose dramatically (from 36 to 62 percent) and unemployment rates rose as well; but the employment rates of female heads fell only slightly-- from 52 percent in 1968 to 48 percent in 1975. Sandefur and Wells (1996) have extended the data on employment rates of female heads through 1992 and found little change had occurred during the period. The stability of employment rates of female heads since the 1960s contrasts with the steady rise of the employment rates of mothers in intact families.

Proponents of the PRWORA reforms argued that past reforms that were “supposed” to increase employment rates of single parents failed in that objective because (1) the policy changes were at best marginal and often contradictory in their effects on work incentives, (2) local welfare administrators were hamstrung by federal regulations and (3) the state’s entitlement to reimbursement of 50 to 78 percent of benefit payments had weakened their resolve to reduce fraud and to assist recipients to find paid employment. This new set of reforms, they promised, would succeed where past reforms have failed.

### **Who has been right so far?**

It’s now two years since welfare reform was signed into law. Caseloads have declined substantially—more rapidly than anyone anticipated. Between August 1996 and March 1998, aggregate caseloads fell by 27 percent or by 1,165,000 families. In some states caseload declines were even larger: 45% in Florida, 38% in Oregon, 68% in Wisconsin, and 74% in Wyoming (Administration for Children and Families 1998).

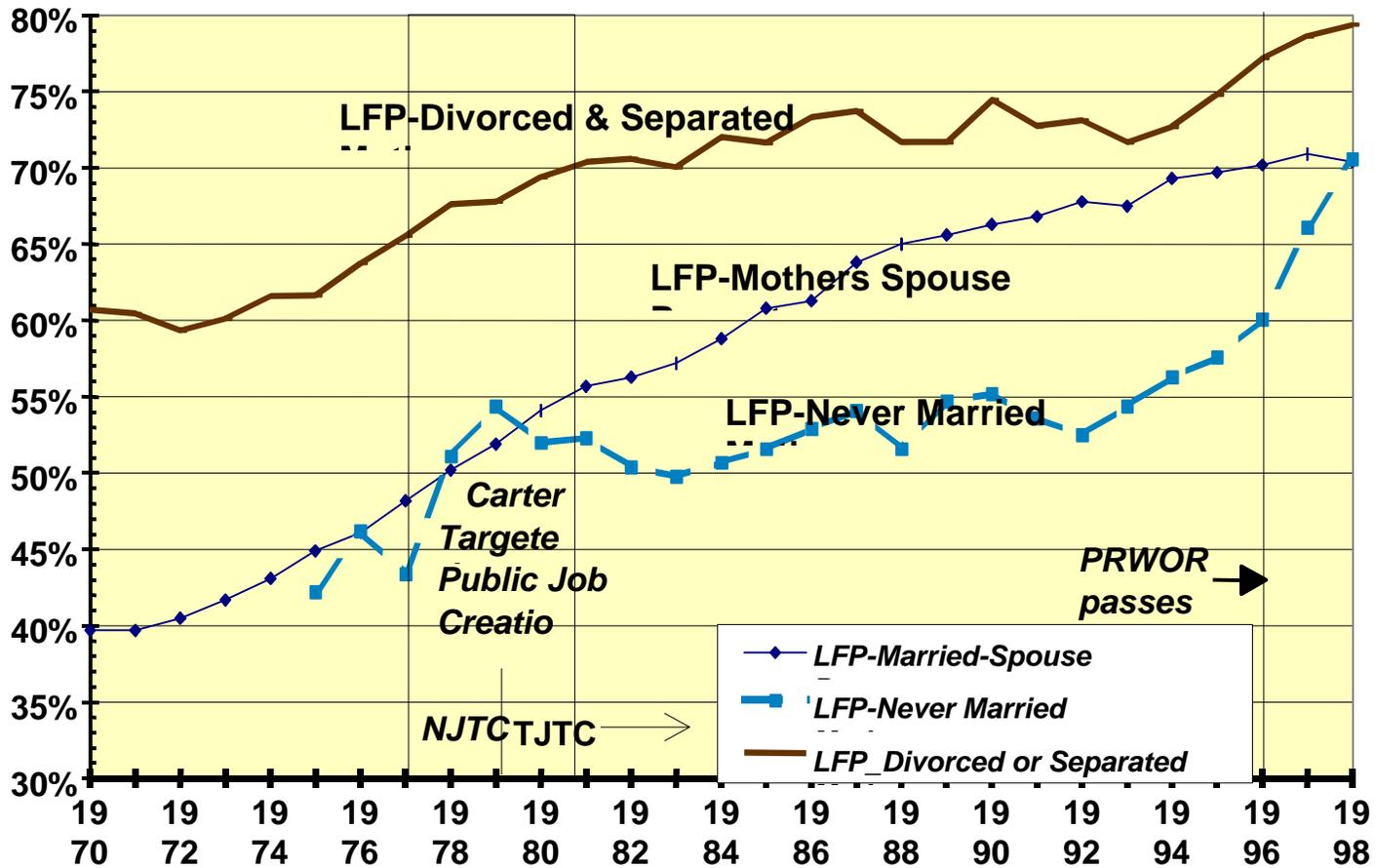
Did welfare reform contribute to these declines? The Council of Economic Advisers (1997) studied the caseload declines that preceded the 1996 passage of welfare reform. They found that the declines were larger in states that obtained waivers allowing them to sanction those not cooperating with job search and training requirements. They concluded that about half of the 1993 to 1996 decline in aggregate caseloads was due to the tightening of the labor market and about one third was due to policy changes associated with waivers. A lively debate has developed over this issue (Wiseman 1997, Ziliak *et al* 1997)

**How has employment been affected by welfare reform?** The effect of welfare reform on employment is a much more important issue than it’s effects on caseloads. Big declines in caseloads caused by welfare reform only demonstrate that state governments are willing and able to administer stringent work tests and time limits or are spending their PRWORA block grant on services and in-kind transfers rather than cash assistance. But if people pushed off welfare cannot find full-time jobs, welfare reform is a failure and the caseload decline is a measure of how many people suffer declines in living standards. If, by contrast, the new policy regime increases employment by about as much as it lowers welfare receipt, welfare reform has to be judged at least a partial success and the market for unskilled labor would have again demonstrated its flexibility just as Gary Burtless and some other economists predicted.

Special BLS tabulations of the monthly Current Population Survey will be used to address this question. Tom Hale and Howard Hayghe of the BLS kindly provided copies of unpublished tabulations of the civilian non-institutional population, labor force, employment,

part-time employment and unemployment by marital status and the presence of dependent children for the first quarter of each year since 1994. These data were then spliced together with published March data for earlier years (BLS 1989 Tables 56-58 &, Jacobs 1997, p. 103-106). Figure 1 presents trend data since 1970 on labor force participation rates of never-married mothers, married mothers with spouse present and mothers who are divorced, widowed or separated from their spouse.

### Fig 1-Trends in Labor Force Participation of Female Single Parents



Participation rates increased steadily throughout the period for mothers in intact families, a group unlikely to be affected by changes in welfare rules. Divorced, widowed and separated mothers were much more likely to be in the labor force than mothers in intact families during the 1970s. Participation rates rose slowly up through 1986 and then remained flat for 7 years. By 1993 the participation rates of mothers in intact families had nearly caught up with the rates of divorced and separated mothers. With the expansion of the EITC in 1993, however, participation rates of divorced and separated mothers began a rapid rise pulling steadily ahead of mothers in intact families. The 1990s welfare reforms appear to have affected this group as well, though less dramatically than the never-married mothers.<sup>1</sup>

By contrast, never-married single parent females, the group most likely to be on welfare, had no increase in participation rates during the 1980s. Then in 1993, the year EITC was liberalized, participation rates started to rise and after 1996, the year PRWORA became law, the increase accelerated. Note further that labor force participation of never married mothers also dramatically increased between 1977 and 1979, the period during which the Carter Administration expanded public sector job creation programs and retargeted them on the disadvantaged.<sup>2</sup> Work related reforms of welfare can apparently affect this group a great deal.

Table 1 presents BLS estimates of change in labor force participation rates and employment rates from 1994 to 1998 for a variety of demographic groups. Let us examine these data to look for clues as to how the changed welfare system—the expanded EITC, the state AFDC waivers and the 1996 devolution of power to the states—has affected the labor force participation of women eligible to receive AFDC/TANF?”

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<sup>1</sup> Two very thorough and careful studies (Eissa and Leibman's (1996) and Meyer and Rosenbaum (1998) have demonstrated that the introduction and liberalization of the EITC has increased the labor supply of single parent families.

<sup>2</sup> Never-married mothers were 6.4 percent of single parents in 1975 and 37 percent in 1998. Since the never-married mothers had much lower participation rates, their growing numbers tended to lower average labor force participation rates for single parents as a whole. This meant that labor force participation rates of single parents did not appear to be rising during the 1970s, even though labor force participation rates of each subset of single mothers--never-married mothers, separated mothers, and divorced mothers--were in fact rising.

**Table 1: Changes in Female Labor Force Participation and Employment Rates  
by Marital Status and Presence of Children—1994 to 1998.Q2**

	LFP- 94.Q1	LFP- 98.Q1	%Chg LFP 94.Q1- 98.Q1	%ChgE/P 94.Q1- 98.Q1	%ChgLFP 96.Q2- 98.Q2
Never Married with children	56.3	70.6	25.4%	32.0 %	16.2 %
Never Married w children-Black	58.2	74.5	28.0%	32.7 %	14.9 %
Never Married w child-Hispanic	44.9	57.9	29.0%	23.1 %	24.0 %
Never Married w/o children	66.5	66.6	0.2 %	2.8 %	- 1.0 %
Never Married w/o child-Black	61.1	59.5	- 2.6 %	2.3 %	1.0 %
Never Married w/o child-Hispanic	56.2	58.3	3.7 %	8.6 %	3.8 %
Married Spouse Abs—w children	65.0	75.1	15.5 %	20.6 %	11.7 %
Married Spouse Abs —w/o child	60.7	59.4	- 2.1 %	- 1.9 %	- 5.0 %
Widowed—with children	53.9	67.7	25.6 %	27.0 %	15.0 %
Widowed—w/o children	16.5	16.6	0.6 %	2.4 %	4.0 %
Divorced---with children	79.3	83.2	4.9 %	6.7 %	0.5%
Divorced---w/o children	70.3	68.5	-2.6 %	- 0.8 %	- 0.6 %
Mother--Spouse Present-w child	69.3	70.4	1.6 %	3.3 %	0.3 %
Married--Spouse Present no child	53.4	53.7	0.6 %	1.7%	0.2%

The impacts of the EITC and welfare reform will be assessed by difference of differences estimators. We will compare changes in labor force participation and employment rates of single parents—the group most affected by 1990s welfare reform—to the changes experienced by groups not affected by welfare reform—childless individuals and married women in intact families.<sup>3</sup> We hypothesize that increases in labor force participation and employment will be largest for the never-married with children group (the group with the highest AFDC participation rate), next largest for widows and mothers who are separated from their husband and smallest for divorced mothers. 1990s welfare reform is unlikely to have a large and visible effect on the employment rates of women in two-parent families for three reasons. The EITC raises the marginal tax rates on second earners in two-parent families, so it depresses the labor supply of married women. Eissa and Hoynes (1998) estimate that the expansion of the EITC has “reduced the likelihood of married women’s labor force participation by up to a full percentage point.” Secondly, tightened work requirements in AFDC-UP operate in the opposite direction, but only a tiny share (about 1 percent) of two-parent families receive AFDC-UP. Thirdly, the new rule that Food Stamp recipients cannot receive more than 3 months of assistance unless they are working or participating in a work or training program does not apply to persons who have responsibility for children. The net effect of all these forces on labor force participation rates of adults in two parent families with children is likely to be small.

Between 1994.Q1 and 1998.Q1, unemployment rates fell from 6.1 to 4.7 percent. Declines in unemployment rates such as these have in the past led to increased labor force participation by teenagers, single individuals and single parents. For the last four years the pattern was different. Participation rates fell for two of these groups (teenagers and single individuals), rose modestly for married women (in line with historical trends) and **rose dramatically for single parents. Between the first quarters of 1994 and 1998, labor force participation rates rose 25.4 percent for never-married mothers, rose 15.5 percent for wives with an absent spouse, rose 25.6 percent for widows with children and rose 4.9 percent for divorced single parents.** By contrast, unmarried individuals and separated and

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<sup>3</sup> Meyer and Rosenbaum’s (1998) paper also uses the contrasting behavior of individuals who do not have children to identify the effects of EITC and welfare to work waivers on the behavior of single mothers. Their carefully constructed data set of state by state EITC programs and welfare waivers, training expenditures and medicaid program parameters provides additional sources of identification. The unique features of this paper are its focus on labor force participation, its use of historical data on single mothers to construct a second counter-factual and its examination of the period after PRWORA’s passage—1997 and 1998--during which the growth of labor force participation was accelerating. I learned of and obtained a copy of the Meyer and Rosenbaum’s paper at the end of July 1998.

divorced women who were not caring for children lowered their rates of participation in the labor market.

The entry of so many single parents into the labor market did not increase their unemployment rate. Indeed, unemployment rates fell for them slightly more rapidly than for all workers. The employment to population ratio rose 32 percent for never-married mothers, 20.6 percent for mothers separated from their spouse and 6.7 percent for divorced mothers (column 4). About 80 percent of the jobs held by single mothers during the first quarter of 1998 were full-time, a slight increase from 1994.

Apparently some of the predictions of those who advocated Work Not Welfare have come true at least during the 1994 to 1998 period. Serious implementation of work requirements and time limits combined with expanded medicaid coverage of children with low wage working parents and a generous EITC generated a substantial increase in the employment of single parents. Further support for this conclusion comes from the Manpower Demonstration Research Corporation's rigorous experimental evaluation of the first work-to-welfare program to combine job search assistance, work requirements and 2 to 3 year time limits, Florida's Family Transition Program (FTP). Six months after hitting the time limit, those subject to the FTP regime were 20 percent more likely to be employed at the end of two years and earned 36 percent more than those who faced the standard AFDC regime (Bloom, Farrell, Kemple & Verma 1998). For the FTP clients who reached their time limit, the reduction in welfare receipt was roughly equal to the increase in employment.

The EITC liberalization was fully phased in by 1995, so the labor supply responses to this change should have been complete by the second quarter of 1996.<sup>4</sup> To the extent that policy contributed to the growth of labor supply after 1996:Q2, the primary influences were probably welfare waiver programs, workfare and other state administrative and training initiatives. We can take a peak at the early effects of these changes by examining changes in labor force participation from the second quarter of 1996 and to the second quarter of 1998 in column 5 of Table 1. The post 1996 changes appears to have had little impact on divorced mothers, but substantial effects on separated, and never-married mothers, the groups with the highest participation in AFDC/TANF.

Table 2 provides information on annual changes in caseloads, labor force and employment. The number of single parent families on AFDC/TANF fell 149,000 in FY1995,

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<sup>4</sup> The revenue cost of the EITC was \$13 billion in 1992, \$15.5 billion in 1993, \$21 billion in 1994, \$26 billion in 1995 and 1996 and \$27 billion in 1997.

282,000 in FY1996, 572,000 in FY1997 and approximately 673,000 between fiscal 1997 and March 1998. Second quarter levels were used to calculate one year employment changes for each of the four years since 1994.Q2. The employment gain over the previous year was 391,000 in 1995.Q2, 310,000 in 1996.Q2, 652,000 in 1997.Q2 and 390,000 for 1998.Q2. This makes the total gain for single parents since 1994.Q2 equal to 1,743,000 jobs. Since the gain in full-time jobs was 1,609,000, 92 percent of the employment gain was in full-time jobs. Some of the employment increase, however, was due to population growth. When you subtract out the effects of the increase in the number of single parents, the residual employment gain due to lower unemployment and higher labor force participation was 1,265,000. Thus, over the full four year period, the increase in full-time employment by single parents was about 75 percent of the decline in caseloads. This suggests that welfare reform and the EITC have, at least so far, been pretty successful at achieving the goal of increasing the employment of single parents.

**Table 2.--Change in Employment and Caseloads—1994 to 1998 (in thousands)**

	1994.Q2	1995.Q2	1996.Q2	1997.Q2	4 year Change
	1995.Q2	1996.Q2	1997.Q2	1998.Q2	
FY Caseload of Single Parent Families	- 149	- 282	- 572	-	- 1,676
Employment of Single Parents	+ 391	+ 310	+ 652	+ 390	+1,743
<u>Change due to increased Labor Force Participation Rates:</u>					
--Single Parents	+ 203	+ 237	+ 453	+ 218	+1,111
--Total Population	+ 564	128	+ 769	- 283	+1,178
<b>Total Employment</b>	<b>+ 2,402</b>	<b>+ 1,825</b>	<b>+ 2,902</b>	<b>+ 2,075</b>	<b>+9,204</b>

Source: Caseload estimates do not include the AFDC-UP program and are from the Green Book and from [www.acf.dhhs.gov/news/3697.htm](http://www.acf.dhhs.gov/news/3697.htm). Since they are for the fiscal year, they lag the employment data by a month and a half. The caseload change in the 1997 to 1998 column is for March 1998 minus Fiscal 1997. It assumes that the caseload of 2-parent families declined at the same rate as the overall TANF caseload. Employment data is from unpublished tabulations of seasonally unadjusted data that BLS refers to as Table 8. Employment estimates are monthly averages for the second quarter of the year. The annual changes in total employment from this source are different from estimates reported in [Employment and Earnings](#) because they are not seasonally adjusted and different person weights were used to construct the marital status tables. Females accounted for about 79 percent of employed single parents in the second quarter of 1998.

Pay levels are, of course, another issue. Did the income of single parents decline between 1994 and 1998 as low wage jobs were substituted for cash assistance? No, it did not. The mean AFDC payment per family was \$377 per month in 1995. Women working full-time earned substantially more. Those with the fewest skills--women with fewer than 12 years of schooling earned an average of \$1157 per month in 1995 working full-time. Working lowers one's eligibility for food stamps, but it increases the Earned Income Tax Credit. The two effects probably roughly offset each other. Thus as long as a family does not lose medical coverage, giving up cash assistance and food stamps to take a full-time job almost always raises the family's income.

How big are the aggregate effects? Making the conservative assumption that the extra single parent workers earn the high school drop out wage, the 1,265,000 increase in employment [holding population constant] 92 percent of which is full-time means the aggregate earnings of single parents increased by \$1,405,000,000 per month. By contrast, the 1,637,000 decline in single parent caseload over four year period implies a reduction of about \$632,000,000 per month in cash assistance payments.

Has the increased employment of single parents been accompanied by slower wage growth in unskilled jobs? Wage data for single parents are not available, but occupational and educational wage data are. Between 1994 and 1997, usual weekly earnings for full-time workers in service and laborer jobs rose 9.76 percent for women and 10.8 percent for men. Usual weekly earnings in professional, technical and managerial jobs rose less rapidly--8.8 percent for both women and men. Table 3 presents data on wage changes since 1995 by years of schooling. For those without a high school degree, the wage increase from 1995 to the 12 month period ending in March 1998 was 6.1 percent for females and 5.5 percent males. Wage increases were slightly higher for those with greater education: 6.6 (6.5) percent for female (male) high school graduates, 7.2 (5.7) percent for those with some college and 6.5 (7.1) for college graduates.

Thus, the two types of wage trend data tell somewhat contradictory stories. Either way, however, the wage response, if there is one, appears to be small.

Table 3 also presents data on employment growth since the first quarter of 1995. Despite a very substantial (6.3 percent) increase in labor force participation rates by high school dropouts, the employment increase has been only 5.7 percent because the population of high school dropouts has been decreasing. Employment of college graduates increased 10.1 percent, despite declines in labor force participation rates because the number of adult

college graduates has been rising rapidly. This plus the tightness of the overall labor market may explain why the relative wages of lower skilled workers have not declined appreciably and by some measures have increased.

**Table 3: Wage and Employment Growth Since 1995 by Years of Schooling**

<b><u>Wage Changes-95 to 97/98</u></b>	<b>High School Dropouts</b>	<b>High School Graduates</b>	<b>Some College</b>	<b>College Graduate or more</b>
Females—Average-25, 50 & 75 <sup>th</sup> percentile	6.1 %	6.6 %	7.2 %	6.5 %
Females—25 <sup>th</sup> percentile within group	8.1 %	7.0 %	7.1 %	4.0 %
Males—Average-25, 50 & 75 <sup>th</sup> percentile	5.5 %	6.5 %	5.7 %	7.1 %
Black Females—1995 to 1997	6.8 %	5.6 %	5.8 %	- 1.7 %
<b><u>Growth of Employment: 1995.Q1--1998.Q1</u></b>	<b>5.7 %</b>	<b>3.5 %</b>	<b>2.9 %</b>	<b>10.1 %</b>
<u>Growth due to:</u> Lower Unemployment	1.9 %	0.7 %	0.8 %	0.6 %
Higher Labor Force Participation Rates	<b>6.3 %</b>	0.4 %	- 0.6 %	- 1.1 %

Source: Bureau of Labor Statistics, Various press releases on usual weekly earnings of full-time wage and salary workers and employment status by years of schooling that start becoming available in the first quarter of 1995. Rows 1, 3 and 4 are averages of wages at the 25<sup>th</sup>, 50<sup>th</sup> and 75<sup>th</sup> percentile. The wage change estimates compare average wages for 1997.Q2 through 1998.Q1 to calendar year 1995.

**Issues of Causality:** How much of the increase in employment of single parents was caused by the EITC and other welfare reform initiatives? That is hard to say, but certainly not all of the 1,743,000 increase during the 4 years prior to 1998.Q2. Some of the growth was due to the rising number of single parent families and some was due to declines in unemployment rates. Subtracting out these two effects, leaves a residual that captures the effect of changing

labor force participation rates (row 3 and of Table 2). For single parents, 64 percent of the employment growth came from increased labor force participation rates. The 1,111,000 estimate of labor force growth of male and female single parents is an upper bound of the causal impact of welfare reform. About 10 percent of this increase was due to a growth in the numbers of males heading single parent families and a small increase in their participation rates. What would have happened to labor force participation rates of single mothers in the absence of welfare reform and the EITC? In Table 1 the labor force participation trends of women with the same marital status but no children were the implicit counterfactual. An alternative method of constructing a counterfactual is to analyze and extrapolate from the past behavior of single mothers.

Table 4 presents time series regressions predicting the logit,  $[\log(LFP_t/(1-LFP_t))]$ , of the labor force participation rates plotted in Figure 1. The logit (or log odds) transformation was used because it takes account of the floor and ceilings to participation rates at zero and one. The analysis began by estimating an a priori specification containing four variables: the unemployment rate, a time trend, an indicator of total wage subsidies and job training expenditures and, for the two groups of female single parents, a spline [zero before 1995 and reaching 4 in 1998] intended to capture the effect of welfare reform. The results are found in the first row of each panel of the table. The welfare reform spline had positive and significant effects on participation of both groups of female single parents. At the end of the 1990s, the estimated trend of participation rates was about one-half of a percentage point per year for divorced and separated mothers and about 0.4 percentage points per year for never-married mothers. Higher unemployment rates had the expected negative effects on participation rates of never married mothers [discouraged worker effect] and positive effects on the participation of mothers in intact families [replacement worker effect].

**Table 4: Labor Force Participation Trends of Mothers by Marital Status---1960 to 1998**

<u>DEPENDENT VARIABLE</u>	<u>WELFARE REFORM</u>	<u>YEAR</u>	<u>(YEAR-75) SQUARED</u>	<u>UNEMP. RATE</u>	<u>JOBINV/ GDP</u>	<u>EITC/ GDP</u>	<u>CETA+ TJC/GDP</u>	<u>DW STAT</u>	<u>R<sup>2</sup> RMSE</u>
<b>Average LFP Never</b> (1)	.108*** (5.33)	.0199*** (5.56)		- 1.813 (1.08)	.236*** (2.96)			1.29	.9041 .0786
<b>Married Mother</b> (2)	.114*** (6.98)	.0240*** (7.53)		- 2.15 (1.63)			.792*** (4.81)	1.70	.9368 .0638
<b>1975-98</b> (3)	.157*** (7.36)	.044*** (5.53)	- .0011** (2.71)	- 2.55** (2.22)			.694*** (4.71)	2.45	.9526 .0552
<b>Average LFP Separated-</b> (1)	.053** (2.57)	.024*** (13.61)		1.709 (1.53)	.062 (.97)			.97	.9295 .0863
<b>Widowed Divorced</b> (2)	.048** (2.44)	.0250*** (16.55)					.272* (1.81)	1.00	.9300 .0859
<b>Mother 1960-98</b> (3)	.031 (1.30)	.0234*** (11.57)	.00023 (1.14)				.412** (2.12)	1.06	.9306 .0856
<b>Average LFP Mothers</b> (1)		.0516*** (51.87)		1.500** (2.18)	.0243 (.57)			.35	.9908 .0576
<b>Spouse Present</b> (2)		.0567*** (36.57)		.625 (1.02)		-.556*** (3.74)	.059 (.65)	.55	.9937 .0478
<b>1960-98</b> (3)		.0572*** (38.00)	.00029* (1.97)	.777 (1.31)		-.924*** (3.94)	.189* (1.74)	.77	.9942 .0459
<b>Ever Employed</b> (1)	.156*** (4.99)	.0049*** (3.26)		-5.38*** (6.57)	.289*** (6.28)			1.37	.8404 .0589
<b>in Year-- Single</b> (2)	.098*** (2.93)	-.0018 (.70)		-5.01*** (6.38)		1.03*** (4.37)	.665*** (6.15)	1.42	.8691 .0533
<b>Mothers 1967-96</b> (4)	.100*** (3.11)	-.0016 (.67)		-4.88*** (6.58)		1.01*** (4.53)	.602*** (6.62)	1.49	.8808 .0509

Source: Regressions predicting the logit  $[\ln(LFP/(1-LFP))]$  of aggregate labor force participation rates for 1960 to 1998. Effects of variables during the late 1990s can be approximated by multiplying by .226 for never married mothers LFP, by .18 for divorced and separated women's LFP, and by .157 for ever employed during the year rates for all single mothers. For never-married mothers data is available only for 1975 to 1998. The ever worked variable was calculated from March CPS tapes by Meyer and Rosenbaum (1998) and is available for 1967 through 1996. The Welfare Reform variable is 0 prior to 1995, 1 in 1995, 2 in 1996, 3 in 1997 and 4 in 1998. The annual CETA+JTPA+TJC variable is the sum of (the revenue cost of the Targeted Jobs Credit and WIN credit plus fiscal year spending on targeted training programs) divided by nominal Gross

Domestic Product. The variable is then averaged with its one year lag. The EITC variable is the cost of the Earned Income Tax Credit divided by GDP. The JOBINV was generated using a priori weights and lags.  $JOBINV = \{EITC + NJTC + \text{lag}(NJTC) + \text{TrainingExpenditure} + \text{lag}(\text{TrainingExpenditure}) + TJTC + \text{lag}(TJTC)\}/GDP$ . Since CETA programs were not targeted on welfare recipients and the disadvantaged prior to 1978, only one half of federal training expenditures in 1977 and prior years are included in the Training Expenditure index.

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The estimated effect of unemployment on labor force participation of divorced and separated mothers was positive, contrary to my theoretical expectations. It was not significantly different from zero, however, so the unemployment rate was dropped from later regressions predicting participation rates of divorced and separated mothers. The JOBINV variable, a summation of all federal wage and earnings subsidies and targeted training expenditures (with the EITC getting half the weight of the others) divided by GDP, had positive estimated coefficients in all regressions but was statistically significant only for never-married mothers.

The next step in the analysis was to drop the assumption that EITC tax expenditure dollars had the same impact on participation rates as half as many dollars of CETA or JTPA training or PSE expenditures or TJTC tax credits and freely estimate their separate effects. Therefore, separate variables for the EITC tax expenditure and for training expenditures and employer wage subsidies were simultaneously entered into the next models estimated. Consistent with Eissa and Hoynes (1998), the EITC had significant negative effects on labor force participation of married women with children. This regression is presented in the eighth row of Table 4. Contrary to Eissa and Leibman (1996), Meyer and Rosenbaum (1998) and theoretical predictions, however, EITC was not found to have a positive effect on participation of single parents. Meyer and Rosenbaum's data and methodology provide a more powerful test of EITC impacts than these simple time series regressions, so I chose to drop the EITC variable from the single parent regressions and to represent federal spending intended to stimulate employment of welfare recipients by TJTC tax expenditures and federal spending on CETA, JTPA, Job Corps etc. The results are presented in the second and fifth rows of Table 4. Note that the resulting refinement of the Training and Wage Subsidy variable substantially increases the size and significance of its coefficient. Coefficients on other variables change very little.

We can use the coefficients in these regressions to predict what would have happened to labor force participation rates of single mothers if welfare reform had not been introduced.

The actual labor force gain (holding the population of single mothers constant at 1998.Q1 levels) was 938,000. Four years of trend growth, a 1.4 percentage point decline in the unemployment rate and a small decline in training expenditures is predicted by our Model 2 regressions to increase labor force participation rates of never-married mothers by 2.51 percentage points (99,000 in 1998) and participation rates of separated and divorced mothers by 1.7 percentage points (98,000). Thus our estimate of the effect of post 1994 welfare reform on labor force gains of single mothers is 741,000 of which the spline variables capture 604,000.<sup>5</sup> Alternatively, if model 2 (minus the welfare reform variable) is fitted to the data through 1994 and that equation is used to predict participation rates in 1996 and 1998, it underpredicts labor force participation of single mothers by 286,000 in 1996 and by 733,000 in 1998. Either way, the derived estimates of welfare reform's effects are large and apparently growing at an accelerating rate.

Model 3 frees up the time trend by including a  $(\text{Year} - 1975)^2$  term in the model. This specification change has substantial effects on the estimated effects of welfare reform. The coefficient on the welfare reform spline in never-married mothers regression increases by 38 percent, while estimated coefficient for divorced and separated mothers drops by 35 percent. The estimated effect of welfare reform on labor force participation of all single parents combined goes up to 813,000 of which the spline variables capture 699,000.

The final check on the robustness of our findings is to estimate the same set of models in a different data set: Meyer and Rosenbaum's estimates of the proportion of single mothers between 19 to 44 years of age who were ever employed in the previous year. These data are available for 1967 through 1996. Single mothers were defined as divorced mothers, widowed mothers and never married mothers. Married mothers with an absent spouse were not included. Since employment rates are the dependent variable, unemployment is included in all models and has the expected negative effects on employment. Remarkably, the welfare reform spline is positive and highly significant despite the absence of 1997 and 1998 from the data and the inclusion of an EITC variable with a large positive and statistically significant coefficient. Note also that the training variable has large significant effects on employment. The year squared variable lowered the adjusted R2 when it was introduced so the results are not reported. Instead, the third row of the panel reports the effects of including the New Jobs

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<sup>5</sup> Estimating the effect of post 1994 welfare reform, by subtracting the effects of year, unemployment and training expenditures from the actual LFP change from 1994 to 1998, attributes to welfare reform both the LFP changes captured by the welfare reform spline and the changes in regression residuals between 1994 and 1998.

Tax Credit in the TJTC plus training expenditure variable. Substituting this variable, causes the training coefficient to fall a little, but it raises the overall explanatory power of the model.<sup>6</sup>

Welfare reform was helped immeasurably by the tight labor market. Low wage employers have been experiencing recruiting difficulties, so they have become more willing to hire former welfare recipients. Knowing jobs were available in the community, agency staff were more willing to demand that clients attend job search clubs and find employment.<sup>7</sup> If the policy changes had occurred at a time of high unemployment, the policy induced increases in employment would no doubt have been smaller, but how much smaller is impossible to say. It is also impossible to predict from these data what will happen when the economy enters a recession. The 741,000 estimate of the impact of 1990s welfare reform includes the main effect of the policy change and the interaction effect of policy change and tight labor markets.

Causation also runs in the opposite direction. Welfare reform and the EITC are contributing to the economy's ability to grow without accelerating inflation. By pushing approximately 741,000 female single parents (and possibly another 90,000 AFDC-UP recipients into jobs), they have increased the economy's productive capacity. Most of the growth of employment between 1994 and 1998 was due to population growth (about 5.66 million) and declining unemployment rates (about 2.36 million). However, a significant share was due to increased labor force participation rates. Much of this increase in labor force participation rates surprised economic forecasters. Gregg Jaffe of the Wall Street Journal reported, "**Economists are truly surprised. As late as 1995, they expected 1.2 percent growth of the labor force in 1996. Instead it grew almost 2%. 'We have added about one million unexpected workers', says David Wyss, an economist at DRI/McGrawHill,** (Jaffe, July 31, 1997, p.1).

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<sup>6</sup> This expanded Tax Credit plus Training expenditure variable was tried with other dependent variables and it performed marginally less well than the original variable. Sensitivity tests were also conducted regarding the functional form of the unemployment rate. When the logarithm of the unemployment rate replaces the its linear counterpart, R2s deteriorate in the employment rate model, remain unchanged in the married spouse present model and improve slightly in the model for never married mothers. Coefficients on the welfare reform spline and estimates of the total effect of welfare reform hardly change at all.

<sup>7</sup> A similar argument can be made that the EITC positively interacts with welfare waivers and PRWORA. Case workers are likely to be more willing to push their clients to work when they know that a minimum wage job plus the EITC pays considerably more than welfare. With AFDC/TANF now a block grant, the EITC is the only open ended entitlement, so state policies that push TANF clients into private sector work maximize the receipt of federal tax expenditure dollars.

Increased participation rates added 1,178,000 workers to the total labor supply during the four year period. Single parents accounted for almost all (1,111,000) of this increase.<sup>8</sup> The causal impact of the EITC and welfare reform on the labor supply of single mothers was about 741,000, or about 63 percent of the total change in the aggregate labor force participation rate.<sup>9</sup>

Demand shocks that under the old welfare regime would have led to accelerating wage inflation and interest rate hikes by the Federal Reserve, instead, produced higher real output and stable or declining interest rates. Welfare reform increased full employment GDP (the output level that is consistent with non-accelerating inflation) and, consequently, changed the relationship of full employment GDP to NAIRU (the non-accelerating inflation rate of unemployment).

It may also be shifting the NAIRU. Wage inflation has been surprisingly low since 1992 (Lown and Rich 1997). The EITC and welfare reform may be one (though certainly not the most important) reason why. About half of the unemployed have children. When these workers exhaust or are ineligible for unemployment insurance, AFDC/TANF is the cash assistance program upon which they must rely. The 432,000 adults reported as unemployed in FY1996 AFDC program records (11 percent of the caseload) represent 18 percent of all unemployed adults in families with children that year. The large decline in the caseload has meant that there is plenty of money for running job clubs and providing intensive job search assistance to welfare clients. Some states and localities are telling able-bodied welfare recipients who cannot find a job that they must do workfare jobs. This changes the clients status from unemployed to employed so unemployment rates fall. But since workfare jobs are not eligible for EITC subsidy and are generally less attractive than unsubsidized jobs, workfare participants continue their job search during their free time. Decades of research using high quality randomized designs has started to payoff. We have learned a lot about how to administer training and job search assistance programs, and this knowledge is being applied in many localities. Changes in the Food Stamp program—time limits for single individuals and ending the eligibility of legal immigrants who are not citizens—have had a similar effects. Much more

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<sup>8</sup> During the three years from 1995 to 1998, increased labor force participation rates of single parents added 908,000 workers to the labor force. Labor force participation rates of other workers fell so the total labor force increase due to changes in labor force participation rates was 614,000.

<sup>9</sup> It is not clear what impact EITC and welfare reform was having on the growth of labor force participation of married men and women during this period. The more generous EITC lowers employment of married women (Eissa and Hoynes 1998) but the changes in AFDC-UP should have had the opposite effect.

is now expected of TANF and Food Stamp recipients and this has made long term unemployment more disagreeable and, therefore, probably less prevalent.

### **Summary, Conclusions and Speculations**

Welfare reform and the EITC have apparently caused a large increase in the labor force participation rates of single parents. Never married mothers and mothers who are separated from their spouse increased their labor supply the most. Almost all of the unanticipated increase in the labor force during the last four years was the result of the rising labor force participation of single parents. The influx of workers has raised the level of full employment Gross Domestic Product and may have even lowered NAIRU, the unemployment rate at which inflation starts to accelerate.

During last four years single parents (holding population constant) increased their employment by about 1,265,000, while AFDC/TANF single parent caseloads were falling by 1,676,000. This suggests that EITC and welfare reform were at least partially successful in achieving their stated goal of pulling/pushing single parents into jobs.

Meyer and Rosenbaum (1998) estimate that the EITC was responsible for almost all of the gain in average monthly employment rates of single mothers between 1984 and 1992 and 36.5 percent of the 4.2 percentage point gain between 1992 and 1996. Welfare waivers were responsible for another 24 percent of the 1992 to 1996 employment rate gain, training program changes for 8 percent and AFDC changes for 12 percent of the gain. Thus the policy instruments conventionally referred to as welfare reform accounted for 44 percent of the employment rate gain from 1992 to 1996. Meyer and Rosenbaum did not study employment increases in 1997 and 1998 because the necessary CPS micro data were not yet available. Our findings for the period through 1996 are consistent with their results. For the 1996 to 1998 period, however, the pattern changes. EITC program parameters and its revenue costs were stable, so the EITC is unlikely to be responsible for much of the labor force growth that occurred after the second quarter of 1996. On the administrative welfare reform front, by contrast, workfare was growing rapidly and time limits were starting to bite. Thirty nine percent of single parents live in jurisdictions that had announced time limits before the end of 1996 (Meyer and Rosenbaum 1998). Of the 671,000 increase in single parent labor force between 1996.Q2 and 1998.Q2 about 100,000 is due to declining unemployment and the continuation of long term trends. Almost all of the remainder is probably due to welfare reform.

Are the labor force participation rates of single parents likely to continue increasing? Good arguments can be made on both sides of this question. Let us look at the negative side

of the proposition first. Participation rates of single mothers are now higher than that of single women and of married women with children. The easy-to-employ welfare recipients may have already found jobs and left welfare. Those remaining on welfare may be much more difficult to place in lasting jobs. None of the welfare to work training programs that have been carefully studied have raised the employment rates (as measured by UI wage record data) of welfare recipients above 40 percent. Riverside County's GAIN program and San Diego's SWIM program achieved employment rates of only 35 percent (Friedlander, Riccio and Freedman 1993; Friedlander and Hamilton 1996). Canada's Self Sufficiency Project, a very generous earnings supplement program, raised the employment rate to 40 percent (Card and Robins 1996). Even though the national unemployment rate was 4.4 percent in the second quarter of 1998, the black and Hispanic never-married mothers of children under 6 years old who were in the labor force had a better than 20 percent chance of being unemployed.

Those who take the affirmative position are more optimistic about the ability of welfare recipients to find and keep jobs. They argue that the studies cited above undercount the proportion of former welfare recipients who get and keep jobs because they miss those who work in other states, in workfare jobs, in uncovered or off-books jobs or who work under a different social security number. Furthermore, the old style welfare-to-work programs cited above were not well enough funded to closely monitor and assist all clients and did not include all of the program elements—work requirements, sanctions, workfare, time limits, extended Medicaid coverage and a generous EITC—that are packaged together in the vanguard states such as Florida and Wisconsin that have achieved big caseload reductions. After two and one half years, 77 percent of those assigned to Florida's Family Transition Program were off AFDC/TANF and 49 percent were employed. Eighty-six percent of those assigned to the two year time limit in the FTP program left welfare before the limit was reached. Half of those who hit their time limit and were forced off AFDC quickly found jobs that paid considerably more than their welfare allowance (Bloom, Farrell, Kemple and Verma 1998). As the welfare-to-work program models developed in these states are applied more generally, national caseloads will fall and employment of former welfare recipients will rise. Welfare-to-work programs are becoming more effective because of (a) the lessons learned in the early prototypes, (b) tighter labor markets, (c) more generous tax credits for hiring welfare recipients and (d) substantially better funding. As caseloads have declined states have been reallocating their federal block grant from cash assistance to job search assistance, skill development and workfare jobs. Thus as those with few barriers to employment find

unsubsidized jobs more money becomes available to train and provide workfare jobs for those who remain on welfare. Time limit clocks have started everywhere, but have not run out for most welfare recipients. In the longer run, ex-welfare recipients who take jobs will develop the skills and work habits that will allow them to move up to better jobs and the example of their success will change the culture of poverty neighborhoods.

There is a limit, however, to how much the employment of single mothers can rise from 2<sup>nd</sup> quarter of 1998 levels. During that quarter unemployment rates were 4.4 percent overall and 10.6 percent for single mothers (down from 14.9 percent in 1994.) Further reductions in unemployment rates of single parents are probably not feasible. Labor force participation rates of single parents can increase from current levels, but it seems unlikely that they would ever exceed 90 percent. If that is the upper bound, the labor force increase since 1994.Q1 is already 46 percent of the potential gain for never married and separated mothers and 41 percent of the potential gain for divorced mothers.

In March 1998, 3,224,052 families were receiving TANF assistance. About 2.9 million of these families were female-headed single parent households. The number of non-working female single parents (either unemployed or out of the labor force) during the 2<sup>nd</sup> quarter of 1998 was almost identical--2,988,000. If participation rates were to rise to 90 percent, another 1,314,000 female single parents would be added to the labor force and their employment would rise by about 1,175,000 (assuming no change in the number of single parents and in unemployment rates). The total number of jobs in the economy would have increased by one percent. Nevertheless, 1.8 million single parents would remain without a job. Alimony, child support, OASDI, Supplementary Security Income and unemployment insurance would support many of these families, but for many others TANF would be the primary safety net. TANF cash assistance may shrink substantially from current levels but it is not going to disappear.

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