

# **Economic Conditions and Welfare Reform**

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## **Chapter 1 - Introduction**

### **What Are the Early Lessons?**

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The papers in this volume were commissioned and presented at a conference held in November 1998 in Washington, D.C. The Joint Center for Poverty Research at the University of Chicago and Northwestern University organized the conference, which was funded by the Office of the Assistant Secretary for Planning and Evaluation (ASPE) at the Department of Health and Human Services. Assisting me in planning the conference were Greg Duncan of Northwestern University and Donald Oellerich of ASPE. Special thanks are due to the conference discussants and participants, who provided valuable suggestions for the revisions that are published here, and to Julie Balzekas and Diane Kallenback for excellent staff assistance.

Based on early analyses of the effects of the 1996 welfare reform act, this introduction focuses on three key questions: Why are caseloads falling? How are recipients faring? How are the states responding?

#### **REFORMING WELFARE**

Welfare reform has generated a great deal of interest in the 1990s. No other domestic policy has generated such intense media coverage, popular discussion, and policy debate. This round of welfare reform began when presidential candidate Clinton gave a 1992 campaign speech calling for dramatic changes in welfare policy: "No one who works full-time and has children at home should be poor anymore. No one who can work should be able to stay on welfare forever." Shortly after Clinton took office, he appointed an interagency task force to turn this promise into legislation. At the time, few expected the years of contentious debate that ensued. In the summer of 1994, the Clinton administration issued its welfare reform plan; it was set aside after the Republican victory in the 1994 elections. A Republican welfare reform plan that had been part of the "Contract with America" shaped much of the subsequent debate. In August 1996, amid great controversy, Congress passed and the president signed P.L. 104-93, the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA).

Since 1996, much attention has focused on the effects of PRWORA. In this volume, economists and policy analysts use the best data that are currently available and sophisticated research techniques to answer some key policy questions. Their goal is to evaluate what has happened to date and what is likely to happen as the business cycle ebbs and flows in the coming years. In particular,

the authors were asked to use their analyses to predict what is likely to happen to welfare caseloads, to recipient well-being, and to state budgets and policies when the next recession arrives. The authors present their estimates and predictions, but they leave it to the reader to weigh the available evidence and decide how successful PRWORA has been in its first few years of “ending welfare as we know it” and to consider how welfare reform might be further reformed when the 1996 act comes up for re-authorization.

The 1996 act represents a dramatic change in the way cash assistance and services are delivered to single mothers and their children. The Aid to Families with Dependent Children (AFDC) program had evolved over the previous 60 years to provide cash benefits to all who met state and federal eligibility criteria. Benefit levels were set by the states, but total costs for this entitlement program were shared between the states and the federal government. The Temporary Assistance to Needy Families (TANF) program, which replaced AFDC, now provides greater discretion to the states concerning eligibility criteria, work requirements, and other programmatic rules. In return, the federal government provides a block grant of fixed size to each state and no longer shares in the cost increases or decreases associated with rising or falling caseloads. The provisions of TANF are discussed in detail in this volume, especially in the chapters of Part III.

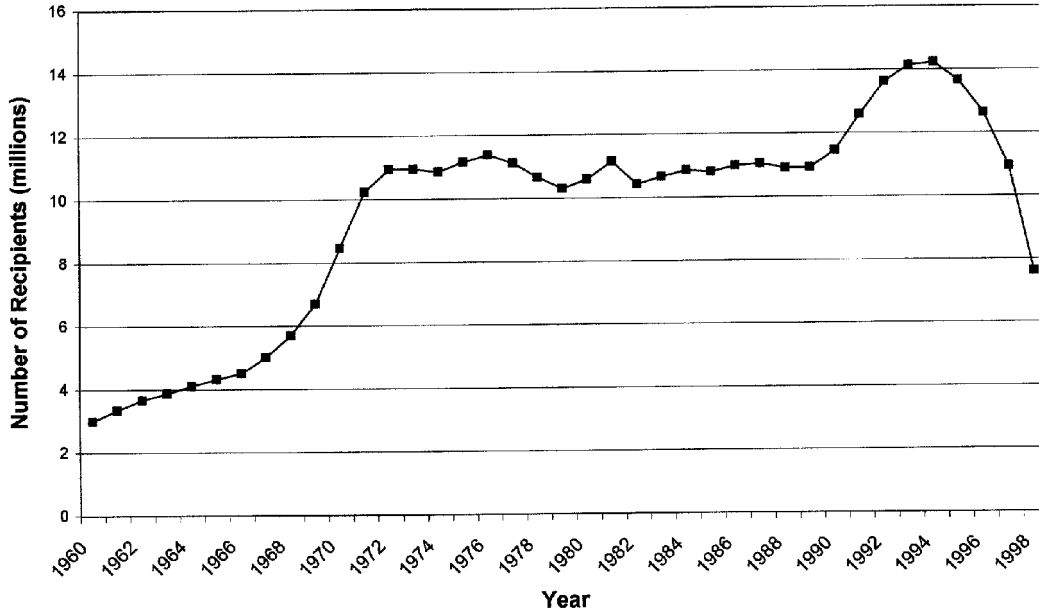
Welfare reform has led to a more rapid decline in the cash assistance caseload than most analysts would have predicted in 1996 when the act was signed. In part, this is because few analysts predicted that the economy would continue to grow so rapidly with so little inflation and with such low unemployment rates. As the papers in Part I discuss, welfare caseloads began falling several years before PRWORA became law, but caseload declines have accelerated since that time.

Consider the trend in the number of welfare recipients (first under AFDC, now under TANF) from 1960 to December 1998 (Figure 1). The caseload rose rapidly in the aftermath of the “War on Poverty” from about 4 million persons in the mid 1960s to about 10 million by the early 1970s; it then fluctuated between 10 and 12 million until the early 1990s, when it rose to about 14 million. By December 1998, the caseload had declined to about 7.5 million, 47 percent below the level of January 1994 and 38 percent below the level of August 1996.<sup>1</sup> The four papers in Part I of this volume analyze the causes of these caseload fluctuations, primarily through 1996, due to data constraints.

Reducing caseloads is a major goal of welfare reform, but it is not the only goal. One issue that has not been resolved in the few years since PRWORA was enacted is how recipients who have left the rolls are faring in the labor market. How interested are employers in hiring them? What kinds of jobs are they getting? How much are they earning? The tight labor markets and low unemployment rates of the late 1990s provide the best possible environment for welfare recipients who are entering the labor market. As a result, the caseload declines have been

accompanied by increased employment among unmarried mothers. However, the increased employment has not led to increased economic well-being for some former recipients, and some of the most disadvantaged single mothers have been unable to find jobs. The two papers in Part II address these issues.

**Figure 1 AFDC Recipients 1960–1998**



Some other recent studies that have focused on all single mothers, regardless of welfare participation, are relevant to understanding the overall labor market context in which welfare reform is proceeding. First, more unmarried mothers are working. According to Gary Burtless (1998), by 1998 the employment-to-population ratio of unmarried mothers—divorced, separated, and never-married women—had caught up with that of married mothers, at about 66 percent. This ratio rose only 2.2 percentage points in the 14 years prior to 1993, but rose 11.5 points between that year and 1998.

Second, the poverty rate for single mothers remains quite high, in part because welfare caseloads have fallen much faster than the poverty rate. Consider the trend in the official poverty rate for families with female householders and no husband present (the group from which most welfare recipients are drawn). According to the Census Bureau (P-60, no. 201), the 1997 rate (35.1 percent) is about the same as the 1989 rate (35.9 percent) and the 1979 rate (34.9 percent). This suggests that many of those who are leaving the cash assistance rolls remain poor. It is possible, however, that the data for 1998 and 1999, when available, will show that poverty rates have fallen further as the economy has continued to grow and caseloads have continued to fall during these years.

On the other hand, the experience in the year following PRWORA suggests caution. Wendell Primus (1999) documents that disposable income increased on

average for all single mothers between 1993 and 1997. Yet, the poorest fifth of single-mother families, many of whom are current or former welfare recipients, had less disposable income in 1997 than in 1995. The disposable income of the next fifth of these families was unchanged over these two years because declines in income from public assistance programs offset increased earnings and benefits from the Earned Income Tax Credit.

Although there has been some discussion about how families that were receiving cash assistance are faring, much greater attention has been given by policymakers and the media to caseload declines. A few studies on how families are faring have recently appeared, and many more will appear in the next few years. It takes time to gather and evaluate this evidence, as it is more difficult to follow families leaving welfare and find out about their incomes than it is to count the number of families remaining on the welfare rolls. Several continuing studies and the Cancian et al. study (Chapter 6 in this volume) suggest that reductions in caseloads do not mean that most families who leave the rolls are “making it.” Recipients are looking harder for jobs in response to the increased policy pressure than were recipients prior to 1996; and, in part because the labor market is so tight, many are getting jobs. Greater numbers of recipients have left the rolls than are getting jobs, however.

In addition, in some states, recipients have been terminated from the rolls because of rule changes, not because they are finding jobs. For example, a report in *The New York Times* (“West Virginia Trims Welfare, but Poor Remain,” March 7, 1999) noted that West Virginia had begun to count child Supplemental Security Income (SSI) benefits as income for TANF recipients, rendering them ineligible for TANF benefits regardless of their ability to find work. A court ruling subsequently overturned this policy. Yet, this demonstrates that some states have instituted administrative rule changes that have reduced caseloads, with little regard for the employability of the affected recipients. For example, some states are pursuing diversion policies that attempt to minimize the number of applicants who enter the rolls, and other states, sanction policies that attempt to maximize exit from the rolls.

To date, all studies, including those in this volume (which were completed in early 1999) can provide only short-term responses to the questions posed here. Because it has only been three years since welfare reform was passed and because macroeconomic conditions have been unusually good, we do not yet know how families who have left the rolls will fare in the long run or in ordinary or recessionary economic periods. Some recipients who have left the rolls, even if they now have earnings below their former welfare benefit level, may gain additional hours of work and/or wage increases if they stay employed. Of course, their current situation might be better than their long run prospects because the labor market is so tight.

Over the next few years, we will learn much more about the issues

analyzed in this volume. For now, however, the chapters that follow tell us about what we have learned so far and speculate about what might happen in the long run. In particular, the authors consider what is likely to happen during an economic slowdown: How responsive are caseloads to changes in economic conditions and policy changes? How are recipients likely to fare as employer willingness to hire them fluctuates over the business cycle? What policy changes might state governments undertake? I now turn to a brief summary of the chapters. Parts I, II and III are organized around the three broad questions: Why are caseloads falling? How are recipients faring? How are the states responding?

## **WHY ARE CASELOADS FALLING?**

The four papers in Part I analyze trends in welfare caseloads in recent years, with particular emphasis on sorting out how much of the caseload changes—increases in the late 1980s and early 1990s, followed by decreases—can be attributed to macroeconomic conditions and how much to welfare reform policy changes. A careful reading of all four papers, each of which uses different data or different estimation strategies, shows how difficult it is to explain caseload changes.

In Chapter 2, David Figlio and James Ziliak attempt to reconcile a controversy about the relative effects of changes in the unemployment rate and pre-TANF changes in state welfare policies on the welfare caseload. In 1997, a paper by staff members of the President’s Council of Economic Advisers (CEA) attributed more than one-third of the decline in caseloads between 1993 and 1996 to declining unemployment and less than one-third to state waiver policies. Another 1997 paper by Ziliak, Figlio, and colleagues attributed a greater share to the former and a smaller share to the latter. In their replication of the CEA model, about one-third of the caseload decline is again attributed to the economy, but only about one-sixth to waivers; their preferred models attribute about half to three-quarters of the change to the economy, but virtually none to welfare reform. Figlio and Ziliak conclude that these differences are due to the fact that the CEA uses a static model, while they prefer a dynamic one, and that “the primary consequence of controlling for caseload dynamics is to reduce the role of welfare reform relative to the macroeconomy in generating the decline in AFDC caseloads.” They also point out that welfare reform has played a larger role in the post-PRWORA caseload decline than it did prior to 1996.

In Chapter 3, Geoffrey Wallace and Rebecca Blank analyze trends in both AFDC and food stamp caseloads for the 1980–1996 period. They document a significant unexplained increase in both caseloads, even after they control for a broad range of economic, demographic, political, and policy-related variables. During the 1994–1996 period, about half of the AFDC caseload change is attributed to the unemployment rate and about one-fifth to state welfare waivers, but for the 1994–1998 period, a much smaller part of the decline is due to unemployment rate changes. They conclude that, based on their historical

estimates, “the expected effect of any future one-point increase in unemployment will be to increase TANF caseloads by 4 to 6 percent and food stamp caseloads by 6 to 7 percent.” This suggests that a severe recession that raises the unemployment rate by 3–4 percentage points, to 7.5–8 percent, would leave welfare caseloads well below the levels reached in the early 1990s. They conclude that the 1996 welfare reform seems to have achieved a large reduction in caseloads independent of the state of the economy.

In Chapter 4, Robert Moffitt applies the CEA methodology not to time series data, but to micro data from the 1976–1996 Current Population Surveys. This allows him to focus more directly on specific population groups such as less-educated women, who are most likely to be affected by welfare reform, and to examine not only changes in welfare caseloads, but also changes in earnings and family income. He finds that state welfare waivers reduced AFDC participation rates among women without high school degrees and increased their labor force attachment, but had little effect on their earnings. Women who were high school graduates fared better: their AFDC participation rates fell, their work effort increased, and their earnings also increased.

In Chapter 5, Timothy Bartik and Randall Eberts extend the kinds of models estimated by the CEA, Figlio and Ziliak, and Wallace and Blank to include measures of economic conditions other than unemployment rates, notably labor demand factors. They focus on state employment growth, the wage premium associated with an area’s industrial mix, the educational requirements implied by the industrial mix, and the extent to which a state’s industries tend to employ welfare recipients. They find that a welfare recipient faces greater barriers to employment than does a typical worker because of low educational attainment and greater volatility in industries that tend to hire recipients, and that caseloads are higher in states with higher concentrations of industries that hire more educated workers. They conclude that the national trend toward higher educational requirements in many industries can account for some of the increase in welfare caseloads in the late 1980s and early 1990s.

## **HOW ARE RECIPIENTS FARING?**

The two papers in Part II focus on the labor market, first on recipient work and earnings outcomes and then on employer willingness to hire welfare recipients. The findings are similar to those in the Moffitt and Bartik/Eberts chapters; i.e., the least-skilled have the hardest time making it in the labor market.

In Chapter 6, Maria Cancian and her colleagues review evidence from several data sources about the post-welfare work effort and the economic well-being of former recipients. Although most former recipients can find some work, most cannot get and keep full-time, year-round work. In their analysis of pre-TANF data from the National Longitudinal Survey of Youth, in each of the five years after exit, about two-thirds worked. However, in any of these years,

only about one-sixth to about one-quarter worked full-time, full-year. The same was true in the post-TANF Wisconsin administrative data they analyze; during the first year after leaving the rolls, about two-thirds of leavers worked. They also found that most former recipients (at least in the first few years) will earn relatively low wages, between \$6.50 and \$7.50 per hour. This is not surprising, given that welfare recipients have low skills and that the real wages of less-skilled workers have fallen dramatically over the past quarter century and have not increased much during the current economic boom.

This finding about the wage prospects of less-skilled workers is not new. It was the motivation for the proposal of the first Clinton administration “to make work pay and end welfare as we know it.” This suggests that former welfare recipients will continue to need government income supplements if they are to support their family at incomes above the poverty line. The expanded Earned Income Tax Credit (EITC) has a very important role here, as does post-welfare access to subsidized child care, health care, and food stamps. As the Cancian et al. chapter cautions, “Even consistent work may not suffice for self-support if wages are low . . . The relatively modest growth in wages for this sample is inconsistent with the suggestion that even if former welfare recipients start in low-paying jobs, they will soon move on to jobs that pay wages that can support a family above the poverty line.” The good news in Wisconsin for the sample of families that had left the welfare rolls is that twice as many of them were above the poverty line relative to those remaining on the rolls. Yet, only 27 percent of those who left cash assistance and did not return escaped poverty, and only about one-third of all leavers obtained the income level they received just before they left welfare.

An additional caveat is in order. The first wave of data from a panel study of welfare recipients being conducted at the University of Michigan<sup>2</sup> shows that women remaining on welfare have characteristics, not evaluated in most studies of recipients, that make their labor market prospects more problematic than those of all single mothers and even those of recipients who have already left the rolls. The study examined 14 potential barriers to employment, including major depression, post-traumatic stress disorder, maternal health, child health, labor market skills, perceived experiences of discrimination, and several standard human capital measures. It found that about 75 percent of single mothers who received cash welfare in February 1997 and had zero or one of these barriers were working in Fall 1997, whereas only about 40 percent of those with four or more barriers were working. As welfare caseloads continue to decline, this suggests that the recipients who remain will be the least employable.

In Chapter 7, Harry Holzer presents evidence from his survey of a large sample of employers in several metropolitan areas in Michigan. He concludes that labor market tightness has a substantial effect on employer demand for welfare recipients. Like Cancian et al., he finds that most welfare recipients can get some work when labor markets are very tight, as they have been in the late 1990s. In

fact, many of the employers whom Holzer interviewed in Fall 1997 told him that they were willing to hire welfare recipients in 1998, although many had not yet done so. Thus, a recession is likely to significantly reduce employer demand for less-skilled workers in general and welfare recipients in particular, because, at the time of the interviews, the employers expected labor market tightness to increase and they were already having difficulty filling current vacant positions. Holzer estimates that a recession would reduce demand for recipients by 25 to 40 percent from current levels, suggesting that the employment experience of recipients may provide a classic example of the “last hired, first fired” syndrome. In addition, he finds that employers are more receptive to many public interventions on behalf of welfare recipients (such as tax credits for hiring or training workers) because of current labor market tightness and their difficulty in finding qualified workers.

### **HOW ARE THE STATES RESPONDING?**

The three chapters in Part III all focus on what states are doing now and how they are likely to respond when a recession comes. This is uncharted territory, as PRWORA has given states a fixed block grant along with greater discretion. The block grant provides states in each year with an amount of federal funds that is the higher of the 1994 or 1995 level or the average for the 1992–1994 period. Because welfare caseloads were much higher during these years than they now are, this has produced a financial windfall for the states. However, as the authors discuss, the federal government will not share the increased welfare costs associated with a recession as it did in the past.

In Chapter 8, LaDonna Pavetti analyzes how states have begun to implement the new work-oriented welfare system in a “resource-rich” environment. Given available resources and declining caseloads, many states have provided expanded job search assistance and support services to many more recipients than was the case prior to PRWORA. The challenge when the economy turns down, according to Pavetti, is that state resources will be fixed, the number of recipients seeking assistance will increase, jobs will be harder to find, and time limits will have come into effect in a greater number of states. She concludes that given the emphasis on mandatory work, it may be necessary to broaden the definition of what constitutes participation in a work activity. Alternatives include increased use of vocational education or training programs, participation in community work experience or public service employment programs, or volunteer activities in the community.

Pavetti’s concerns are important given the difficulty of many former recipients in finding stable employment in the tight labor market of 1998 and 1999. She suggests that states should begin experimenting with community service employment or work-for-your-welfare policy options now, while caseloads are still declining and resources are plentiful. The next recession is likely to occur when some single mothers will have already exhausted their lifetime eligibility for TANF benefits. It will be easier to pilot these programs now when the labor market is

good than to reach the next recession without this kind of safety net in place.<sup>3</sup>

In Chapter 9, Phillip Levine examines how much states will likely be forced to spend on additional welfare payments in the event of a recession. He concludes that costs will rise by \$7–14 billion, depending on the severity of the recession, and this will impose a serious financial burden on some states. He also shows that the rules governing how states can draw funds from the federal contingency fund are such that many states will receive little relief. Levine uses the states' experiences with the unemployment insurance system to predict how states are likely to handle the burden imposed by the increased cyclicalities of their welfare spending. His simulations suggest that some states will have a very hard time saving for a rainy day.

In Chapter 10, Howard Chernick and Therese McGuire speculate about how states might respond now that the open-ended matching grant program of AFDC has been changed to a fixed block grant. They analyze the long-run spending responses of governments to other matching and block grants and past variations in state revenues and expenditures over the business cycle. They argue that because PRWORA's maintenance-of-effort requirement limits a state's spending reduction to 20 or 25 percent of the 1994 level, and because caseloads have already declined by so much, the shift to TANF's block grant has not led to immediate cuts in benefit levels. Over time, benefits are likely to be, at most, 10 percent lower as a consequence of the price increase for public assistance that is associated with PRWORA's elimination of matching grants. This reduction does not lend support to the idea that there will be a "race to the bottom" in state benefit levels. They estimate that in a recession comparable in magnitude to the 1990–1991 recession, most states should be able to avoid drastic spending cuts. However, in the past, some states have sharply reduced their welfare spending in response to a downturn, and some states now have tax systems that make their revenues especially sensitive to economic downturns. Some states, like California, are considered likely to face difficult problems by both the Levine and the Chernick/McGuire analyses.

## **SUMMARY**

Taken together, the chapters in this volume suggest that, in its first few years, the 1996 welfare reform has been more successful in some dimensions (notably, reducing caseloads) than in others (raising disposable income). Much of the success to date is due to a booming economy and to a fiscal environment in which states have more funds to spend per recipient than they had in the past. Nonetheless, even under these optimal economic and fiscal conditions, some recipients have already "slipped through the cracks." The end of entitlement has meant that some single mothers, with poor labor market prospects and no other means of support, have not received the benefits they would have under the pre-PRWORA welfare system. Indeed, there are concerns that some recipients have lost not only their cash assistance, but also the food stamp and Medicaid

benefits to which they are still entitled.

The chapters collectively raise a cautionary flag that, given current rules, much of the success achieved to date may disappear during the next recession. The cyclical effects on state budgets will be greater during the next recession than they were during previous ones. Then, some single mothers will have reached their lifetime benefit limit and will require benefit extensions/exemptions; others will not be able to get benefits to which they are eligible without some changes in diversion/sanction policies; and both groups may need access to community service jobs if they are to avoid serious material hardships.

The authors analyze some of the key issues that Congress and the next administration should consider when the 1996 act comes up for re-authorization, and they provide a road map for “reforming welfare reform” to avoid problems that are inherent in current law. State policymakers would also be well-served if they began to make contingency plans in response to the authors’ projections. To end on an optimistic note, the relative success of welfare reform in reducing caseloads may have created the fiscal and political context that will allow the reforming of welfare reform in order to better serve those who need further assistance, especially those who have fallen through the cracks in the new safety net.

### **Notes**

1. For the most recent caseload statistics by state, see the web site of the Administration for Children and Families, [www.acf.dhhs.gov/news/stats/caseload.htm](http://www.acf.dhhs.gov/news/stats/caseload.htm).
2. Sandra Danziger, Mary Corcoran, Sheldon Danziger, Colleen Heflin, Ariel Kalil, Judith Levine, Daniel Rosen, Kristin Seefeldt, Kristine Siefert, and Richard Tolman. “Barriers to the Employment of Welfare Recipients.” University of Michigan School of Social Work, April 1999, [www.ssw.umich.edu/poverty/pubs.html](http://www.ssw.umich.edu/poverty/pubs.html).
3. For a discussion of current state and local efforts in this area, see Clifford Johnson, “Publicly-Funded Jobs for Hard-to-Employ Welfare Recipients,” Center on Budget and Policy Priorities, March 1, 1999, [www.cbpp.org](http://www.cbpp.org).

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