

Does Work Pay? An Analysis of the Work Incentives under TANF

Gregory Acs
Norma Coe
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The Urban Institute

Occasional Paper Number 9



Assessing
the New
Federalism

*An Urban Institute
Program to Assess
Changing Social Policies*

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This report is part of The Urban Institute's *Assessing the New Federalism* project, a multi-year effort to monitor and assess the devolution of social programs from the federal to the state and local levels. Alan Weil is the project director and Anna Kondratas is deputy director. The project analyzes changes in income support, social services, and health programs. In collaboration with Child Trends, Inc., the project studies child and family well-being.

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Assessing the New Federalism

A *ssessing the New Federalism* is a multi-year Urban Institute project designed to analyze the devolution of responsibility for social programs from the federal government to the states, focusing primarily on health care, income security, job training, and social services. Researchers monitor program changes and fiscal developments. In collaboration with Child Trends, Inc., the project studies changes in family well-being. The project aims to provide timely, nonpartisan information to inform public debate and to help state and local decisionmakers carry out their new responsibilities more effectively.

Key components of the project include a household survey, studies of policies in 13 states, and a database with information on all states and the District of Columbia, available at the Urban Institute's Web site. This paper is one in a series of occasional papers analyzing information from these and other sources.

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Does Work Pay? An Analysis of the Work Incentives under TANF

Executive Summary

For years, policymakers have struggled to find ways to make a paycheck more attractive than a welfare check while still ensuring that poor children do not suffer from serious material deprivation. The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA) represents the most recent attempt to encourage families to leave welfare and go to work. The legislation made several important modifications to existing laws to achieve this goal. First, it transformed cash assistance to the able-bodied poor from an entitlement to a block grant and imposed lifetime limits on the number of months a family could receive cash aid. Second, it gave states wide-ranging authority to require welfare recipients to participate in work-related activities and to impose sanctions for noncompliance, change benefit levels, and change the way benefits are reduced as families attempt to work themselves off welfare. This report examines how state policy choices and current federal laws affect the incentives a family of three faces as it attempts to move from welfare to work in 12 states.¹

The basic analysis describes how the income of a single parent with two children changes as she moves from not working to working at a part-time job at minimum wage, then to full-time work at minimum wage, and finally to a full-time job paying \$9/hour. In calculating income, we consider the family's earnings, its Temporary Assistance for Needy Families (TANF) grant, the cash value of food stamps it receives, federal and state earned income tax credits, any

other state tax credits, and all federal and state tax liabilities.² In subsequent analyses, we consider the impact of other public assistance programs—such as federal housing assistance, child care subsidies, and Medicaid—on work incentives. We then explore how lifetime time limits may affect a family’s work-welfare decisions. While we focus on the incentives of welfare recipients to go to work, we also examine how the differential treatment of participants and applicants in benefit determination may affect the decisions of low-income workers to leave work and go on welfare.

Our major findings are as follows:

As a family moves from no work to part-time work at minimum wage, its total income grows dramatically.

Across the 12 states we examine, a family of three’s income would increase by 51 percent, on average, if the single parent began working 20 hours a week at a job paying \$5.15/hour. There is considerable variation across states: in Washington state, a family of three moving from welfare with no earnings to part-time, minimum wage work would enjoy a 38 percent increase in income; in Mississippi, the family’s income would rise by 108 percent.

As a family moves from part-time work to full-time work at minimum wage, its total income grows by 20 percent, on average.

Across the 12 states, a 75 percent increase in work effort—from 20 to 35 hours a week—leads to a 20 percent increase in income, on average, for a family of three. The impact ranges from a low of 16 percent in Michigan to a high of 37 percent in Texas.

As a family moves from full-time work at minimum wage to full-time work at \$9/hour, its total income grows by 16 percent, on average.

Across the 12 states, a 75 percent increase in wage rate—from \$5.15 to \$9.00 per hour—leads to a 16 percent increase in income, on average, for a family of three. The impact ranges from a low of 4 percent in California to a high of 22 percent in Mississippi.

The federal Earned Income Tax Credit (EITC) is responsible for a considerable portion of the increase in income as families move from welfare to full-time minimum wage work.

Without federal and state EITC programs, a Mississippi family of three that moved from no work to part-time work at minimum wage would receive a 67 percent increase in income; when EITC is included, the increase is 108 percent. Without federal and state EITC programs, a New York family of three that moved from no work to part-time work at minimum wage would receive only a 19 percent increase in income; when EITC is included, the increase is 45 percent.

Federal housing assistance can also affect work incentives, but only 20 percent of families on cash assistance receive housing aid.

When we incorporate the value of federal housing assistance into our income package, we find that in the average state, the income of a family of three would rise by 30 percent if the family moved from no work to part-time minimum wage work. In the absence of housing assistance, moving from no work to work would make the family's income rise by 54 percent.

In the absence of subsidies, the cost of child care could serve as a significant deterrent to work.

If a Colorado single mother on TANF with two children had to pay child care costs for just one child when she began a part-time minimum wage job, her net income would rise by 32 percent, compared with 54 percent if she had no child care costs. However, because child care subsidies are pegged closely to costs and because copayment requirements are modest, subsidies for child care should offset the work disincentives generated by child care costs. If parents are concerned about the quality of child care that is available, even generous subsidies may not help remove the work disincentive presented by the need for child care. Further, if the costs that parents face are considerably higher than those estimated by the state or if statutory subsidies are not available, child care may remain a serious obstacle for women trying to leave welfare for work.

Research has shown that the loss of Medicaid benefits upon leaving AFDC was a significant deterrent to leaving welfare. The decoupling of Medicaid eligibility from the receipt of cash aid and recent expansions of Medicaid eligibility should mitigate the program's work disincentives at lower income levels.

Families leaving TANF for work can receive Transitional Medicaid Assistance (TMA) for at least one year, albeit with some reduction in services and possibly with some premium copayments. Further, children in low-income families, and even some parents, may be eligible for Medicaid either through expansions for children or because they qualify for benefits under the medically needy program. Since families actually do not lose Medicaid benefits when they move from TANF to work, at least in the short run, Medicaid should not hinder the movement of families from welfare to work. However, there is some evidence that low-income families and family service organizations do not understand Medicaid eligibility rules. Thus, even though, statutorily, Medicaid should not interfere with a TANF recipient's decision to work, TANF recipients may fear losing health benefits under Medicaid and choose not to work.

Lifetime time limits on the receipt of TANF benefits provide an incentive to leave welfare for work; the magnitude of the effect, however, is entirely dependent on TANF recipients' views of the future.

Because of the lifetime time limit, receiving TANF benefits this month means potentially forfeiting a month of benefits in the future. Thus, a family



deciding whether to receive TANF or work this month must consider the possibility that they may need TANF in the future. To the extent that families worry about the future and believe they will need TANF benefits in the future, time limits could serve as a strong incentive to move from welfare to work. To the extent that families are not “future oriented” and believe they will either not need TANF in the future or be exempt from the time limit, time limits will have little impact on the incentive to move from welfare to work.

The differential treatment of TANF recipients and TANF applicants leads to considerable inequities in some states.

In some states, a family trying to work its way off TANF may receive TANF benefits even if its income exceeds the eligibility limit for a family applying for benefits. For example, in Massachusetts, a single mother with two children earning \$655 a month would not be eligible for TANF; however, if she had been receiving TANF benefits and then began working and earned \$655 a month, she would receive \$297 in TANF benefits. Thus, the differential treatment of recipients and applicants may induce low-income non-TANF working families to stop working in order to qualify for benefits.

Introduction

The law of nature is simple: hunt, gather, or starve. The laws of a civil society are somewhat more complex. Virtually everyone agrees that the poor, especially the “deserving” poor such as children, should receive some public support, but no consensus exists on the level and nature of that support. Indeed, every society that has attempted to aid the poor has had to grapple with the paradox of public altruism: Meager amounts of aid provide plenty of incentive to hunt, gather, and, in more advanced societies, work but do not adequately protect the well-being of the poor; generosity raises the level of protection but reduces the incentive to work—enhanced public aid may actually increase the demand for assistance.

Traditionally, policymakers have attempted to strike a balance between aid and incentive by segmenting the poor and providing assistance to the very young, the very old, and the infirm—individuals who are not expected to work. Those who could or should work were not eligible for public aid. This is evident in the social welfare legislation enacted under President Franklin Delano Roosevelt’s New Deal in the 1930s. Under the New Deal, the federal government took up the central role of providing public aid to the elderly, the disabled, and widows and their children. Over time, the “widows” program—Aid to Dependent Children (later Aid to Families with Dependent Children [AFDC])—became primarily a program for divorced, separated, and never-married mothers. And over time more women, including mothers, entered the labor force. Thus, a program whose recipients were not expected to work became a program for individuals who were now expected to work, and for three decades, the federal government struggled with the challenge of providing both adequate aid and adequate incentive to move AFDC recipients from aid to work.

With the passage of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA), federal lawmakers replaced the AFDC program with the Temporary Assistance for Needy Families (TANF) block grant and thereby devolved considerable responsibility from the federal government to the states to balance the competing goals of aiding the poor and encouraging work. With this step, federal lawmakers implicitly assert that states can better tailor programs to meet the needs of their citizens and balance adequate support with work incentives.

This paper examines the trade-offs inherent in this balancing act, describes the different policy choices states have made, and illustrates the consequences of those choices for the well-being of the poor and the incentives to work. We begin by reviewing federal welfare policies in the wake of PRWORA and describe the policy choices available to states. We then examine how family incomes can change as a family moves from complete reliance on public support to increasing levels of work and pay. We initially focus on cash income and food stamps. Then we expand our analysis to include other public programs such as federal housing assistance, child care subsidies, and Medicaid. In addition, we discuss the impact of new policy dimensions like TANF's time limits on incentives to work. Most of our analyses examine the incentives for TANF recipients to go to work; in our final section, we examine the incentives for low-income families to stop working and take up TANF benefits.

Federal Rules and State Policy Choices under TANF

Overview

Critics of PRWORA decry it as an abandonment of the poor. Proponents claim that it has radically altered social welfare policy and returned control to the states. Both positions are exaggerated or at least premature. Even under the old AFDC program, states set benefit levels and had some flexibility in establishing eligibility guidelines. And under the Section 1115 waiver process, most states began experimenting with different welfare program rules designed to reduce welfare dependence and encourage work. To a certain extent, replacing AFDC with TANF block grants simply codifies state flexibility. Yet even under block grants, states must adhere to certain strict federal rules.

The most significant of the federal rules restricting state spending of federal TANF monies (and perhaps the most significant policy change) is the lifetime time limit: Individuals can receive TANF support for a maximum of 60 months. States are, however, allowed to exempt 20 percent of their TANF caseload from the time limit. Further, states are free to use their own funds to provide aid to those who exhaust their lifetime TANF benefits. States may also establish shorter, intermittent time limits. Another federal stricture is the requirement that an escalating percentage of all TANF recipients must engage in work-related activities. If a TANF recipient fails to comply with a work requirement, she can be sanctioned and her benefits reduced.

Beyond TANF, the federal government still provides other aid to the poor. Many of the poor are eligible for food stamps and Medicaid; some may receive

additional support through the Women, Infants, and Children (WIC) nutritional program and subsidized housing. And of those who are working, many may qualify for the earned income tax credit (EITC). Finally, for those with disabilities, the Supplemental Security Income program (SSI) provides some financial support.

It is under these strictures and in the context of these supplementary federal programs that states must work to balance the needs of the poor with the incentive to work.

State Choices

State-controlled cash assistance. States first must decide how much money they will provide to a family with no other income. The lower the maximum welfare benefit payment, the less attractive welfare is as an option and the greater the incentive to work. Next, states must decide how benefits are reduced as income increases. In general, this has two components: the earnings disregard and the benefit reduction rate (BRR). The earnings disregard is simply the amount of money a family can earn and still keep its full benefit. The BRR is the rate at which benefits are reduced as earnings rise above the earnings disregard. Under AFDC, states were free to set benefit levels, but unless the state had a federal waiver of these provisions, the earnings disregard was set at \$120 per month and the BRR was 67 percent.³ States are now free to change the earnings disregard and BRR. To illustrate, assume a state elected to keep the old AFDC rules, and a family of three with no other income is eligible for a TANF benefit of \$400 per month. If the family begins to work and earns \$120, it can keep the \$400 in TANF benefits and \$120 in earnings. As the family works more, it will see its TANF benefit reduced by \$0.67 for every \$1 it earns over \$120 per month. Thus a family earning \$180 will be able to keep \$360 in TANF benefits plus \$180 in earnings. From the point of view of a welfare recipient, higher income disregards and lower BRRs may represent strong incentives to work.⁴

In some states, referred to as “gap states,” the statutory earnings disregards and BRRs can be misleading. In gap states, the maximum benefit payment is lower than the payment standard used to compute benefits—families receive the lower of the computed benefit and the maximum payment.⁵ As a result of this gap between the payment standard and the maximum benefit, a family in a gap state can earn more than the state’s statutory disregard without having its TANF grant reduced. For example, Colorado’s monthly earnings disregard for TANF is \$120 and its BRR is 67 percent. However, because it is a gap state with a payment standard of \$421 (for a family of three) and a maximum payment of \$356, a family can earn \$217 (not just \$120) and still receive the full TANF payment of \$356.⁶

Outside of a state’s welfare system, a state’s tax code also affects the work incentives faced by low-income and welfare families. While most families whose incomes are sufficiently low to qualify for welfare have no state tax lia-

bility, they may be eligible for earned income tax credits if the state has such a program. EITCs enhance the earnings of low-income families in a way that rewards work. People only receive the EITC if they are working, and the amount they receive varies with their earnings. Thus, for individuals who are not working or working few hours at low wages, the EITC enhances the incentive to work. At some point the EITC must phase out (the credit gets smaller and smaller as earnings pass some point until the credit reaches zero). In the phase-out range, the credit actually raises the tax rate faced by working low-income families and may discourage additional work effort.

Non-cash state-controlled policy choices. States can affect the attractiveness of work through a variety of other program rules. For example, they can impose strict work requirements on TANF recipients and levy tough sanctions (reduced benefits) on those who do not comply with the requirements. Alternatively, they can make work more attractive by providing child care and other services to families working their way off welfare. Finally, states can decide how and when to impose time limits. While only a limited number of families can receive TANF benefits for more than 60 months, states can choose to use state funds to aid long-term dependent families. Alternatively, states can set more stringent time limits. For example, some states permit a family to receive only 24 months of assistance in any 60-month period.

Time limits play an interesting role in the incentives a family faces in choosing between welfare and work. If a family receives support from TANF this month, it is effectively losing the option of receiving TANF at some point in the future. To the extent that families worry about the future and believe they will need TANF benefits in the future, time limits will serve as a strong incentive to move from welfare to work. To the extent that families are not “future oriented,” believe they either will not need TANF in the future or will be exempt from the time limit, and/or are unaware of the existence of time limits, time limits will have little impact on the incentive to move from welfare to work.

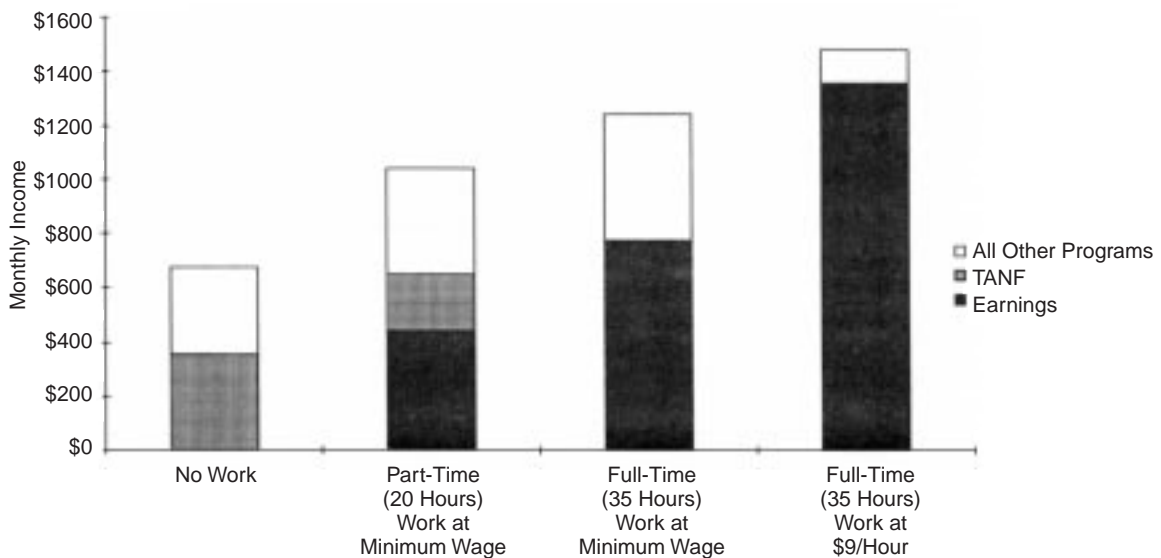
The federal context for state policy choices. States’ TANF policy decisions, however, are not made in a vacuum. Other federal policies also have significant effects on the overall incentives faced by welfare recipients and low-income families. For example, most low-income families are eligible for food stamps. Since other family income affects the amount of food stamps a family receives, families who receive low TANF grants receive higher food stamp allotments. The federal EITC supplements the earnings of low-wage, low-hour workers and encourages work among the very low income population.⁷ In addition, federal housing subsidies pegged to income provide larger grants to lower-income families. Finally, health care figures into families’ welfare and work decisions. Most TANF families can receive Medicaid, a policy that may draw families onto welfare since most low-paying jobs provide no health benefits. For families who move off welfare into work, transitional Medicaid is available for 12 months, and some states offer transitional Medicaid benefits for up to 24 months. Also, all states offer Medicaid coverage to low-income children regardless of their TANF status.



These are the broad parameters and factors that states must consider in designing their welfare programs. Figure 1 illustrates how a state’s policy choices and federal programs interact and affect the work incentives facing a low-income family. Recall that states must balance the competing goals of ensuring an adequate safety net for poor families while rewarding increasing work effort. Figure 1 shows how the income for a family of three (parent and two children) would change as the parent’s work effort increases in a single state (Colorado). If the parent does not work, the family would receive \$674/month: about half in TANF, and half from federal programs (food stamps). If the parent begins working 20 hours/week at minimum wage, the family’s income would rise—work is being rewarded. However, part of the gains from work are offset by a falling TANF grant. By the time the parent is working 35 hours/week in this example, the family no longer receives any TANF benefits; if she works full-time at \$9/hour, almost all the family’s income will come from earnings.

In the next section we describe the programs established by 12 states: Alabama, California, Colorado, Florida, Massachusetts, Michigan, Minnesota, Mississippi, New Jersey, New York, Texas, and Washington. These 12 states contain almost half the nation’s population, including about half of all AFDC recipients, and represent a broad range with respect to geography, fiscal capacity, citizen needs, and traditions of providing government services. Focusing on these states presents us with a fairly general, albeit incomplete, picture of the work incentives facing TANF recipients. We examine how much better off a family is as it moves from no work on TANF to a part-time job at minimum wage, then to a full-time job at minimum wage, and finally to a full-time job paying \$9/hour.

Figure 1 *Composition of Family Income for a Family of Three under Four Work/Welfare Scenarios—An Illustrative Example*



Notes: The “All Other Programs” category consists of the cash value of food stamps, the federal Earned Income Tax Credit, and state earned income and other tax credits, less payroll taxes and federal and state income tax liabilities. The figure depicts program rules for Colorado in October 1997.

Work Incentives under TANF in 12 States

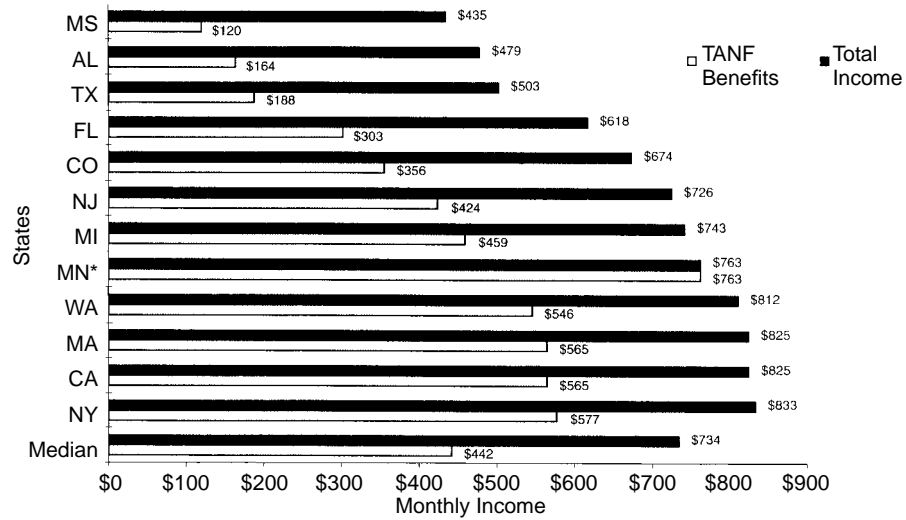
TANF benefit levels, federal sources of support, and taxes all depend on family size. For ease of presentation, we consider one standard family: a single parent with two dependent children.⁸ We present this family's income under four different work/welfare scenarios: (1) no work; (2) working 20 hours/week at minimum wage (\$5.15/hour); (3) working 35 hours/week at minimum wage; and (4) working 35 hours/week at \$9.00/hour. In our initial analyses, we consider this family's first month on TANF in the no-work scenario and the first month the family moved into one of the working scenarios from TANF.⁹ Unless otherwise noted, we assume that the family meets all participation requirements. Appendix A describes how we calculate the family's income.

TANF and Total Income at Zero Hours Worked

The basic benefit level provided by TANF to our focal family of three varies considerably from state to state. Figure 2 shows that in our no-work scenario, the monthly TANF benefits this family could receive range from \$577 in New York to \$120 in Mississippi.¹⁰ Median TANF benefit levels across our 12 states are \$442/month.¹¹ When we factor in the value of food stamps, the overall benefit level rises and the disparity between states narrows. In New York, our representative family could receive \$833/month; in Mississippi, it could receive \$435. The median monthly income is \$734.

In most cases, the parent in our three-person family cannot stay at home raising children and collect public assistance. Under TANF, states require able-

Figure 2 Monthly TANF Benefits and Total Income for a Family of Three with No Earned Income in 12 States



Notes: Total income consists of TANF benefits and cash value of food stamps. All other sources of income are zero when there are no earnings.

Program rules are based on the Urban Institute's summary of state TANF plans, legislation, and regulations as of October 1997.

*Minnesota combines TANF benefit and food stamp allotment.

bodied adult recipients to work or engage in work-related activities. Generally, the family has some time to “get its act together” before the work requirement takes effect, although families with very young children may be exempt from the work requirements.¹² Once a family member is required to fulfill a work requirement, failure to meet the requirement may result in the family’s benefits being reduced. The size of the sanction varies considerably from state to state.

Table 1 compares family income at zero hours worked for a family that is fully compliant with family income for a family that is sanctioned for the first time—sanctions become progressively more severe if a family continues to be noncompliant. In Florida and Mississippi, a sanctioned family loses its entire TANF benefit. While compliant families in Florida have considerably more income than compliant families in Alabama and Texas, noncompliant families would fare better in the latter two states. In Michigan, a noncompliant family loses 25 percent of its TANF and food stamp allotment. Sanctions are less severe in other states—generally, the family either loses the portion of its TANF grant that is allocated to the parent, or the family’s TANF grant (but not food stamps) is reduced by 10 to 25 percent.

As we examine the incentives for the parent to move from no work to work, the reader should keep in mind that because of the presence of work requirements and sanctions, the parent is not necessarily forgoing child-rearing time in order to work. She may have to work or perform work-related activities just to receive her full TANF and food stamp allotment.

Table 1 *Monthly Total Income for a Family of Three with No Work Hours in 12 States: Fully Compliant Family vs. Family with Initial Sanction*

State	Fully Compliant	Sanctioned
Alabama	\$479	\$438
California	825	716
Colorado	674	585
Florida	618	315
Massachusetts	825	734
Michigan	743	557
Minnesota	763	687
Mississippi	435	315
New Jersey	726	624
New York	833	724
Texas	503	478
Washington	812	706
Median	734	605

Notes: Total income consists of earnings, TANF benefit, cash value of food stamp allotment, federal Earned Income Tax Credit, and state earned income and other tax credits, less the employee's share of payroll taxes and federal and state income tax liabilities.

Program rules are based on the Urban Institute's summary of state TANF plans, legislation, and regulations as of October 1997.

Basic Family Income as Work Effort Rises

Here we consider income for our fully compliant family of three as the parent moves from no work to part-time minimum wage work, to full-time minimum wage work, and finally to full-time work at \$9/hour. We consider only the income sources that this family is likely to receive: earnings, TANF, and the cash equivalent of food stamps. Since the family will be subject to payroll taxes and potentially to federal and state taxes and may also qualify for federal and state EITCs, we take taxes into account. Three major sources of public aid are not incorporated in our initial analysis but are discussed in depth later: Medicaid, housing assistance, and child care subsidies. We do not include the cash value of Medicaid because the family would be receiving either Medicaid or transitional Medicaid in all of our work scenarios. Also, it is difficult to place a value on Medicaid benefits. We exclude housing assistance because only 20 percent of families receiving cash assistance live in subsidized housing (Kingsley 1997). Finally, we neither include child care subsidies nor deduct child care costs because only families that need child care actually receive subsidies, and subsidies are pegged closely to cost—from a pragmatic standpoint, the availability of quality care may be more important than state-to-state variations in subsidy levels.



Table 2 *Monthly Total Income for a Family of Three under Four Work Scenarios in 12 States*

State	Work Scenario			
	No Work	Part-Time, Minimum Wage	Full-Time, Minimum Wage	Full-Time, \$9/Hour
Alabama	\$479	\$894	\$1,198	\$1,442
California	825	1,226	1,449	1,512
Colorado	674	1,041	1,243	1,478
Florida	618	1,036	1,275	1,489
Massachusetts	825	1,209	1,448	1,522
Michigan	743	1,082	1,257	1,470
Minnesota	763	1,168	1,409	1,475
Mississippi	435	905	1,215	1,477
New Jersey	726	1,066	1,300	1,491
New York	833	1,205	1,447	1,536
Texas	503	901	1,233	1,482
Washington	812	1,120	1,344	1,482
Median	734	1,074	1,287	1,482

Notes: Total income consists of earnings, TANF benefit, cash value of food stamp allotment, federal Earned Income Tax Credit, and state earned income and other tax credits, less the employee's share of payroll taxes and federal and state income tax liabilities.

Program rules are based on the Urban Institute's summary of state TANF plans, legislation, and regulations as of October 1997.

Table 2 shows how net income changes for a family of three as work effort and wage rates rise. In Mississippi, a family of three's net monthly income grows from \$435 at no work to \$905 at a 20-hour/week minimum wage job, to \$1,215 at a 35-hour/week minimum wage job, and to \$1,477 at a 35-hour/week \$9/hour job.¹³ In New York, monthly income grows from \$833 to \$1,205 to \$1,447 to \$1,536, respectively, as work effort and wage rates increase.

Table 3 shows the family's income as a percentage of the poverty level for each of the four work/welfare scenarios. In the median state, the income of a family of three in which the single parent did not work would reach 68 percent of the federal poverty level (FPL); if the parent worked part-time at minimum wage, the family's income would be right at the FPL. Full-time minimum wage work would lift the family out of poverty in all 12 states, and full-time work at \$9/hour would bring the family's income to 138 percent of FPL in the median state.

Work Incentives under TANF

Traditionally, economists have analyzed the work incentives in cash transfer programs by examining "effective marginal tax rates": that is, what percentage of a family's increase in earned income is offset by lost benefits and tax liabilities. For example, if a family's earnings rise by \$100 but the family's net income, after welfare payments are reduced and tax liabilities are assessed, only rises by \$25, economists say that the marginal tax rate faced by this family is 75 percent—out of the

Table 3 *Monthly Total Income as Percentage of Poverty for a Family of Three under Four Work Scenarios in 12 States*

State	Work Scenario			
	No Work	Part-Time, Minimum Wage	Full-Time, Minimum Wage	Full-Time, \$9/Hour
Alabama	44%	83%	111%	134%
California	77	114	134	140
Colorado	63	97	115	137
Florida	57	96	118	138
Massachusetts	77	112	134	141
Michigan	69	100	117	136
Minnesota	71	108	131	137
Mississippi	40	84	113	137
New Jersey	67	99	121	138
New York	77	112	134	143
Texas	47	84	114	138
Washington	75	104	125	138
Median	68	100	119	138

Notes: Total income consists of earnings, TANF benefit, cash value of food stamp allotment, federal Earned Income Tax Credit, and state earned income and other tax credits, less the employee's share of payroll taxes and federal and state income tax liabilities.

Program rules are based on the Urban Institute's summary of state TANF plans, legislation, and regulations as of October 1997.

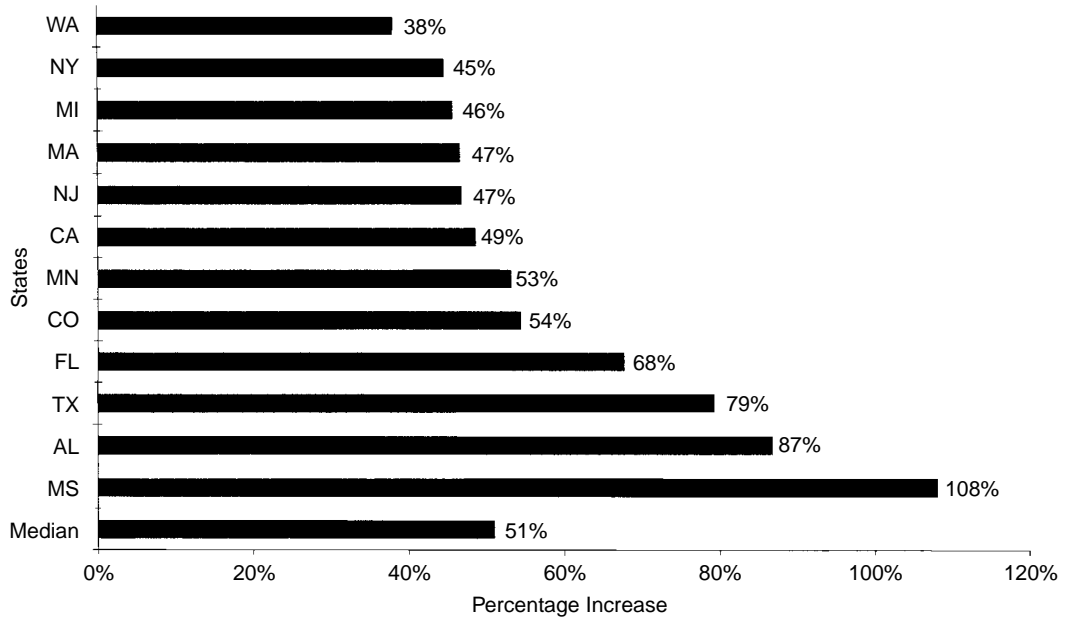
additional \$100 earned, 75 percent was “taxed” away, leaving the family only \$25 better off. In general, the lower the tax rate, the larger the incentive to work.

However, there are also important “wealth” effects to take into account in cross-state comparisons. Consider the following example focusing solely on TANF grants. States A and B both disregard the first \$200 of earnings in a month. A family is choosing between not working and taking a part-time job that pays \$200 a month. In both states, the effective marginal tax rate for this family is zero percent—hence there is no apparent difference in work incentives. But if the TANF grant in state A is \$400 while in state B it is \$200, then the family in state A would only realize a 50 percent increase in income by taking the job compared with a 100 percent increase in state B. By examining the change in total income rather than the marginal tax rate, we would say the incentive to increase work effort is larger in state B. Indeed, this has intuitive appeal: A child with a \$10/week allowance is more likely to accept \$10 to cut the grass than a child with a \$25/week allowance. Examining work incentives using the percentage change in total income allows us to account for the “tax” impact of income disregards and benefit reduction rates as well as the “wealth” effects of program generosity.¹⁴ For this report, we focus on changes in total income to examine work incentives, although we also discuss the marginal tax rates faced by families contemplating increasing their work effort.

Moving from no work to part-time work at minimum wage. Figure 3 shows changes in income for a family of three as it moves from TANF and no work to part-time work at minimum wage. The median increase in family income across



Figure 3 *Percentage Increase in Monthly Total Income for a Family of Three Moving from No Work to a Part-Time Minimum Wage Job in 12 States*



Notes: Total income consists of earnings, TANF benefits, cash value of food stamps, federal Earned Income Tax Credit, and state earned income and other tax credits, less payroll taxes and federal and state income tax liabilities. Program rules are based on the Urban Institute's summary of state TANF plans, legislation, and regulations as of October 1997.

the 12 states is 51 percent; however, there is considerable variation from state to state. In Mississippi, moving into a part-time minimum wage job raises the family's income by 108 percent; in Washington state, moving from no work to part-time work at minimum wage raises income by only 38 percent.

The first column in table 4 shows the effective marginal tax rates on earnings for the family of three as it moves from no work to part-time minimum wage work. In Mississippi, low benefit levels and the federal EITC generate a negative tax rate. The family would face the highest tax rate in Washington, 30 percent. The median marginal tax rate on earnings across our 12 states is 12 percent.

Interestingly, this wide disparity in work incentives is not solely a function of different choices in BRRs and earned income disregards: Both Alabama and Washington reduce their TANF payments beginning with the first earned dollar, and Washington actually has a more generous BRR than Alabama (50 versus 80 percent); however, the incentive to move from no work to part-time minimum wage work is substantially greater in Alabama than in Washington. This disparity reflects differences in the level of TANF payments. Simply put, the incentive to go to work in Alabama is very high because the basic grant level is so low.

Figure 4 illustrates the inverse relationship between the basic grant level and the work incentive as measured by percentage changes in total income.

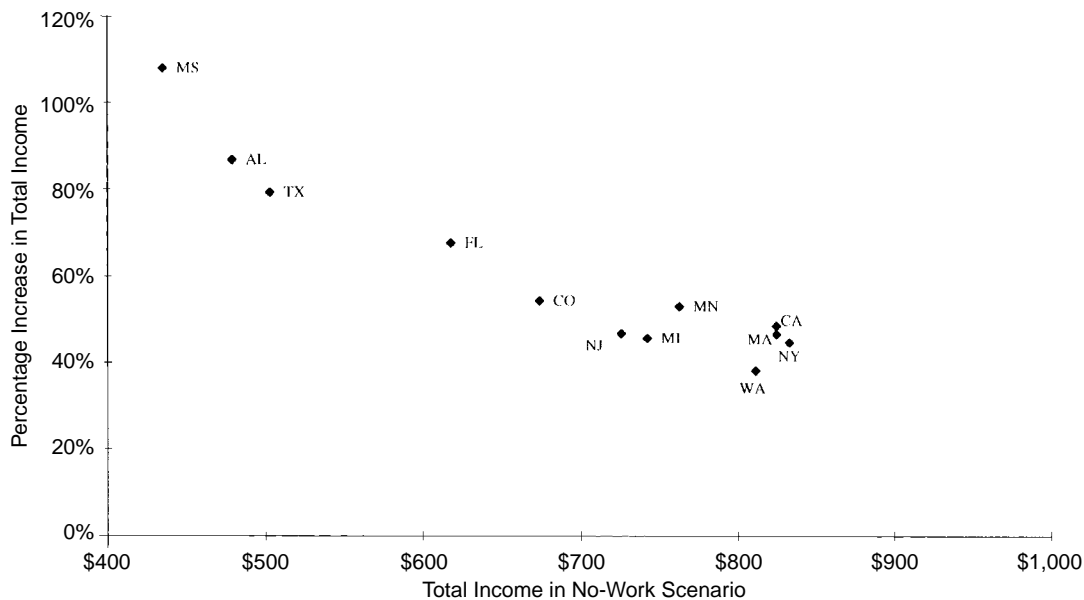
Table 4 *Effective Incremental Marginal Tax Rates on Earnings for a Family of Three as Work Effort and Wage Rates Increase*

State	No Work to Part-Time Minimum Wage	Part-Time Minimum Wage to Full-Time Minimum Wage	Full-Time Minimum Wage to Full-Time \$9/Hour
Alabama	6%	9%	58%
California	9	33	89
Colorado	17	39	59
Florida	6	28	63
Massachusetts	13	28	87
Michigan	23	47	63
Minnesota	8	27	89
Mississippi	-6	7	55
New Jersey	23	30	67
New York	16	27	84
Texas	10	0	57
Washington	30	33	76
Median	12	28	65

Note: Based on the Urban Institute's summary of state TANF plans, legislation, and regulations as of October 1997.

Generally, if the family lives in a low-benefit state like Mississippi, Alabama, or Texas, its income will rise dramatically if the parent begins working.¹⁵ Conversely, if the family lives in a high-benefit state like New York or California, the family's earned income from a part-time, minimum wage job will be relatively small compared with the size of the family's TANF grant. Even though

Figure 4 *Relationship between Work Incentives and Benefit Levels for a Family of Three Moving from No Work to a Part-Time Minimum Wage Job in 12 States*



Note: Program rules are based on the Urban Institute's summary of state TANF plans, legislation, and regulations as of October 1997.



the incentive to work is larger in low-benefit states, the family would still have more income in high-benefit states. For example, in Mississippi, the state with the largest incentive to move from no work to a part-time, minimum wage job, the family's monthly income from all sources is \$905, compared with \$1,120 in Washington, the state with the smallest work incentive for making that change.

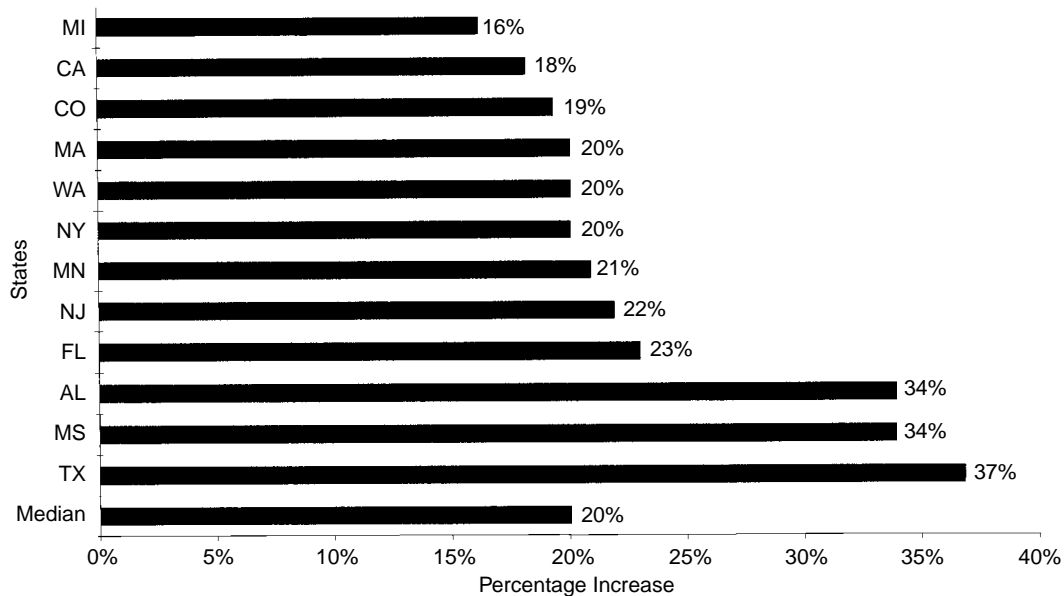
Note, however, that state policy choices concerning earnings disregards and BRRs do matter—their effects are masked by wide differences in basic TANF grant levels. For example, consider the three states with the lowest basic benefit level for families that do not work (from lowest to highest): Mississippi, Alabama, and Texas. Alabama reduces the grant by \$0.80 for every dollar earned beginning with the first dollar, and Texas disregards the first \$120 and reduces benefits by \$0.67 for every additional dollar earned. Mississippi, on the other hand, is a gap state and effectively disregards the first \$258 dollars earned and reduces benefits by \$0.60 for every additional dollar earned. Because Texas and Alabama have low benefit levels and high BRRs, a family of three would be completely off the TANF rolls at a part-time, minimum wage job. Thus, if we examine family income for a family that began working a part-time, minimum wage job, we find that the family would have the least income in Alabama (\$894/month), followed by Texas (\$901/month); if the family lived in Mississippi, the state with the lowest basic TANF grant, its income at part-time, minimum wage work would be \$905.

Similarly, while New York provides the highest basic benefit among our 12 states, the family of three would have a higher income in California if it worked part-time at a minimum wage job. California surpasses New York in generosity for families who are working part-time at minimum wage because the state has a very generous income disregard: California disregards the first \$225 dollars the family earns every month before beginning to reduce its TANF grant; New York only disregards the first \$90. Thus, a family of three in which the parent works 20 hours per week at minimum wage would receive \$1,226 per month in California and \$1,205 in New York.

Moving from part-time to full-time work at minimum wage. Next, consider what happens to a family's income as the working parent increases her work effort from 20 hours/week to 35 hours/week (full-time). Figure 5 shows that as the parent in a family of three moves from part-time to full-time work at minimum wage—a 75 percent increase in hours worked—the family's income increases by an average of 20 percent.¹⁶ This is a far smaller increase than the one enjoyed by the family when it moved from no work to part-time work at minimum wage. The variation across states is also much smaller. The smallest increase in family income occurs in Michigan: Moving from part-time to full-time minimum wage work increases the family's income by only 16 percent. The largest increase occurs in Texas—37 percent. The second column in table 4 shows that the effective marginal tax rate faced by a family of three as the parent moves from part-time to full-time minimum wage work ranges from zero percent in Texas to 47 percent in Michigan. The median is 28 percent.

In five of our 12 states—Alabama, Colorado, Michigan, Mississippi, and Texas—a family of three in which the parent works full-time at minimum wage

Figure 5 *Percentage Increase in Monthly Total Income for Family of Three Moving from a Part-Time Minimum Wage Job to a Full-Time Minimum Wage Job in 12 States*



Notes: Total income consists of earnings, TANF benefits, cash value of food stamps, federal Earned Income Tax Credit, and state earned income and other tax credits, less payroll taxes and federal and state income tax liabilities.

Program rules are based on the Urban Institute's summary of state TANF plans, legislation, and regulations as of October 1997.

would receive no TANF payment. The family's income would range from a high of \$1,449 in California to a low of \$1,198 in Alabama (see table 2).

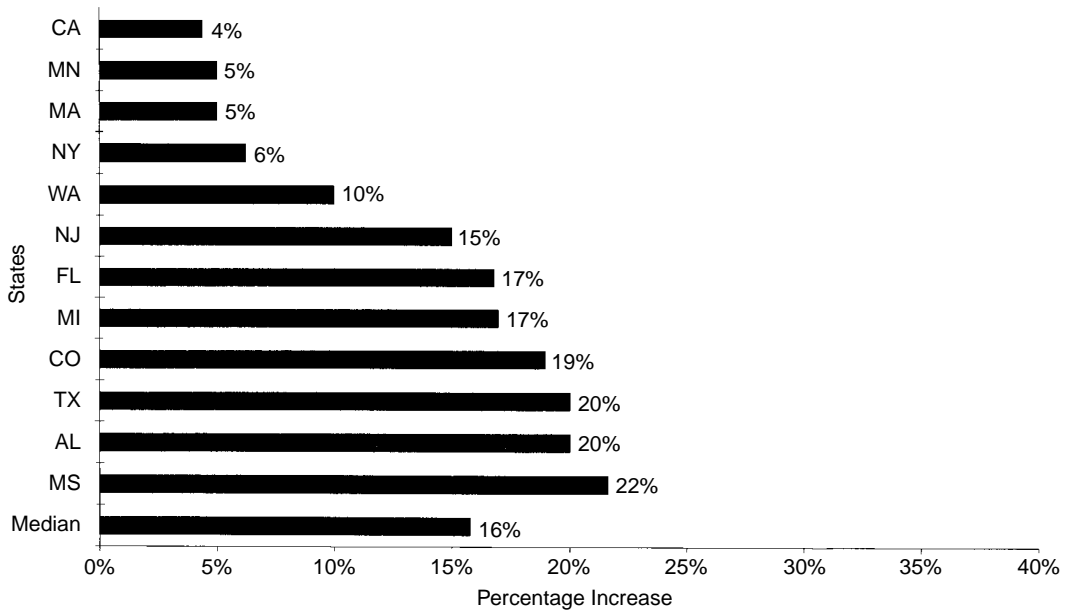
Moving from full-time minimum wage work to full-time work at \$9/hour. Finally, consider what happens to a family's income as the parent's wage rate increases from minimum wage to \$9/hour—a 75 percent increase. As figure 6 shows, the family's income would rise by 16 percent, on average. The largest increase in income from working full-time at minimum wage to working full-time at \$9/hour would occur in Mississippi: 22 percent. The smallest would occur in California: 4 percent. Column 3 of table 4 shows that effective marginal tax rates are quite high in this range because the federal EITC begins to phase out and most remaining TANF benefits are lost. The median tax rate across our 12 states is 65 percent, ranging from 55 percent in Mississippi to 89 percent in California and Minnesota.

If the parent in our family held a full-time job at \$9/hour, the family would no longer receive TANF benefits in any of our 12 states. As table 2 shows, family incomes for families working full-time at \$9/hour are very similar across states in which the families no longer receive TANF grants. Differences in family incomes across these states reflect differences in state taxes and in the shelter allowance used in calculating the cash value of food stamp benefits.

In general, states have structured their TANF programs to offer big rewards for going to work at least part-time, even at low wages. The big incentives for moving from no work to some low-wage work reflect very low benefit levels in



Figure 6 *Percentage Increase in Monthly Total Income for a Family of Three Moving from a Full-Time Minimum Wage Job to a Full-Time \$9/Hour Job in 12 States*



Notes: Total income consists of earnings, TANF benefits, cash value of food stamps, federal Earned Income Tax Credit, and state earned income and other tax credits, less payroll taxes and federal and state income tax liabilities. Program rules are based on the Urban Institute's summary of state TANF plans, legislation, and regulations as of October 1997.

some states and generous earnings disregards in others. A consequence of generous disregards is that states have to have very high BRRs to keep program costs manageable, and this leads to very high marginal tax rates as families move from some low-wage work to more hours and higher wages. Combined with the phaseout of food stamp benefits as income increases, families working part-time at minimum wage will keep just over 20 percent of the additional income they earn by increasing their hours by 75 percent (from 20 to 35 hours per week). Similarly, a full-time working parent with two children will only enjoy a 16 percent increase in income if she receives a 75 percent pay raise from minimum wage to \$9/hour. Thus, the incentives built into TANF tend to encourage recipient parents to work even at a bad job; however, additional labor and even substantial pay increases have only modest rewards.

The Role of Taxes

For a financial incentive to have an effect on work behavior, individuals have to be aware of it. While the EITC does reward work, most people who are eligible to receive money from the federal and state EITC programs receive that money in a lump sum only as part of their tax refund. While workers can adjust their withholding in anticipation of the EITC, most do not. Critics of the EITC charge that low-income workers do not connect their annual EITC windfall with their work effort and doubt that it provides much of an incentive to work.¹⁷

The federal EITC provides considerable support to a family of three as the parent moves from a part-time minimum wage job to a full-time \$9/hour job. A single parent with two children would be eligible for \$177 a month if the parent worked 20 hours/week at minimum wage for the year (providing the family met all other eligibility criteria for the EITC—see appendix A). This would rise to \$305 a month if the parent worked 35 hours/week at minimum wage. At full-time and \$9/hour, the EITC begins to phase out, and the family also has a positive federal tax liability; the net benefit of the EITC (subtracting the tax liability) is \$201 per month.¹⁸ Further, three of the 12 states studied (and eight in the entire nation) have state EITC programs. In New York, the net gain from the state EITC (EITC less state tax liability) for a family of three is \$35, \$61, and \$27 per month as the working parent moves up from part-time minimum wage work to full-time minimum wage work to full-time work at \$9/hour, respectively. In Minnesota, the net value of the state EITC is \$27, \$46, and \$23 per month; in Massachusetts, \$18, \$31, and \$23 per month.

Table 5 shows that removing the value of federal and state EITCs reduces the apparent incentive to work. For example, in Mississippi, a family of three's monthly income based on a part-time minimum wage job without the federal EITC would be \$728 instead of \$905, and the percent increase in income over not working at all would drop from 108 percent to 67 percent. Similarly, netting out the federal and state EITCs reduces the increase in monthly total income from 45 to 19 percent in New York and from 53 to 26 percent in Minnesota.

Table 5 *Percentage Change in Monthly Total Income for a Family of Three as Work Effort and Wage Rates Increase: With and without Federal and State Earned Income Tax Credits (EITC)*

State	No Work to Part-Time Minimum Wage		Part-Time Minimum Wage to Full-Time Minimum Wage		Full-Time Minimum Wage to Full-Time \$9/Hour	
	EITC	No EITC	EITC	No EITC	EITC	No EITC
Alabama	87%	50%	34%	25%	20%	36%
California	49	27	18	9	4	12
Colorado	54	28	19	9	19	33
Florida	68	39	23	13	17	30
Massachusetts	47	23	20	10	5	14
Michigan	46	22	16	5	17	30
Minnesota	53	26	21	10	5	14
Mississippi	108	67	34	25	22	37
New Jersey	47	22	22	12	15	27
New York	45	19	20	9	6	17
Texas	79	44	37	28	20	35
Washington	38	16	20	10	10	21
Median	51	27	20	11	16	28

Notes: Total income consists of earnings, TANF benefit, cash value of food stamp allotment, federal Earned Income Tax Credit, and state earned income and other tax credits, less the employee's share of payroll taxes and federal and state income tax liabilities.

Program rules are based on the Urban Institute's summary of state TANF plans, legislation, and regulations as of October 1997.



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Other Public Assistance: Housing, Child Care, and Medicaid

Low-income families may be eligible for and may receive additional in-kind and cash assistance, and these additional sources of aid affect the work incentives faced by families on, or just working their way off, TANF. These forms of assistance include federal housing assistance, child care subsidies, and Medicaid.¹⁹ Even though housing and child care are not universally needed or received and placing a value on Medicaid is difficult, it is useful to examine how these programs may affect the work incentives facing low-income families.

Housing. While some families on public assistance can live rent-free in the home of a grandparent or other relative, most have to pay rent. In our analysis, we assume that a family of three pays rent along with all its other expenses (food, clothing, utilities, etc.) out of the total net income it receives under each of the four work scenarios. But one out of five families receiving federal cash aid also receives federal housing assistance. The money these families receive for housing frees up money (aid and earnings) to be spent on other things. Since housing aid falls as income rises, families receiving housing assistance face lower incentives to increase their work effort.

Table 6 compares how much our family of three's income would rise as it moved from no work to part-time work at minimum wage and then to full-time minimum wage work and finally to full-time work at \$9/hour, assuming the family receives federal housing assistance.²⁰ Keep in mind that, like food stamps, federal housing assistance reduces some of the cross-state variation in

Table 6 *Percentage Change in Monthly Total Income for a Family of Three as Work Effort and Wage Rates Increase: With and without Federal Housing Assistance (FHA)*

State	No Work to Part-Time Minimum Wage		Part-Time Minimum Wage to Full-Time Minimum Wage		Full-Time Minimum Wage to Full-Time \$9/Hour	
	FHA	No FHA	FHA	No FHA	FHA	No FHA
Alabama	37%	87%	24%	34%	13%	20%
California	26	49	13	18	0	4
Colorado	31	54	14	19	8	19
Florida	39	68	15	23	8	17
Massachusetts	26	47	14	20	1	5
Michigan	29	46	12	16	7	17
Minnesota	34	53	16	21	0	5
Mississippi	44	108	24	34	13	22
New Jersey	24	47	13	22	6	15
New York	26	45	14	20	1	6
Texas	32	79	23	37	9	20
Washington	24	38	14	20	4	10
Median	29	51	14	20	7	16

Notes: Total income consists of earnings, TANF benefits, cash value of food stamps, federal Earned Income Tax Credit, and state earned income and other tax credits, less net housing expenditures (after subsidy), the employee's share of payroll taxes, and federal and state income tax liabilities.

Program rules are based on the Urban Institute's summary of state TANF plans, legislation, and regulations as of October 1997.

public assistance and represents a larger share of a family's income package in low-benefit states. In Mississippi, for example, the income of a family of three in which the parent did not work would be \$300 higher if it received federal housing assistance than if it received no housing aid. As a result, when we incorporate federal housing assistance, we find that the family's income would rise 44 percent when the parent began working 20 hours/week at minimum wage; without housing assistance, its income would rise by 108 percent. But Mississippi is the most extreme example. At the median for our 12 states, a family of three's income, including housing assistance, would rise by 30 percent if it moved from no work to part-time work at minimum wage. Without housing assistance, the median income would rise by 51 percent.

The impact of the phaseout of housing subsidies can be most clearly seen when we examine the increase in family income as the parent moves from a full-time minimum wage job to a full-time job paying \$9/hour. In five states (California, Massachusetts, Minnesota, New York, and Washington), this 75 percent increase in hourly wage rate translates into virtually no increase in income.

Child care. Our analysis up to this point has excluded the child care costs that a parent may face when moving from welfare to work. While some parents may be able to avoid paying for child care by relying on relatives or other informal sources of care, many others will have to either pay for care themselves or rely on a child care subsidy provided by the state. The lack of quality child care and the cost of child care may present substantial obstacles to families trying to move from welfare to work.

States provide child care subsidies to working families receiving TANF and other low-income working families through state programs funded under the federal Child Care and Development Fund (CCDF). CCDF gives states flexibility in establishing their child care programs, including factors that affect family finances such as the income limits for families that may be served under the program, the copayment that families must make to receive child care subsidies, and the maximum amount that the state will pay to child care providers.

Table 7 shows some of the variety in CCDF-funded programs across six states for which we have reasonable child care data (Alabama, California, Colorado, Florida, Massachusetts, and Minnesota). Low-income families may be required to make copayments for child care, which vary based on family size, family income, and the number of children receiving care. In three of the six states, working TANF families are effectively exempt from paying a copayment.²¹ For a single mother of two children seeking care for one 18-month-old child, Colorado requires a copayment of \$54; the copayments range between \$32 and \$39 in Alabama, Florida, and Massachusetts. Similar families in California and Minnesota are not subject to copayments.

States reimburse the family or child care provider for the cost of care up to a state-established maximum. The maximum reimbursement is typically based on surveys of child care providers to determine market rates. The maximum



Table 7 Selected Characteristics of Subsidized Child Care Programs under the Child Care and Development Fund in Six States

	Are Working TANF Families Exempt from Copayment?	Monthly Copayment for Full-Time Minimum Wage Family (Not Receiving TANF)	Monthly Maximum Reimbursement for 18-Month-Old In Family Day Care Home	Income Eligibility Cutoff for Families Transitioning from TANF to Work
Alabama	No	\$32	\$294	\$1,444
California	^a	0	477	3,337
Colorado	Yes	54	354	2,055 ^b
Florida	No	35	303	2,055
Massachusetts	Yes	39	455	2,771
Minnesota	No	0	476	2,856

Source: Authors' summary of state Child Care and Development Fund plans for FY 1997–99.

a. California does not specifically exempt TANF recipients from having to pay a copayment for subsidized child care; however, families with monthly incomes below \$1,669 are exempt from the copayment requirement. Because this is greater than the TANF income limit, TANF families are de facto exempt from the copayment requirement.

b. Income eligibility cutoff shown is the state limit; however, counties may set it at a lower amount.

monthly reimbursement to child care providers varies from \$294 per month in Alabama to \$477 in California. Finally, states limit child care subsidies to families with incomes below a maximum income limit. The income eligibility cutoff for families transitioning off of TANF varies from \$1,444 in Alabama to \$3,337 in California.

In addition to the financial aspects of child care, there are nonfinancial factors that may affect family work incentives. Two of the major nonfinancial factors are quality of care and access to care. Cost aside, a parent may be more likely to go to work and place her children in day care if the day care is of high quality, providing a safe and nurturing environment for her children. Access to care also affects work incentives. Not all families that are income-eligible for child care are guaranteed child care. States may limit access to child care to those families that are given priority, while placing lower-priority families on waiting lists. Although very low-income families and families transitioning from TANF to work are typically given priority by states, families that have not been on TANF for a year or more may in some states be given lower priority and be at greater risk for losing access to subsidized child care slots. Indeed, studies of income support and social services for low-income people in Alabama and Minnesota find that there are insufficient funds to provide child care subsidies to all eligible families (Clark et al. 1998; Burt et al. 1997). In Boston, Massachusetts, the waiting list for subsidized child care for low-income working families is over 7,000 families long (Kirby et al. 1997). Thus, access also affects a parent's work incentive because even those families that are financially eligible may not be able to obtain subsidized child care, forcing them to pay the full cost of child care themselves.

Although we cannot incorporate the nonfinancial factors that influence work incentives such as quality and access, below we illustrate the impact of child care costs on financial work incentives for a single mother with two children moving from welfare to work. We assume that the mother requires child

care only for her younger child, who is 18 months old. We further assume that the child is placed in a family day care home, which is generally less expensive than a child care center but more costly than in-home care. Finally, we assume that the cost of care is equal to the maximum reimbursement paid by the state to family day care home providers in the largest city, county, or metropolitan area in the state. States generally determine the maximum reimbursement based on a market rate survey of providers, so this analysis captures the differences in the cost of care across states. It should be noted that in addition to the direct effect of child care costs on family incomes, child care payments made by the family also may affect the family's food stamp payment as well as its federal and state tax liability because of child care expense deductions and credits allowed in each.

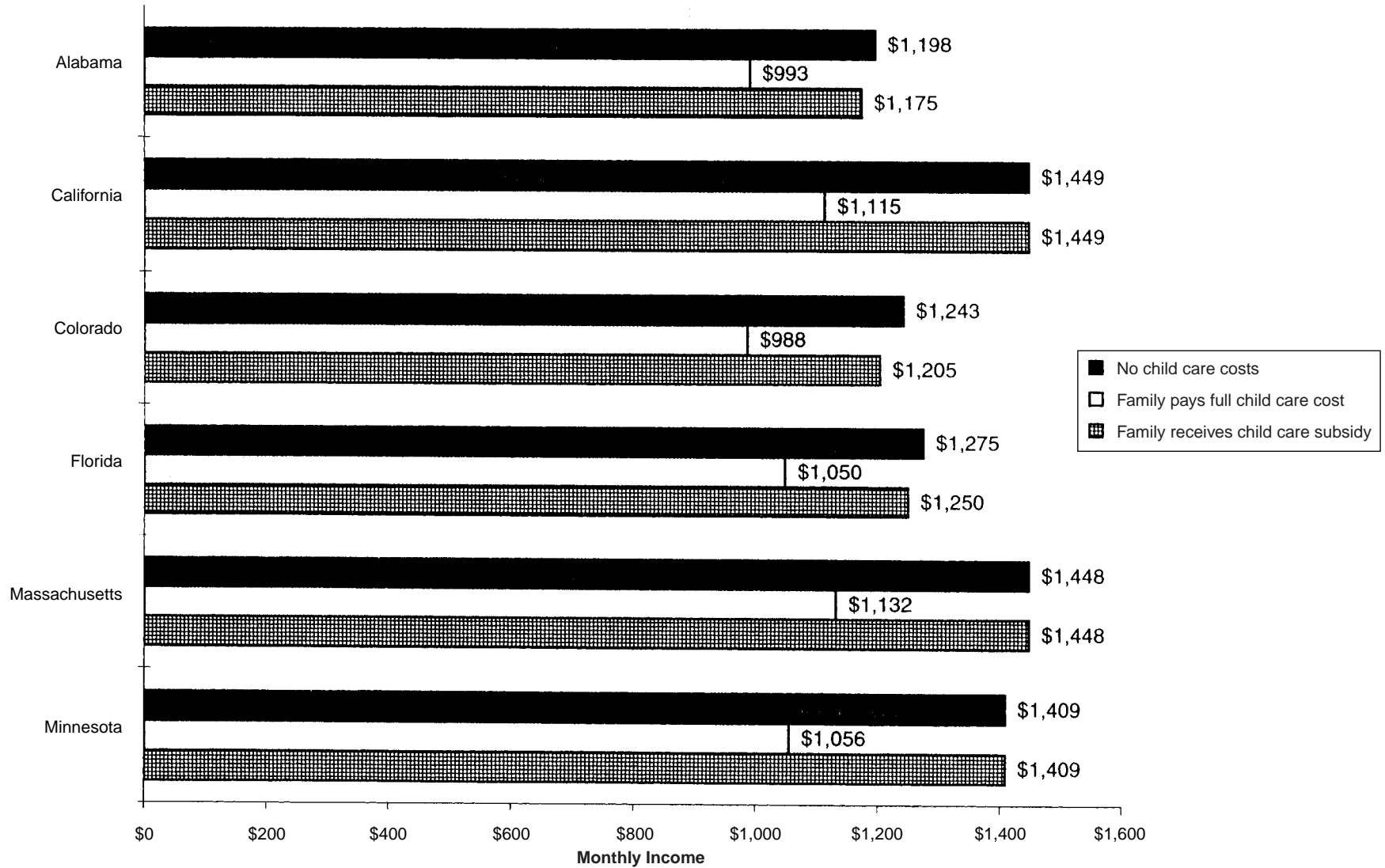
Figure 7 shows the impact of child care costs on the monthly income of the family in six states when the parent is working 35 hours per week at minimum wage. When the family must pay the full cost of child care, monthly income is reduced by roughly \$300; differences in the net cost of child care between states primarily reflect differences in the cost of care in each state and, to a much lesser extent, the treatment of child care expenses in the state income tax code. Since the states' child care subsidies are based on cost, the child care costs of families receiving subsidies are fully covered in states whose copayments are zero at this level of earnings (California, Massachusetts, and Minnesota) and mostly covered in Alabama, Colorado, and Florida (where copayments range from \$20 to \$30 per month).²²

In the absence of subsidies, a single mother moving from welfare to work will find that child care costs eat up a substantial share of her income; thus, child care costs reduce her incentive to work. Figure 8 shows that the percentage change in total income for moving from welfare to a part-time minimum wage job would be appreciably lower in each of the six states if the mother had to pay child care costs out of pocket.²³ For example, in Colorado (the approximate average of the six states), the percentage increase in monthly income from part-time work drops from 54 to 32 percent. However, if she receives a child care subsidy, the subsidy is sufficiently large to cover most of the cost, and the returns to work are similar for a family receiving subsidized care and a family that has no child care expenses.

If the family were to increase income by increasing work hours, its child care needs would also expand. With subsidies in these six states, a single mother moving from part-time to full-time minimum wage work will find that stated subsidy levels offset her additional child care costs, and the financial incentives for increasing hours worked at minimum wage are unaffected. Without subsidies, the increased cost reduces the rewards of additional work in five of our six states.²⁴ Alternatively, if a parent increases her income through a higher wage rate rather than by changing hours worked, her need for child care remains the same. If she receives no subsidy, her child care costs will not increase; if she receives a subsidy, her child care costs will likely *increase* because the copayment is based on a sliding fee scale. Thus, the percentage increase in total income for a single mother moving from a full-time minimum

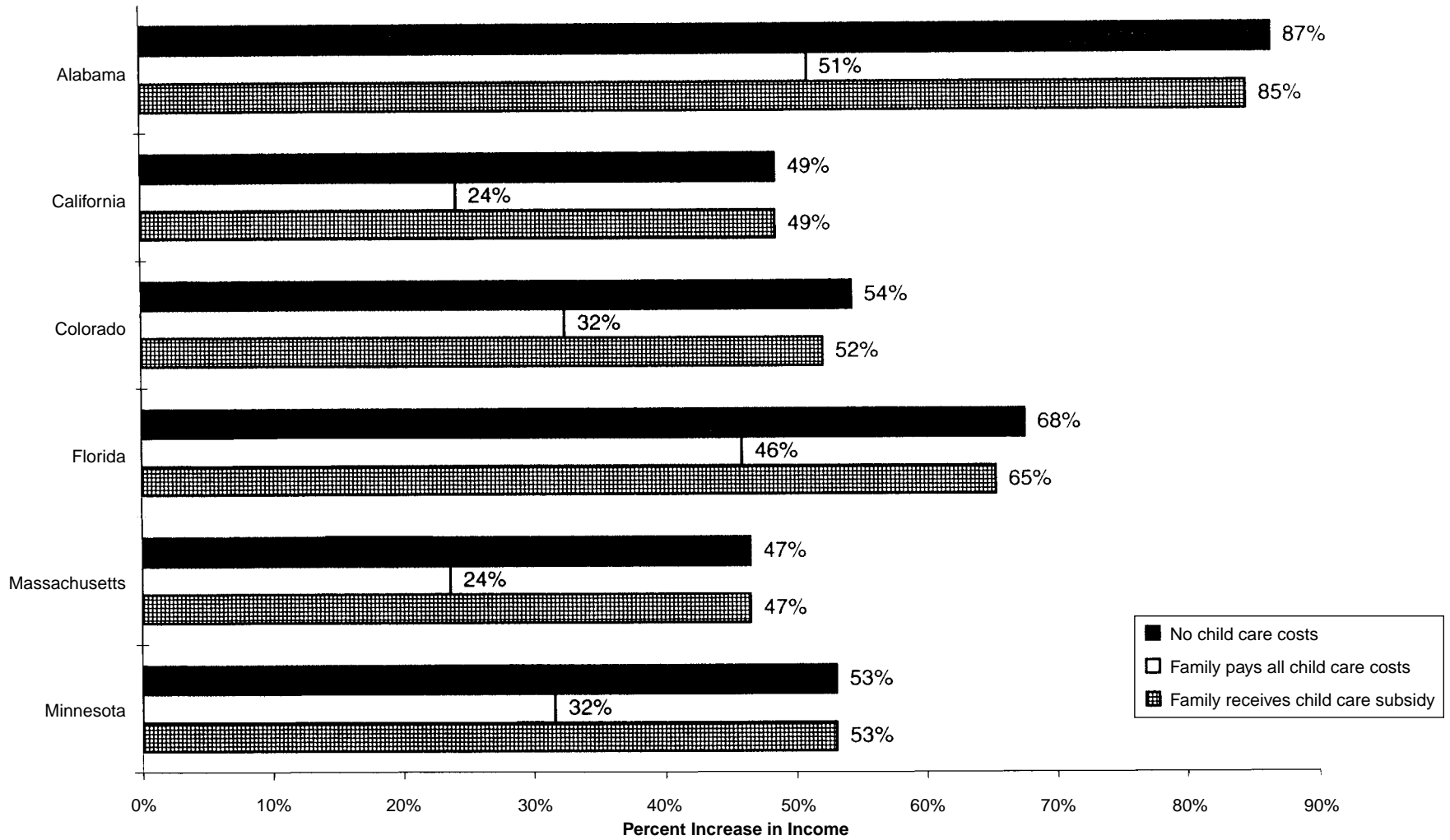


Figure 7 Monthly Total Income for a Family of Three (Single Parent with Two Children Working Full-Time at \$5.15/Hour) under Three Child Care Scenarios



Note: Unsubsidized child care cost based on the maximum reimbursement for full-time care for an 18-month-old child in a family day care home. Subsidized cost of child care based on the copayment required for such a child.

Figure 8 Percentage Increase in Monthly Total Income for Family of Three Moving from No Work to a Part-Time Minimum Wage Job, under Three Child Care Scenarios



Note: Unsubsidized child care cost based on the maximum reimbursement for full-time care for an 18-month-old child in a family day care home. Subsidized cost of child care based on the copayment required for such a child.

wage job to a full-time \$9/hour job will be greater for mothers who do *not* receive a subsidy. Ironically, because the subsidy phases out, the child care subsidy reduces the work incentive to move from full-time jobs paying minimum wage to higher-paying jobs in four out of the six states we consider.²⁵

This analysis shows that child care subsidies play an important role in preserving work incentives for families as they move from welfare into part-time and full-time minimum wage jobs. These subsidies also provide a form of income support by maintaining family incomes above what they would be if the family were to pay the full cost of child care. At higher income levels, however, the impact of child care subsidies is harder to assess and is partially dependent on the number of hours the parent works. In general, families receiving subsidies at higher income levels have higher total incomes than families paying the full cost of child care. But for states in which copayments increase sharply as incomes rise, work incentives may fall below their already low levels by increasing child care costs at the same time that food stamps and the EITC are being reduced.

It is important to note that this analysis assumes that the maximum reimbursement set by the state covers the full cost of child care. If the maximum reimbursement paid by the state is lower than the rates charged by providers, or if the state maximums are not increased in the future to keep pace with increases in market rates, it is possible that the family may need to pay additional child care costs. If this is the case, returns to work and family incomes will be lower than in the results shown above for families receiving a child care subsidy.

Medicaid. The Medicaid program provides health care to low-income and medically needy families. During 1994, the federal government spent nearly \$140 billion on Medicaid (Liska 1997), more than six times as much as it spent on AFDC. Policymakers have long feared, and academic research has shown, that the potential loss of Medicaid benefits deters families from leaving welfare for work (Winkler 1991; Yelowitz 1995). Indeed, while historically families receiving AFDC were categorically eligible for Medicaid, many low-wage workers had no health insurance (Uccello 1998). Since loss of Medicaid is a strong disincentive to leave welfare for work, Congress, under the Family Support Act of 1988, required states to expand Medicaid coverage for up to 12 months for families leaving AFDC for work. Under waivers, some states have expanded coverage for up to 24 months.

PRWORA broke the direct link between eligibility for cash assistance and Medicaid. While states enjoy a great deal of flexibility to set cash benefit levels, earnings disregards, and benefit reduction rates for aid under TANF, they must use policies that are at least as liberal as those under their old AFDC rules for determining eligibility for Medicaid (Ellwood and Ku 1998). Further, families that leave TANF for work are still eligible to receive 12 months of Transitional Medicaid Assistance (TMA).²⁶ And once transitional Medicaid benefits are exhausted, Medicaid expansions now provide coverage to all children under six years of age living in families with incomes below 133 percent

of the federal poverty level and to all children born after September 30, 1983, living in families with incomes below the poverty level (Ellwood and Ku 1998). Note that if the parent in a family of three worked 35 hours a week and earned \$9/hour, the family's earnings would still fall below 133 percent of poverty, and any children ages 6 and younger would still be covered by Medicaid. The parent would still need to find health insurance for herself, but after a year of steady employment she might even have access to employer-sponsored health insurance or be able to purchase reasonably priced individual coverage.²⁷

In addition, several states have been aggressive at expanding health insurance coverage to low-income families. For example, under its Basic Health Plan, Washington provides health coverage to 130,000 people who are not enrolled in Medicaid (Nichols et al. 1997). Similarly, Minnesota's MinnesotaCare program provides subsidized insurance for families with incomes up to 275 percent of the federal poverty level. And New York's Child Health Plus program provides coverage to Medicaid-ineligible children in families with incomes up to 222 percent of the federal poverty level (Holahan et al. 1997).

By decoupling Medicaid and cash assistance, making transitional benefits available, expanding the availability of coverage for children in low-income families, and creating state programs to help Medicaid-ineligible low-income families obtain health coverage, policymakers have attempted to minimize the work disincentives in the Medicaid program, at least in the short run. At the very least, Medicaid should not deter a parent from moving from no work to at least a part-time job. And historically, the negative impact of Medicaid on labor supply has centered around the movement from zero hours to some work; Medicaid does not appear to affect hours worked among those who do work (Winkler 1991).

As long as TANF recipients understand Medicaid's eligibility rules, we would not expect Medicaid to deter TANF recipients from leaving welfare; however, TANF recipients may not realize that they can continue to receive Medicaid when they leave TANF. A study by the Southern Institute of Families and Children finds that three out of four welfare families interviewed in North Carolina and Tennessee had misconceptions about Medicaid coverage. Further, community organizations working with welfare families in these two states were generally unaware of transitional Medicaid benefits (Ellwood and Ku 1998). Thus, while policy changes in Medicaid have significantly reduced, at least in the short run, the work disincentives that had been present, in the mind of a TANF recipient the perceived loss of Medicaid coverage may be a substantial obstacle to work.

In the long run, however, the adult's loss of health insurance under Medicaid after she has been off the TANF rolls and exhausted her TMA may force some families back onto public assistance. The work disincentives in the Medicaid program may be further reduced by extending TMA or by expansions in employer-sponsored health insurance.



The Impact of Time Limits on Work Incentives

Perhaps the most significant difference between TANF and AFDC is the lifetime time limit on the receipt of federal cash assistance. While one of our states (Michigan) has decided to use state funds to provide aid to families that have exceeded the federal lifetime 60-month limit, other states are prepared to impose time limits. Some states, such as Florida, have opted for a more stringent lifetime limit (48 months), and some states, such as Massachusetts, have elected to impose intermittent time limits (60 months total but no more than 24 months in any 60-month period). California will impose its time limit on parents but not on children: Exceeding the time limit will result in the TANF grant falling, because the parent will not be included in the TANF unit; it will not fall to zero, because the children in the family will still receive cash aid. All states, however, are allowed to provide hardship exemptions for up to 20 percent of their TANF caseloads. These exemptions usually cover domestic violence victims, the aged, and the disabled.²⁸

Ultimately, when a family reaches the time limit, the family will lose TANF benefits, and this provides a strong incentive to work. But even before a family exhausts its lifetime benefit, the presence of a time limit may affect work and welfare decisions. If a family knows that it will eventually be cut off from welfare, the adults in the family may decide to go to work. Further, parents may realize that if they receive TANF this month, they then have one less month of potential TANF benefits in the future. Consequently, a parent who has the option of taking a job this month may choose to take that job and forgo TANF now in order to preserve the option of receiving TANF at some time in the future when she may not be able to find work. How much is the option of TANF aid in the future worth to a parent choosing between work and welfare today?

Calculating today's value of a cash payment in the future requires us to make many assumptions. First, we must assess the probability that a given family will exhaust its lifetime benefits. Next, because families may cycle on and off welfare, we need to determine how many years it will take a family to exhaust its lifetime benefits. For example, it may take a family 10 years of elapsed time to exhaust 5 years worth of TANF benefits. Then, since some families will be given exemptions from the time limit, we must assess the probability that the family will not receive an exemption. We must also guess where the family expects TANF benefit levels to be in the future. For example, one family may assume that benefit levels will remain constant over time while another family may feel that swelling caseloads or inflation will erode future benefit levels. Finally, we need to know the value the family places on income today relative to income in the future. For example, a family that is not future oriented may prefer to have \$100 today rather than \$150 a year from today, while another family would be willing to forgo \$100 today for \$110 one year from now. The former family places a higher value on the present relative to the future than the latter family. The value a family places on the present relative to the future is referred to as the "subjective discount rate." Families with higher discount rates place a higher value on the present.

Since the work incentive impact depends on how families view their chances of exhausting the lifetime benefit, the number of years it will take them to exhaust the benefit, the chances of obtaining an exemption from the time limit, their estimation of future benefit levels, and their subjective discount rates, there is clearly no way to make strong statements about the incentive effects of time limits on the work/welfare choices of a "typical" family. However, we can show how different assumptions affect the relative value of today's TANF benefits.²⁹

Table 8 shows how much receiving TANF benefits today "costs" a family in terms of forgone benefits in the future under various scenarios. We assume the state has a single 60-month lifetime time limit. In scenario 1, we assume the family is certain that it will exhaust its lifetime benefit in five years and will not receive an exemption from the time limit. Further, benefits in the future will be the same as today. Finally, we assume a discount rate of 3 percent—roughly the rate of interest on savings accounts. Under this scenario, the family believes it is very likely that a month's benefit today will lead to losing a valuable benefit in the future. In fact, the cost of forgoing the benefit in the future is 86.3 percent of today's TANF benefit. Thus, the time limit makes TANF today considerably less attractive relative to work.

However, the assumptions in scenario 1 are rather extreme. Historically, 35 percent of new entrants to AFDC received AFDC for more than five years in their lifetimes (Pavetti 1995); consequently, for scenarios 2 through 6, we will assume that the family has a 35 percent chance of exhausting its lifetime benefits. When we reduce the probability of exhausting one's lifetime supply of TANF benefits to 35 percent yet make all the other assumptions we made in scenario 1, we find that receiving TANF today costs the family only 30.2 percent of its current TANF benefit. Many families cycle on and off welfare; as a result, it

Table 8 *The Impact of Time Limits on the Perceived Value of TANF Benefits in Month 1 under Various Assumptions*

Scenario	Assumptions					
	Probability of Exhausting Benefits (P_e)	Years until Benefits Are Exhausted (N)	Probability of Exemption from Time Limits (P_m)	Real Value of Benefits (B)	Discount Rate (δ)	Perceived Reduction in TANF Benefits
1	100%	5	0%	100%	3%	86%
2	35	5	0	100	3	30
3	35	10	0	100	3	26
4	35	10	0	100	3	21
5	35	10	20	100	20	5
6	35	10	20	50	20	1

Note: The percentage reduction in the perceived value of TANF benefits today as a result of time limits is calculated

$$\frac{B \cdot P_e \cdot (1 - P_m)}{(1 + \delta)^N}$$

where B = expected value of benefits in the future
 P_e = probability of reaching the time limit
 P_m = probability of being exempted from the time limit
 δ = subjective discount rate
 N = number of years until lifetime limit is reached

may take a family 10 years to exhaust 5 years of lifetime benefits. In scenario 3, we assume the family believes it has a 35 percent chance of reaching the time limit and will take 10 years to reach the limit; all other assumptions are as they were in scenario 1. Now we find that receiving TANF today costs the family 26 percent of its current TANF benefit.

In scenarios 4 through 6 we progressively relax additional assumptions. In scenario 4, we allow a 20 percent chance for an exemption. The cost of receiving TANF today falls to 20.8 percent of current benefits. In scenario 5, we allow the discount rate to rise to 20 percent, suggesting that the family is not future oriented. Under this scenario the cost falls to 4.5 percent of current benefits. And finally, in scenario 6, we assume that TANF benefits will fall over time. Assuming a 50 percent decline in benefits over 10 years, we find that receiving TANF today and forgoing TANF in the future costs a family about 0.9 percent of its current TANF benefit. Under this final scenario, time limits have little impact on current work incentives.

We do not wish to imply that any of these scenarios are plausible or more likely to arise than other scenarios. We simply want to illustrate how factors that are purely subjective on the part of families and unknowable to the policy analyst can affect how time limits affect the work incentives under TANF. And all these scenarios assume that the family is aware of the time limit, which may not be the case. In short, how the time limit affects TANF recipients and would-be recipients depends entirely on their view of the future relative to the present. To the extent that families worry about the future and believe they will need TANF support and will not be able to obtain an exemption, the time limit increases the incentive to work today. To the extent that they do not believe the time limit will be enforced, value the present over the future, or



believe that benefit levels will fall in the future, the time limit will be less effective in encouraging work today. Ironically, the fact that TANF is a block grant and not an entitlement may lead some would-be welfare recipients to believe that TANF benefits will fall in the future, and this in turn may foster a “get it while I can” mentality and actually make TANF more attractive than work in the short run.

Finally, it is not uncommon for families working part-time at low wages, and in some states working full-time at higher wages, to receive some support from TANF. Because families lose future benefit months when they combine work and TANF in most states, some families may choose to forgo TANF when they are working to preserve future TANF benefits.

The Treatment of Working TANF Recipients versus Other Low-Income Workers

This report has focused thus far on the incentives that TANF recipients face as their work effort and wage rates increase. To encourage families to begin working, some states have allowed TANF recipients to keep substantial portions of their TANF grants as their earnings rise; to keep program costs down, however, these same states have set eligibility standards to prevent low-wage workers from receiving TANF benefits. Thus, a family that qualified for TANF last month may be able to combine TANF and earnings and consequently have a higher total income than a family with the same level of earnings but no prior TANF receipt. This differential treatment of recipients and applicants raises significant equity concerns. Further, some families may reduce their work effort to qualify for TANF, then increase their effort to enjoy the higher income.

Table 9 illustrates the differential treatment of families trying to work their way off TANF and otherwise identical families who never received TANF benefits in five of our 12 focal states. In Massachusetts, for example, a single mother with two children earning \$655 a month would not be eligible for TANF benefits; however, if that same woman had been receiving TANF benefits and was trying to work her way off welfare, she would receive \$297 in benefits. Put another way, a single mother in Massachusetts with two children working about 30 hours per week at minimum wage can raise her income substantially if she quits work, draws TANF benefits for a month, and then goes back to her old job.

Table 9 <i>TANF Income Eligibility Limits of a Family of Three: Differential Treatment of Applicants and Recipients in Six States</i>		
State	Earnings Limit for TANF Eligibility	TANF Payment to a Family Working Its Way off TANF with Earnings at Eligibility Limit
Colorado	\$511	\$159
Massachusetts	655	297
Minnesota	930	249
New Jersey	636	125
New York	667	244

Source: Urban Institute calculations based on the Urban Institute's summary of state TANF plans, legislation, and regulations as of October 1997.

While Massachusetts represents one example of unequal treatment between TANF and non-TANF workers, substantial differentials exist in other states. In Minnesota, our family of three would not be eligible to receive TANF benefits if its monthly income exceeded \$930; if the family were working its way off TANF and earning \$930/month, however, it would receive \$249 in TANF benefits to supplement its earnings. A TANF family of three working its way off the rolls whose earnings just matched the eligibility cutoff for a non-TANF family could receive \$244, \$159, and \$125 in New York, Colorado, and New Jersey, respectively.

Other factors may also affect the incentives a working family faces to reduce its earnings and receive TANF benefits. For example, a family's food stamp grant would be higher if the family relied on earnings alone. On the other hand, families trying to work their way off TANF may be given preferential treatment for subsidized child care slots. Other programs, such as Medicaid, may affect the decisions of low-income, non-TANF families, but these effects are difficult to calculate.

Finally, time limits may affect a non-TANF family's work and welfare decisions. A family in which the parent is uncertain about her low-wage job and is relatively confident that TANF benefits in the future will be comparable to or better than those currently prevailing may choose to keep working and preserve future TANF eligibility. A family in which the parent is confident that she can retain or always find a low-wage job but fears that future TANF benefits will be significantly lower than those currently prevailing may choose to temporarily reduce her work effort, qualify for TANF, and then combine TANF and work until her benefits expire.

The differential treatment of TANF recipients and TANF applicants leads to considerable inequities in some states; thus, there is an incentive for working non-TANF families to reduce their earnings in order to qualify for benefits. Programs such as the Food Stamp program, whose benefits are based on earn-

ings and other transfer income, dampen the potential impact of this disparity. Other work support programs that may give preferential treatment to TANF families may increase the potential impact of the differential treatment of recipients and applicants. A priori, it is not clear how factors such as lifetime time limits will affect the incentive of working families to reduce their earnings so they may receive cash assistance under TANF.



Conclusion

One of the primary goals of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA) was to move welfare recipients off the public assistance rolls and into jobs. The legislation took a two-pronged approach: (1) it altered federal public assistance rules to make welfare less attractive relative to work, and (2) it gave broad authority to the states to adjust program rules to encourage recipients of federal cash aid to move into jobs. This report has examined the incentives faced by a single mother with two children as she attempts to move from welfare to work.

Using program rules from a representative sample of 12 states and considering earnings, cash benefits under TANF, the cash value of food stamps, the federal Earned Income Tax Credit (EITC), state EITCs, and other state tax credits as well as payroll, federal, and state tax liabilities, we find that, on average, a woman moving from no work to a 20-hour-per-week job paying \$5.15 an hour would enjoy a 54 percent increase in her income. The increase varies considerably from state to state, ranging from 108 percent in Mississippi to 38 percent in Washington state.

The work incentives under TANF are heavily weighted toward inducing nonworking families to move to work. However, the benefits of increased work effort and higher wage rates beyond part-time minimum wage work are offset by declines in cash aid and the phaseout of earned income tax credits. For example, a single mother with two children working full-time at minimum wage would see her net income rise by only 4 percent in California if she were to receive a 75 percent pay raise to \$9/hour.

Other public assistance programs may affect the incentives families face as they contemplate their welfare and work choices. Roughly one in five recipients

of cash aid receives federal housing assistance. Since housing aid falls as income rises, the work incentives faced by families receiving housing aid are somewhat lower than those faced by other families. Further, policymakers recognize that child care costs and the potential loss of health insurance may present substantial obstacles to families trying to move from welfare to work. As a result, statutory policies on child care subsidies have gone a long way to meeting child care costs. However, if child care costs far exceed state estimates or if the supply of sufficiently good child care providers is inadequate, child care needs may deter some families from moving from welfare to work. Similarly, expansion and liberalization of Medicaid eligibility basically allow families to keep health insurance coverage for at least a year after leaving TANF, and the children (and occasionally the parent) in these low-income families may retain coverage indefinitely. However, surveys of welfare recipients and family service organizations indicate that many recipients and organizations dedicated to helping low-income families are unaware of the Medicaid eligibility rules and may believe that TANF recipients will be cut off from health benefits when they attempt to move to work. This perceived loss of Medicaid may serve as a deterrent to work.

Finally, by imposing a lifetime time limit on the receipt of federal cash aid under TANF, the federal government may have significantly altered the work incentives for welfare recipients, but the impact depends on how low-income families view the future. If a family confronting the work-TANF choice today is worried about the future and feels that it will likely need support from TANF in the future, the lifetime time limit will effectively make TANF less attractive relative to work today. If the family is not very concerned about the future, feels it will not need TANF in the future, believes it will be exempt from the time limit, and/or believes that TANF benefits will be appreciably lower in the future, time limits will have little impact on work incentives.

Our analysis of the work incentives under TANF in 12 states highlights two important considerations for policymakers. First, while the financial incentives for moving from no work to some work are quite strong, it is not clear whether TANF recipients perceive this. Indeed, a significant factor in making work more attractive than welfare is the EITC. If TANF recipients do not receive advance payment of the EITC and do not associate their annual tax refund windfall with their work behavior, then the perceived work incentive is considerably lower than the actual incentive. Further, if TANF recipients are unaware of the Medicaid and child care benefits they will receive after leaving TANF, they may be unduly reluctant to leave TANF for work. Thus, policymakers may wish to engage in outreach activities to ensure that TANF recipients know how much work really pays.

Second, a single mother of two working full-time at minimum wage has almost as much income as she would have if she earned \$9/hour. While many critics of PRWORA fear that welfare recipients will be stuck in low-wage

(“bad”) jobs and never make it to good jobs paying \$8 to \$10 an hour, our analysis indicates that this fear may be misplaced—a family’s income from a “bad” job can be just as high as from a “good” job. This underscores the importance of maintaining and improving programs such as the EITC, child care subsidies, and expanded Medicaid that make work more attractive than welfare.



Appendices

Appendix A: Description of Benefit Calculation

To examine the incentives under Temporary Assistance for Needy Families (TANF), we compute the take-home income of a hypothetical family, consisting of a single parent and two children, in 12 states.¹ We assume that the family lives in the largest city in the state, does not possess assets that would preclude receiving TANF assistance, and only receives income from earnings and the public transfer programs we consider. We consider four work possibilities for this family: (1) no job; (2) a part-time job, 20 hours per week, at minimum wage; (3) a full-time job, 35 hours per week, at minimum wage; and (4) a full-time job at \$9/hour.

The take-home income for this family consists of earnings, TANF benefits, the estimated value of its food stamp allotment, and payments from the federal and state earned income tax credits (EITCs), less payroll taxes and federal and state tax liabilities.

Most states use the same method for computing TANF benefits as they did to compute benefits under the old Aid to Families with Dependent Children (AFDC) program; however, they have altered many of the parameters, such as earnings disregards and benefit reduction rates.² A family's benefit is based on its income. To receive benefits under the old AFDC rules, gross income had to be below 185 percent of the need standard. If a family passed the gross income test, the state would compute net income by disregarding the first \$120 of monthly earnings and one-third of the remainder. The benefit paid was the difference between the state's payment standard and net income, although in some states it could not exceed an established maximum payment.



Under TANF and, in some cases, waivers, Michigan, Minnesota, and New Jersey eliminated the gross income test and Florida modified rules such that gross income must be less than 130 percent of the federal poverty level. The earnings disregard rules were changed much more liberally, with only Colorado and Texas retaining the AFDC disregards. The new disregards vary greatly from state to state, ranging from \$225 and half of the remainder in California to 20 percent of monthly income in Alabama.

A family's food stamp allotment depends on income and housing costs. Housing expenses for families not receiving rental assistance were based on U.S. Department of Housing and Urban Development (HUD) estimates of the cost of renting in different regions of the country as well as reported housing expenses for food stamp recipients. Using data from the 1995 Food Stamp Quality Control System, we average the reported shelter expenses for single mothers with two children, omitting families with zero shelter expenses. This average was compared with the 1995 state average fair market rents (FMR). We derive our estimate of 1997 shelter expenses by multiplying the average ratio of these two measures (68 percent) by the 1997 FMR in the largest city in the state and assume this is what the family must spend in rent.

We model the federal rules that apply to families receiving a housing subsidy as follows: Families' rent payments are the maximum of either 10 percent of earnings plus TANF benefits or 30 percent of earnings plus TANF, disregarding \$40 for each dependent child. Rent payments are subject to a \$25 minimum.³ The housing subsidy equals fair market rent less family rent payments.

To calculate food stamp benefits, we first calculate net income, which includes earnings and TANF benefits but disregards 20 percent of earnings, 50 percent of any shelter expenses that exceed the maximum (\$247 per month in 1997), child care expenses (subject to a maximum), and a standard deduction of \$134 per month.⁴ We use the housing calculations described above as the actual shelter expenses. If net income is less than the federal poverty level and gross income is less than 130 percent of poverty, the family is eligible for food stamps. The food stamp benefit is the maximum allotment minus 30 percent of the net income.

Payroll taxes equal 7.65 percent of earnings in all the work scenarios. For 1997 federal tax computing purposes, we assume that the parent files as a head of household unless the earnings are less than her TANF and food stamp payments combined, in which case she must file as "single," according to IRS rules. Taxable income consists of earnings less the standard deduction and the deduction for the number of dependents in the household, which is dependent on filing status.⁵ The amount of income tax is 15 percent of the taxable income. We do not include the \$400 child deduction that will take effect in 1998. Generally speaking, federal tax liabilities have little impact on the total income calculations in these income ranges.

Unlike the tax liability, the federal EITC has a relatively large impact on total income. We assume that both children in our family of three lived with the parent for all 12 months and did not live with a biological relative (such as a grandmother) who has a higher income and supplies more support than their parent. For a family with two qualifying children in 1997, the credit is phased in at 40 percent until earnings reach \$762 monthly; at this level the EITC is worth \$305 per month. The amount of the credit remains constant until earnings exceed \$994 a month. Then the credit is phased out at 21.06 percent until it falls to zero, when a family's income reaches \$2,441 a month. Since this is a refundable credit, the amount of the EITC is included as income even if the family owed little or no federal taxes.

We calculate state tax liabilities using 1997 state tax forms. Florida, Texas, and Washington do not have state income taxes. We make a few more assumptions to simplify the tax calculation. For all states, we assume the family resides within the state all year, files on time, and files for the federal EITC if it qualifies. For families in New Jersey who do not live in public housing, we assume that they rent their residence and receive a rent-credit property tax refund. In Michigan, again we assume the family rents its residence and claims the Homestead Property Tax credit. For Minnesota, we assume that the family is not Native American. In general, the state tax liability is small, ranging from nothing to \$40 a month.

As with the federal tax, the state refundable credits have a larger impact on total income than the liabilities. Six states have refundable credits of varying sizes. Colorado has a refundable sales tax credit, New Jersey a property tax credit, and New York, Massachusetts, and Minnesota a state EITC program of their own. Michigan has an interesting refundable housing credit: Not only is the credit dependent on adjusted gross income and the amount of rent paid, it is also inversely related to the percentage of income that comes from welfare.

Appendix B: How Much Has the World Changed?

One of the goals of the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) is to encourage innovation at the state level. The architects of the legislation clearly believe that a state can design a social welfare system that is better suited to the needs of the state's population than a centralized federal bureaucracy. While states have only recently developed their plans for providing aid under TANF, we can begin to see how states have used their new freedom to alter their social welfare programs. We compare the work incentives prevalent under state TANF plans in 1997 to the state's cash assistance rules in 1994. In 1994, some states still operated under the federal AFDC



Table B.1 *Ratio of Total Income for a Family of Three under TANF to Total Income under 1994 AFDC and 1115 Waiver Rules in 12 States*

State	No Work	Part-Time, Minimum Wage	Full-Time, Minimum Wage	Full-Time, \$9/Hour
Alabama	-4%	4%	6%	4%
California	-8	-3	2	4
Colorado	-4	3	5	4
Florida	-5	9	7	4
Massachusetts	-6	4	9	7
Michigan	-4	2	5	3
Minnesota	-8	5	9	3
Mississippi	-4	-3	6	4
New Jersey	-13	-6	1	-1
New York	-5	3	8	6
Texas	-4	4	6	4
Washington	-4	0	5	4
Median	-4	3	5	4

Notes: Total income consists of earnings, TANF benefit, cash value of food stamp allotment, federal Earned Income Tax Credit, and state earned income and other tax credits, less the employee's share of payroll taxes and federal and state income tax liabilities.

Program rules are based on the Urban Institute's summary of state TANF plans, legislation, and regulations as of October 1997.

Total income in 1994 was calculated by deflating \$5.15 and \$9 to 1994 dollars, using the Consumer Price Index (CPI). For comparison, we inflated 1994 total income to 1997 dollars using the CPI.

program rules,* while other states, such as Michigan, received waivers that allowed them to establish alternative program rules.

For our calculations, we deflate our \$5.15 and \$9.00 per hour wage rates to 1994 dollars. (Note that in 1994, a job paying \$4.55/hour paid more than the prevailing minimum wage.) We then used 1994 program and tax rules to calculate total income for a family of three under our four work/welfare scenarios. Finally, we inflated our 1994 total incomes up to 1997 dollars.

Table B.1 shows that in purely financial terms, the world under TANF is similar to the world under AFDC and waivers. Generally, a family of three with no labor income fared better under AFDC than it does under TANF, while a family in which the parent works fares slightly better under TANF. Under TANF, our family of three's total income would be, on average, 4 to 5 percent lower than it would have been under AFDC if the parent did not work. A family in which the parent worked part time at \$5.15/hour is better off under TANF than under AFDC in all our study states except New Jersey. The difference between 1994 and 1997, however, is quite small—about 4 percent on average. As a family moves from part-time work to full-time work at \$5.15/hour, the TANF

*As a family tried to work its way off AFDC, the first \$120 of monthly earnings and one-third of all remaining earnings were disregarded in calculating the family's cash grant.

Table B.2 *Differences in Work Incentives between TANF and 1994 AFDC and 1115 Waiver Rules as Hours and Wages Rise*

State	No Work to Part-Time Minimum Wage	Part-Time Minimum Wage to Full-Time Minimum Wage	Full-Time Minimum Wage to Full-Time \$9/Hour
Alabama	0.14	0.02	-0.02
California	0.08	0.05	0.01
Colorado	0.12	0.02	-0.01
Florida	0.21	-0.02	-0.03
Massachusetts	0.13	0.06	-0.02
Michigan	0.09	0.03	-0.03
Minnesota	0.18	0.05	-0.07
Mississippi	0.02	0.11	-0.02
New Jersey	0.10	0.08	-0.01
New York	0.10	0.05	-0.02
Texas	0.15	0.02	-0.02
Washington	0.06	0.06	-0.01
Median	0.11	0.05	-0.02

Note: Table presents the percentage point difference between the percentage change in total income under TANF and the change in total income under 1994 AFDC rules.

advantage grows slightly. As wage rates rise to \$9/hour, the TANF advantage ebbs slightly in all states except California.

Table B.2 shows differences between TANF and AFDC in how a family's total income changes as work effort and wage rates increase. Under TANF, as a family in, for example, Alabama moved from no work to part-time work at \$5.15/hour, its total income would grow by 86 percent. Under 1994 AFDC rules, the same family's income would have grown by 72 percent. Thus, the reward for moving from no work to part-time low-wage work for a family of three in Alabama is 14 percentage points higher under TANF than it was under the 1994 AFDC rules. The largest increase in work incentive is in Florida (21 percentage points) and the smallest is in Washington (6 percentage points). In 11 out of 12 states, increasing hours from part-time to full-time is rewarded more under TANF than under AFDC. And in 11 out of 12 states, the rewards for a 75 percent increase in wage rate for a full-time worker were greater under AFDC than under TANF.

In short, maximum benefits were a little less generous under TANF than under AFDC (mostly because benefit levels were not adjusted for inflation), but they allowed workers to keep more of their earnings as they began to work. Because benefits generally phase out more slowly under TANF than under AFDC, the rewards of large pay increases for full-time workers are somewhat smaller under TANF than under AFDC. For the most part, however, the differences in total income under the two regimes are small, and differences in the work incentives are modest at best.



Appendix C: Supplementary Tables

	TANF Rules		Effective Disregards	
	Flat Disregard	Benefit Reduction Rate	Flat Disregard	Benefit Reduction Rate
Alabama	\$0	80%	\$0	80%
California	225	50	225	50
Colorado*	120	66.7	217	66.7
Florida	200	50	200	50
Massachusetts	120	50	120	50
Michigan	200	80	200	80
Minnesota*	0	64	118	64
Mississippi*	90	100	258	60
New Jersey*	0	50	38	50
New York	90	58	90	58
Texas	120	66.7	120	66.7
Washington	0	50	0	50

Source: The Urban Institute's summary of state TANF plans, legislation, and regulations as of October 1997, and Urban Institute tabulations.

*Gap state (a state whose TANF payment standard exceeds its maximum benefit).

Table C.2 *Monthly Total Income for a Family of Three under Four Work Scenarios and Three Child Care Scenarios in Six States*

State	Child Care Scenario	Work Scenario			
		No Work	Part-Time, Minimum Wage	Full-Time, Minimum Wage	Full-Time, \$9/Hour
Alabama	No child care costs	\$479	\$894	\$1,198	\$1,442
	Family pays full child care costs	479	724	993	1,266
	Family receives child care subsidy	479	885	1,175	1,404
California	No child care costs	825	1,226	1,449	1,512
	Family pays full child care costs	825	1,025	1,115	1,207
	Family receives child care subsidy	825	1,226	1,449	1,512
Colorado	No child care costs	674	1,041	1,243	1,478
	Family pays full child care costs	674	893	988	1,260
	Family receives child care subsidy	674	1,026	1,205	1,405
Florida	No child care costs	618	1,036	1,275	1,489
	Family pays full child care costs	618	902	1,050	1,306
	Family receives child care subsidy	618	1,022	1,250	1,451
Massachusetts	No child care costs	825	1,209	1,448	1,522
	Family pays full child care costs	825	1,020	1,132	1,235
	Family receives child care subsidy	825	1,209	1,445	1,466
Minnesota	No child care costs	763	1,168	1,409	1,475
	Family pays full child care costs	763	1,004	1,056	1,150
	Family receives child care subsidy	763	1,168	1,409	1,481

Source: The Urban Institute's summary of state TANF plans, legislation, and regulations as of October 1997.

Notes: Total income consists of earnings, TANF benefit, cash value of food stamp allotment, federal Earned Income Tax Credit, and state earned income and other tax credits, less the employee's share of payroll taxes and federal and state income tax liabilities.

Unsubsidized child care cost based on the maximum reimbursement for full-time care for an 18-month-old child in a family day care home. Subsidized cost of child care based on the copayment required for such a child.



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Notes

1. The 12 states are Alabama, California, Colorado, Florida, Massachusetts, Michigan, Minnesota, Mississippi, New Jersey, New York, Texas, and Washington. These 12 states contain a large portion of the nation's population, including about half of all Aid to Families with Dependent Children (AFDC) recipients. They represent a broad range with respect to geography, fiscal capacity, citizen needs, and traditions of providing government services. Focusing on these states presents us with a fairly general, albeit incomplete, picture of the work incentives facing TANF recipients.
2. Information on state TANF plans is drawn from Jerome Gallagher, Megan Gallagher, Kevin Perese, Susan Schreiber, and Keith Watson (1998) and reflects program rules as of October 1997. All federal and state programs and tax rules are as of 1997.
3. Under AFDC's "30 and a third" rule, recipients were allowed to disregard \$90 per month to cover work expenses plus an additional \$30 and one-third of all additional earnings in the first few months of working. Thus, the income disregard was effectively \$120, and the BRR was 1-1/3 or 67 percent.
4. Economists differentiate between income/wealth and substitution effects. Put simply, the more income/wealth the individual has, the less likely she is to work; the higher her wage rate, the more likely she is to substitute work for leisure. Lower BRRs or tax rates effectively increase an individual's wage rate. This has two offsetting effects: (1) the individual will substitute work for leisure and work more, and (2) for any given amount of hours the individual works, she will have more income and so she will work less. Generally, the substitution effect dominates the income/wealth effect, although it is theoretically possible for the income effect to dominate. We will assume that the net impact of higher disregards and lower BRRs unambiguously provides an incentive to work for the low-income population.
5. In some gap states, recipients receive the lesser of the maximum payment and fraction of the difference between the payment standard and net income.
6. A full description of benefit computations appears in appendix A. Table C.1 shows statutory and effective earnings disregards and BRRs for the 12 states.
7. Because the federal EITC phases out after a family's income passes a certain level (\$11,950 for a family with two children in 1997, for example), it may serve as a work disincentive for higher-earning yet still low-income families.
8. We assume the family lives alone and receives no child support or other unearned income.
9. Alabama and Mississippi disregard all earnings in the first three months of work and New Jersey disregards all earnings in the first month of work. For these three states, we use the disregards that apply after this initial period is completed.
10. Minnesota combines TANF with food stamps; consequently, we do not present a measure of Minnesota's TANF grant alone.
11. The median benefit level of the 12 states is calculated as the simple average of the benefit levels in the sixth and seventh most generous states.
12. For a detailed description of work requirements, see Gallagher et al. (1998).
13. We assume 4.3 weeks in a month.
14. An economist might refer to this argument as the "diminishing marginal utility of income"—the more income a person has, the less each additional dollar is worth to that person.
15. Mississippi is a gap state. Not only is its payment standard higher than its maximum benefit but it only pays the lesser of 60 percent of its computed benefit or the maximum benefit. Thus, while its maximum benefit is only \$120 for a family of three, its effective earnings disregard is \$372 and its effective BRR is 40 percent. As a result, the strong work incentive in Mississippi is a function of both low benefit levels and generous disregards and BRRs.
16. For virtually all workers in the United States, not just low-wage workers, a 75 percent increase in gross income will translate into a smaller increase in net income because of pay-

roll taxes and progressive income tax rates. For example, if a single parent of two working 35 hours per week at \$12/hour were to receive a 75 percent pay increase, to \$21/hour, her income would increase by about 50 percent.

17. Meyer and Rosenbaum (1997), however, find that a large share of the increase in work by single mothers in recent years can be attributed to the EITC.
18. The Tax Payer Relief Act of 1997 enacted a nonrefundable \$400 child tax credit for 1998. With this tax credit, a single mother with two children working full time at \$9/hour would have no federal tax liability (currently, her federal tax liability is \$28/month). Had this credit been in place for 1997, the percentage change in family income for moving from a full-time, minimum wage job to a full-time \$9/hour job would have been about 2 percentage points higher in all 12 states.
19. Families with very young children may be eligible for food vouchers through the Women, Infants, and Children (WIC) program. While some states also run General Assistance programs, most of these programs generally provide aid to families and individuals who are not eligible to receive federal cash assistance.
20. We describe how we calculate the value of federal housing assistance in appendix A.
21. California does not specifically exempt TANF recipients from having to pay a copayment for subsidized child care; however, families with incomes less than \$1,669 are exempt from the copay requirement. Because this is greater than the TANF income limit, TANF families are de facto exempt from copayments.
22. Table C.2 presents monthly total income for all four work scenarios and all three child care scenarios.
23. This assumes that the family has no child care costs when the parent is not working, even if she requires child care in order to participate in a work activity required under the state's TANF program.
24. The exception is Alabama. This occurs because the increase in child care costs for a parent moving from part-time to full-time work is relatively small in Alabama and is offset through increases in food stamps (because of the child care expense deduction).
25. California and Minnesota are exceptions. In California, a mother working full time at \$9/hour does not have to make a copayment for child care—thus, the subsidy still covers the full cost. In Minnesota, a state tax credit offsets the copayment.
26. The 12-month TMA period is divided into two 6-month periods. For the first six months, the family's benefits remain unchanged; for the second six months, states can require the family to enroll in a managed care program, reduce services, and require some copayment or contribution toward premiums. Some states have provisions to extend TMA for longer periods. For example, Mississippi and Minnesota offer TMA for up to 24 months.
27. It is likely that a privately purchased plan or an employer-sponsored plan will require a subscriber to meet a deductible and copayment requirements and will not offer the same scope of coverage as Medicaid.
28. Families with disabled adults or children may qualify for aid under the SSI program and under state General Assistance and disability programs.
29. To calculate the cost today of forgoing benefits in the future as a percentage of today's benefit, we use the following formula

$$\frac{B \cdot P_e \cdot (1 - P_m)}{(1 + \delta)^N}$$

Where B is the expected value of benefits in the future as a share of today's benefit (i.e., if a family believes that its monthly TANF benefit in the future will purchase the same amount of goods and services as its TANF benefit this month, then $B=100$ percent), P_e is the probability of reaching the time limit, P_m is the probability of receiving an exemption to the time limit, δ is the annual subjective discount rate, and N is the number of years until the time limit is reached.



Notes to Appendices

1. The 12 states are Alabama, California, Colorado, Florida, Massachusetts, Michigan, Minnesota, Mississippi, New Jersey, New York, Texas, and Washington.
2. For a description of welfare parameters and rules see Gallagher et al. (1998).
3. The \$25 minimum rent tries to capture rules that differ locally. Starting in 1996, local public housing authorities (PHAs) have had the authority to charge a minimum rent of up to \$50 per family, but as of March 1997, HUD had not collected data on the number of PHAs instituting a minimum rent policy or the amount at which it is set. In addition, HUD began charging a minimum rent of \$25 for families in Section 8 project-based housing. The amount of the housing subsidy equals the FMR minus the out-of-pocket cost.
4. Food stamp parameters and rules were published October 1996 by the U.S. Department of Agriculture and appear on the World Wide Web at www.usda.gov/fcs/stamps/fselig.htm.
5. Federal tax and EITC information can be found at www.irs.treas.gov.

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