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When Is Tinkering with Safety Net Programs Harmful to Beneficiaries?

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The U.S. safety net has many moving parts. Redistributive transfers are made in cash and in kind, often come through regulation, and are implemented by multiple levels of government. Arrangements related to health care and health insurance are particularly complicated, as low-income households must navigate eligibility for free care, Medicaid, subsidized coverage, and employer-provided coverage.

Policymakers tinker with program parameters regularly. The desirability of any policy change depends crucially, of course, on the particulars of the program involved. Our work takes up a question that is distinct from standard program-specific welfare analysis. We ask whether policy tinkering per se can affect program beneficiaries' well-being.

The effects of policy tinkering depend on the ease with which beneficiaries navigate both the labor market and the programs in which they participate. Changes in program generosity and eligibility rules can alter beneficiaries' budget constraints in both anticipated and unanticipated ways. If responding to such changes is difficult, they may generate significant costs. Alternatively, if little effort is required for beneficiaries to adapt, such adjustments may be a nuisance rather than a substantive concern. To shed light on the relevance of adjustment costs, we analyze a setting well suited for precisely this purpose. We empirically and theoretically analyze the responses of working Medicaid beneficiaries to minimum wage increases. When the minimum wage rises, jobs that initially enabled workers to maintain Medicaid eligibility may no longer do so. Because Medicaid eligibility phases out with a "notch," small changes in earnings can affect eligibility for benefits worth thousands of dollars. In addition to influencing labor demand, as analyzed in the voluminous literature, a minimum wage increase may thus, in this scenario, have surprising effects on workers' preferences for hours of work.

The implications of interactions between Medicaid eligibility notches and the minimum wage depend on factors such as the cost of searching for a job and the rigidity of firms' job offerings. If adjustment is seamless, a change in a notch's location (that is, the wage limit set for eligibility)

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may have minimal welfare implications; workers shifted out of eligibility can reduce hours slightly to maintain benefits. If there are significant labor market frictions, however, reducing hours may require a costly search for alternative employment. Workers shifted over a notch may lose access to benefits while they seek employment that permits fewer hours of work. Some may exit employment to maintain benefit eligibility. Loss of benefits, loss of earned income, and time spent searching are all costly. The implications of a shift in an eligibility notch's location thus depend crucially on the relevance of these frictions.

Analyzing the program of interest requires high frequency panel data on wage rates, Medicaid participation, employment, and job searches. The Survey of Income and Program Participation (SIPP) is uniquely suitable for this purpose. Using the 2008 SIPP panel, we estimate the responses of low-wage adult Medicaid beneficiaries to the July 2009 increase in the federal minimum wage. In July 2009, the federal minimum wage rose from $6.55 to $7.25 per hour. Between 2007 and 2009, many states saw their effective minimum wages rise by 40 percent (from $5.15 to $7.25). These increases were disproportionately binding in states whose initial minimum wage rates were well below $7.25, generating natural treatment and control groups for us to analyze.

For minimum wage workers, the cumulative $2.10 minimum wage increase implied a 40 percent reduction in the work hours linked to Medicaid eligibility thresholds. Importantly, this period's eligibility thresholds were often well below 50 percent of the federal poverty line. For adults in many states, maintaining employment and Medicaid eligibility could thus be difficult.

In our sample of affected workers, binding minimum wage increases were followed by declines in Medicaid participation, declines in employment, and increases in job searches. The observed outcomes point to an important role for adjustment costs in the labor markets faced by low-skilled workers.

There are two problems with interpreting the observed changes in employment, insurance status, and job searches as being caused by the interaction between minimum wage increases and the Medicaid eligibility notch. First, the states bound by this period's minimum wage increases also had relatively low Medicaid eligibility thresholds. It is thus possible that the transitions of working Medicaid beneficiaries from these "bound" states would have differed from the transitions of those in "unbound" states in the absence of minimum wage changes. We explore the relevance of this problem by examining the transitions of similarly selected samples during earlier SIPP panels. We find that working Medicaid beneficiaries in bound states were indeed more likely to transition away from Medicaid in prior periods, though only moderately so.

Second, employment and insurance transitions may in part reflect the Great Recession's different effects between states. We thus explore the robustness of our results to the inclusion of proxies for the Great Recession's severity. Our baseline analysis directly controls for a housing price index from the Federal Housing Finance Agency. We show that alternative approaches to controlling for variations in the Great Recession's severity have little impact on our estimates. The employment and insurance transitions we observe thus do not appear to have been driven by differences in macroeconomic factors.

Our analysis complements existing work on the potential costs associated with administratively complex benefit designs. The findings imply that the costs of adjusting to changes in complex benefit designs are relevant to the question of how best to design society's safety net. The setting we analyze also presents a novel opportunity to learn about labor markets. Our evidence suggests that labor market frictions can be substantial, while other work on frictions focuses primarily on middle- to high-income taxpayers and the elderly. Our evidence suggests that frictions may also be essential for understanding labor supply responses to low-income support programs.

NOTE

This research brief is based on Jeffrey Clemens and Michael J. Wither, "When Is Tinkering with Safety Net Programs Harmful to Beneficiaries?," NBER Working Paper no. 29028, July 2021, http://www.nber.org/papers/w29028.

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