WELFARE REFORM

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THE ISSUE: THE U.S. WELFARE SYSTEM MAKES IT HARD TO MOVE FROM WELFARE TO WORK AND TO BECOME SELF-SUFFICIENT

The bulk of government efforts to fight poverty can be best described as throwing money at the problem. Contrary to public perception, the American welfare system is far from stingy. Although the exact number fluctuates yearly, the federal government funds more than 100 separate anti-poverty programs. Some 70 of these provide cash or in-kind benefits to individuals, while the remainder target specific groups.

Altogether, the federal government spent more than $1.1 trillion on welfare programs in 2021. State and local governments added about $744 billion in additional funding. Thus, government at all levels is spending roughly $1.8 trillion per year to fight poverty (not counting payments related to COVID-19). Stretching back to 1965, when President Lyndon Johnson first declared war on poverty, anti-poverty spending has totaled more than $25 trillion.[1]

Yet the results of all this spending have been disappointing. In terms of material deprivation, welfare payments have reduced poverty. In fact, a 2018 Cato Institute study suggests that if all benefits and other factors are fully accounted for, the true poverty rate may be under 3 percent.[2] Other studies are more cautious but still suggest that welfare programs reduce poverty rates by half or more. On the other hand, these studies also suggest that most of the improvement took place in the welfare programs' early years, and that the marginal gains of recent additional spending have been minimal.

More significantly, current welfare policy seems almost perversely designed to work against its overarching goal of enabling Americans to not just endure poverty more comfortably but to escape it altogether. This goal requires that the incentives within the welfare system encourage work, savings, and family formation. Overall, the system should make it as easy as possible for people to leave welfare for work, but several factors undermine that objective.

First, the magnitude of the current welfare system, with its multitude of overlapping programs—often with contradictory eligibility requirements, differing rules, mixed oversight, and divided management—is a bureaucratic nightmare.

For example, there are 34 housing programs run by seven different cabinet departments, including even the Department of Energy. There are 23 different programs providing food or food-purchasing assistance administered by three different cabinet departments. There are 13 different healthcare programs administered by three separate agencies within the Department of Health and Human Services as well as the Department of Veteran Affairs. Five cabinet departments oversee 15 cash or general-assistance programs. Altogether, 13 cabinet departments and four independent agencies administer at least one explicitly anti-poverty program.[3]

The complexity and lack of transparency make it difficult to measure whether programs are accomplishing their goals. Many existing programs have become fiefs for special interests, providing a bureaucratic roadblock to reform. And, while the overhead and administrative costs for most programs are modest (generally less than 5 percent), the costs do add up. Moreover, the sheer number of programs works to suck more people into the welfare system, increasing both cost and enrollment, without necessarily targeting those efforts to the people who are most in need.

Second, households in or near poverty that do receive assistance and participate in multiple programs can face marginal effective tax rates that are counterproductive, deterring work effort or putting a low ceiling on how much these families can increase their standard of living. In those cases, much of each additional dollar earned is clawed back through higher taxes or reduced benefits.

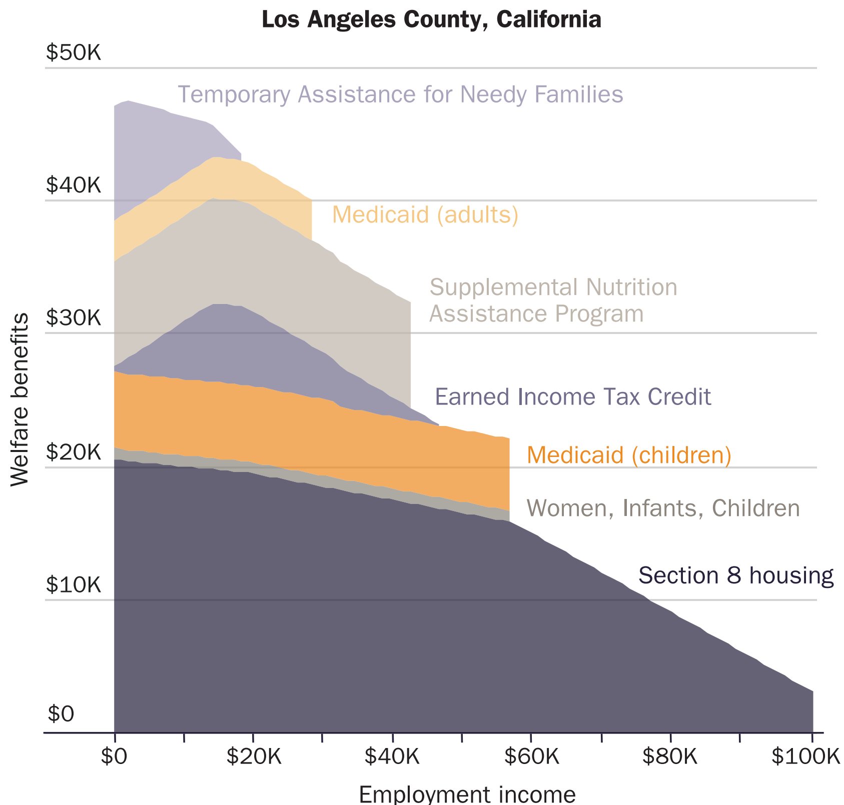
A 2013 Cato Institute study, for example, found that an unemployed single mother with two children who participated in seven common welfare programs—Temporary Assistance for Needy Families (TANF); food stamps (SNAP); Medicaid; housing assistance; Special Supplemental Nutrition Program for Women, Infants, and Children (WIC); energy assistance (LIHEAP); and free commodities—could take home an income higher than what she would have earned from a minimum-wage job in 35 states, even after accounting for the Earned Income Tax Credit (EITC) and Child Tax Credit (CTC), for which she would have been eligible, if employed. In fact, in Connecticut, Hawaii, Massachusetts, New Jersey, New York, Rhode Island, Vermont, and Washington, DC, welfare paid more than a $20 per hour job ($25.44 in 2022 dollars), and in five additional states it paid more than a $15 per hour job ($19.08 in 2022 dollars) job.[4] As a result, someone who left welfare for work could have found themselves worse off financially.

A 2012 Congressional Budget Office report looking at the example of Pennsylvania found that marginal tax rates, after accounting for the loss of benefits, could reach extremely high levels, discouraging labor-force entry and work hours. The report found that unemployed single taxpayers with one child would face an effective marginal tax rate of 47 percent for taking a job paying the minimum wage in 2012, and if their earnings disqualified them from Medicaid, they could have faced an astonishing marginal tax rate of 95 percent.[5]

Likewise, Maag et al. (2012), looking at a single parent with two children, found that in moving from no earnings to poverty-level earnings, this family faced a marginal tax rate that was as high as 25.5 percent in Hawaii.[6] A 2014 Illinois Policy Institute study found that a single mother with two children in that state who increased her hourly earnings from the minimum wage of $8.25 to $12 would increase her net take-home wage by less than $400 per year. Even worse, if she further increased her earnings to $18 an hour, her annual net income would *decrease* by more than $24,800 due to benefit reductions and tax increases.[7]

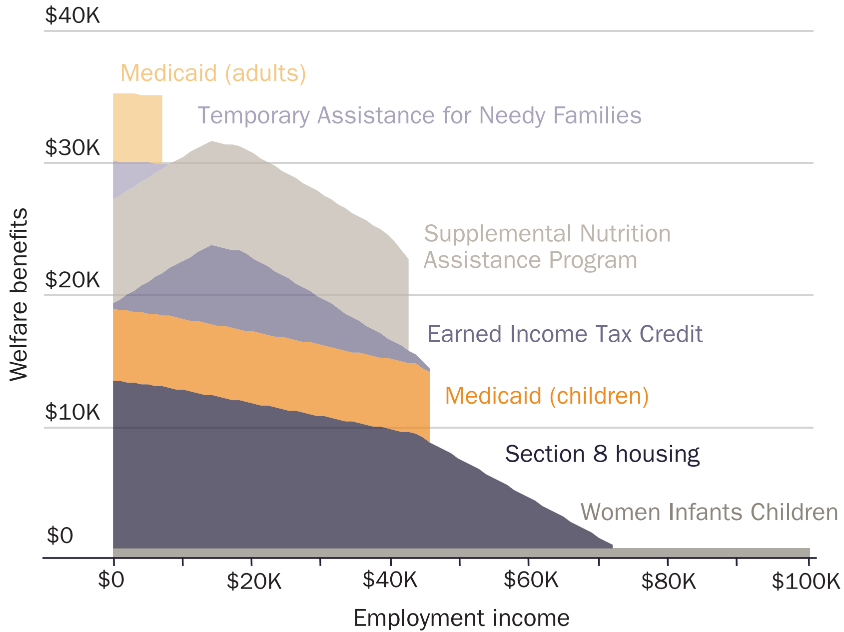
Although inflation and policy changes over the last decade have changed some of these studies' details, the general conclusions remain the same today. For example, the Federal Reserve Bank of Atlanta's Career Ladder Identifier and Financial Forecaster Policy Rules Database illustrates the public assistance program eligibility based on household incomes. The examples in Figures 1A and 1B depict the welfare benefits earned by a single parent with two children under five years of age. The most common welfare programs (TANF, SNAP, EITC, WIC, Medicaid, and Section 8 Housing Vouchers) were chosen to portray the benefit drop-off as household incomes increase.[8] The two counties in question, Los Angeles County, California, and Wake County, North Carolina, have very different eligibility rules for various programs leading to differing marginal tax rates in the two jurisdictions. Yet both show a sizable barrier to leaving welfare for work.

FIGURE 1A Across the country, income-related benefit "cliffs" can discourage welfare recipients from taking new jobs or working more hours



Source: Policy Rules Database Dashboard from the Federal Reserve Bank of Atlanta (2022).
Note: Data based on the most common welfare programs for a single parent with two children under the age of five.

FIGURE 1B Across the country, income-related benefit "cliffs" can discourage welfare recipients from taking new jobs or working more hours



Source: Policy Rules Database Dashboard from the Federal Reserve Bank of Atlanta (2022).
Note: Data based on the most common welfare programs for a single parent with two children under the age of five.

Third, many programs are designed in ways that further discourage economic and geographic mobility. Some also include a bias against marriage, which has been shown to be correlated with higher earnings and financial independence. A mother who marries the father of her children may lose a substantial portion of her benefits depending on her new spouse's income. Unmarried parents are better able to meet the income and asset eligibility tests for programs such as TANF and SNAP. For example, if a single mother with a net income of 125 percent of the federal poverty level marries someone with an income, it could push them over the threshold, and no one in the household would be eligible for SNAP. If they chose instead to cohabitate without marrying, the benefits would continue to flow. As detailed below, there is a similar mechanism in the EITC: benefits begin to phase out and are exhausted at lower income levels for married couples.[9]

Furthermore, the majority of welfare benefits today are provided not in cash but rather as in-kind benefits. This effectively infantilizes the poor: they are not expected to budget or choose among competing priorities the way that people

who are not on welfare are expected to do, and they simply follow the government's choices, values, and priorities instead of their own. Indeed, direct cash assistance programs, including refundable tax credits, made up just 22 percent of federal assistance in 2020, down from roughly 29 percent two decades ago. In-kind programs—such as food stamps, housing assistance, and Medicaid—provide the poor with assistance, but only for specific purposes. In most cases, the payments are made directly to providers. The person being helped never even sees the money.

Virtually all programs go even further in limiting the use of benefits to government-approved purchases. For example, WIC can only be used to purchase certain foods determined by government regulation. SNAP's use is restricted to stores that stock a certain level of healthy food products, often eliminating the eligibility of small neighborhood stores. Even with cash programs like TANF, state lawmakers have enacted a host of restrictions around things like the locations where electronic benefit transfer cards may be used to access ATMs.

Thus, the current welfare system not only stigmatizes the poor, but also is one more factor pushing them into narrowly concentrated neighborhoods clustered around subsidized housing because the system relies on providers who are willing to accept government benefits (e.g., landlords willing to take Section 8 vouchers). Those neighborhoods often offer poor schools, few jobs, high crime rates, a lack of role models, and have been shown to inhibit residents' upward income mobility.[10]

One program that provides cash directly to the poor is the EITC, but it is rife with problems that discourage work and family formation. The EITC is specifically designed as a wage supplement and is tied directly to work to offset the high marginal tax rate that many poor people encounter when they leave welfare for work. The evidence suggests that the EITC increases work effort, and single mothers, in particular, have seen significant labor-force gains.

Studies also suggest that the EITC has been more successful than other welfare programs in reducing poverty. The Census Bureau claims that the poverty rate would be 2.5 percent higher in the absence of refundable tax credits.[11] As measured by the additional outlays needed to lift one million people out of poverty (using the supplemental poverty measure), refundable tax credits are clearly more cost-effective than other types of welfare programs.

As the EITC has grown, however, problems with the program have become more apparent. For example, the benefit level for childless workers is small and phases out quickly because the EITC focuses on families. The maximum credit available to a childless worker was only $1,502 in 2021, and all benefits phase out before the earned income hits $21,430 (the maximum credit for a single parent with one child was $3,618).[12] Childless workers under age 25 are not allowed to claim the EITC at all. As a result, they accounted for only 3 percent of EITC funding.

As noted above, moreover, the EITC can impose significant marriage penalties. According to the Tax Policy Center, "if a single parent receiving the EITC

marries, the addition of the spouse's income may reduce or eliminate the credit."[13] Furthermore, the credit is mostly determined by the number of children in a family, thus making the maximum credit the same for a single parent as it is for a married couple. As a result, a married couple with two children would receive a maximum annual credit of $5,980—the same as for a single filer with two children. But the married couple would exhaust EITC benefits upon hitting $53,665 of total earned income, while the single parent would do so at only a few thousand dollars less ($47,915). Thus, the single parent can continue to receive benefits at higher income levels relative to the poverty level than married couples can—and the credit is more generous since the benefits are being distributed among the three people, rather than four.

Finally, as a refundable tax credit, the EITC is paid annually in the manner of a tax refund. While such a lump-sum payment can certainly help many low-income families, it still leaves them relying on wages throughout much of the year. In its current form, the EITC represents an income supplement, not a wage supplement, and does not address the year-round financial needs of low-income families who are often left living paycheck to paycheck, or worse, for the rest of the year.

THE POLICY SOLUTIONS: CONSOLIDATE AND DECENTRALIZE FEDERAL WELFARE PROGRAMS; MOVE TO CASH TRANSFERS; EMPHASIZE INDIVIDUAL CONTROL

Given the failure of more than 50 years of federal welfare policy to significantly reduce poverty or increase economic mobility, it should be apparent that the federal government does not know best. Nor have we demonstrated that we know enough about how to reduce poverty to impose a one-size-fits-all policy throughout the country. Five decades of failure should have taught us to be modest.

Wherever possible, Congress should shift both the funding and operational authority for welfare and other anti-poverty programs to the states. The "laboratories of democracy," as Justice Louis Brandeis described them, should be the primary focus of anti-poverty efforts, not an afterthought. That means more than simply giving states the authority to tinker with programs as they exist today. It means federal funding, even in block grant form, should not be accompanied by federal strings. Instead, states should be given control over broad categories of funding, with the ability to shift funds freely between programs at their discretion, but within a framework in which their efforts are rigorously evaluated and held accountable for achieving results. Some states may wish to emphasize job training or public service jobs. Others may feel that education provides the biggest bang for the buck. In some states, housing may be a priority; in others, the need for

nutrition assistance may be greater. Some may wish to impose strict eligibility requirements, while others may choose to experiment with unconditional benefits, even a universal basic income.

Moreover, states that have successfully reduced poverty while also reducing the number of people on the welfare rolls should be allowed to shift funds to other priorities entirely. Success should be rewarded. States that fail to achieve results, after accounting for factors beyond their control, should have their funding reduced, with any shortfall made up from state funds. Failure should not be subsidized.

While shifting funds from the federal government to the states represents a good first step, the states should go even further by moving away from in-kind benefits and to direct cash payments. While it is reasonable for taxpayers to seek accountability for how their funds are used, this paternalism may be both unnecessary and self-defeating. For starters, arguments that the poor can't be trusted with cash are too often based on erroneous and racially biased stereotypes rather than on sound evidence. In fact, studies from states that drug-test welfare recipients suggest that the use of drugs is no higher among welfare recipients than among the general population.[14] And numerous studies have shown that even when welfare recipients are given totally unrestricted cash, they do not increase their expenditure on "temptation goods" like tobacco or alcohol.[15]

Furthermore, cash benefits can allow the poor to decide for themselves how much of their income should be allocated to rent, food, education, or transportation. They might also choose to save more or invest in learning new skills that will help them earn more in the future. A 2015 Financial Industry Regulatory Authority report found that 53 percent of American households with incomes less than $25,000 had no investment accounts, compared to just 1 percent of households making over $150,000 a year without investment accounts.[16] We can't expect people to behave responsibly if they are never given any responsibility.

Cash benefits also could encourage mobility, helping to break up geographic concentrations of poverty that can isolate the poor from the rest of society and reinforce the worst aspects of the poverty culture, especially if those benefits are received early in life. Armed with money instead of vouchers redeemable only at certain locations, the poor could escape bad neighborhoods the same way vouchers and tax credits allow children to escape bad schools. Doing so can produce tremendous results: Chetty et al. (2016), for example, found that families that moved into low-poverty areas before their children entered their teen years saw the children go on to earn 31 percent more later in life than did comparable children who remained in high-poverty areas. Beyond higher earnings, children from families that moved saw a wide range of other positive outcomes. They were more likely to attend college, less likely to be single parents, and more likely to live in better neighborhoods when they grew up and left home.[17]

Any cash payment system should be designed to help low-income Americans solve their immediate problems without becoming ensconced in the welfare

system. Thus, Congress could encourage states to expand existing cash-diversion programs, which provide lump-sum cash payments in lieu of traditional welfare benefits.[18] Currently in use in 32 states and DC, these programs are designed to assist families facing an immediate financial crisis or short-term need. The family is given a single cash payment in the hope that if the immediate problem is resolved, there will be no need for going on welfare. In exchange for receiving the lump-sum payment, welfare applicants in most states—but not all—give up their eligibility for TANF for a period ranging from a couple of months to a year.[19] Several studies indicate that for individuals who had not previously been on welfare, diversion programs significantly reduced their likelihood of ending up there. Studies also suggest that diversion participants are subsequently more likely to work than become traditional recipients of welfare.[20]

Finally, Congress should reform the EITC to turn it into a pure wage supplement. Benefits should be available to childless adults and should not rise with the number of children in a family. Payments should arrive monthly rather than in an annual lump sum. Any additional cost due to expansion should be paid for by reductions in other welfare programs.

ACTION PLAN

Provision of public welfare to at least some people may be justified, according to certain ethical viewpoints, but is insufficient and counterproductive to effectively deliver human flourishing. We should not judge the success of our efforts to end poverty by how much charity the state redistributes to the poor, but by how few people need such charity in the first place.

Truly improving the lives of the poor is not a question of spending slightly more or less money, tinkering with the number of hours mandated under work requirements, or rooting out fraud, waste, and abuse. We need a new debate, one that moves beyond our current approach to fighting poverty to focus on what works rather than noble sentiments or good intentions—a system built on work, individual empowerment, and Americans' philanthropic impulse.

Congress should therefore

- consolidate all current welfare and anti-poverty programs;
- shift remaining welfare programs to the states with as few strings as possible;
- encourage states to transition from in-kind benefits to cash grants;
- encourage states to make greater use of welfare diversion (lump-sum cash) programs; and
- transform the EITC into a pure wage supplement linked to work rather than family size/composition.

State governments should

- transition from in-kind benefits to cash grants;
- review benefit levels; phaseout ranges and asset and income tests to reduce "welfare cliffs" and disincentives to work, savings, and family formation;
- avoid arbitrary and punitive restrictions on the use of benefits;
- expand the use of diversion programs and lump-sum payments in lieu of traditional benefits; and
- make greater use of federal waivers to experiment with different ways to deliver benefits, combine programs, and change program incentives.

NOTES

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