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The pitfalls of work requirements in welfare-to-work policies: Experimental evidence on human capital accumulation in the Self-Sufficiency Project ☆

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ABSTRACT

This paper investigates whether policies that encourage recipients to exit welfare for full-time employment influence participation in educational activity. The Self-Sufficiency Project ('SSP') was a demonstration project where long-term welfare recipients randomly assigned to the treatment group were offered a generous earnings supplement if they exited welfare for full-time employment. We find that treatment group members were less likely to upgrade their education along all dimensions: high-school completion, enrolling in a community college or trade school, and enrolling in university. Thus, 'work-first' policies that encourage full-time employment may reduce educational activity and may have adverse consequences on the long-run earnings capacity of welfare recipients. We also find that there was a substantial amount of educational upgrading in this population. For instance, among high-school dropouts at the baseline, 19% completed their diploma by the end of the demonstration. Finally, we simulate the consequences of the earnings supplement in the absence of adverse effects on educational upgrading. Doing so alters the interpretation of the lessons from the SSP demonstration.

1. Introduction

A central issue in the design of social programs is minimizing adverse consequences. In structuring their welfare programs many countries have struggled with the conflicting objectives of providing adequate support to low-income families, encouraging work and achieving low government costs. Much economic research has been devoted to understanding the effects of program design on work incentives. Impacts on family composition and fertility have also received attention. Little is known, however, about the subject of this paper — the impacts of welfare programs on educational attainment.

During the 1990s, traditional welfare programs were substantially restructured in the U.S. and several other countries. A central goal of these reforms was to encourage work and economic self-sufficiency. Although much has been learned about the consequences of these policy changes, several unresolved issues remain. One contentious issue involves the choice between "work-first" and "human capital development" approaches to achieving self-sufficiency. The work-first approach – which emphasizes moving recipients into jobs quickly, even if at low initial wages – reflects the view that welfare recipients can best acquire work habits and skills at the workplace. In contrast, the human capital approach seeks to raise the long-term earnings capacity of welfare recipients by providing training and educational opportunities.

A noteworthy feature of recent welfare policies has been the emphasis on financial incentives. Many U.S. states have experimented with welfare-to-work programs since the early 1980s. The replacement in 1996 of the Aid to Families with Dependent Children program with the Temporary Assistance for Needy Families block grant gave states much more discretion in the design of their welfare programs. This greater authority, together with federal targets for work requirements, led to increased use of financial incentives. Unlike the negative income

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tax programs evaluated in the 1960s and 1970s, recent financial incentives often emphasize full-time employment (Blank et al., 2000).

This paper makes three contributions. First, and foremost, we contribute to the debate over alternative approaches to welfare reform by investigating whether policies that provide a financial incentive to exit welfare for full-time work influence participation in educational activity. As noted by Moffitt (2002), the effects of transfer programs on human capital investment have received little attention.[1] By raising the return to existing skills, such policies may reduce the incentive to invest in additional education. In addition, by encouraging full-time participation in the workforce they reduce the time available for other activities, including acquiring further education. Earnings supplements that are conditional on full-time employment may thus inadvertently reduce the long run earnings capacity of welfare recipients. Our investigation provides rather striking evidence that this may indeed be the case.

The second contribution is to our understanding of the factors that influence the behavior of welfare recipients. Most economic analysis of income support policies employs a static choice framework.[2] Central to this workhorse model is the way that alternative policies alter the budget constraint faced by current and potential program participants. Our analysis highlights two aspects of behavior that standard models often abstract from. One is the time constraint. Raising young children and upgrading one's formal schooling are activities that compete with market work for available time. The second is forward-looking behavior, a feature emphasized by Miller and Saunders (1997), Keane and Wolpin (2002) and others. In our setting, investing in additional education involves incurring time and financial costs today in return for expected future benefits. Our results indicate that taking into account the longer-term consequences of current decisions is important to understanding the behavior of welfare recipients.

To address these issues we employ data from the Self-Sufficiency Project (SSP), a demonstration project designed to provide a rigorous test of a temporary earnings supplement. The SSP was carried out in the Canadian provinces of British Columbia and New Brunswick during the 1990s and was evaluated using a random assignment design. The treatment involved a generous earnings supplement for those leaving welfare to take full-time employment.

The paper's final contribution is to enhancing our understanding of the lessons from the SSP demonstration itself. A central objective of the experiment was to test the theory that a temporary earnings supplement could have long-term impacts on employment, earnings and welfare receipt. By providing recipients with a strong financial incentive to exit welfare and take up full-time work, treatment group members would gain additional work experience, potentially leading to higher wages and improved employment opportunities. Preferences between work and non-work activities might also be altered by increased exposure to the workplace. As a consequence, work could become a better alternative to welfare after the end of the earnings supplement.

The results of the SSP demonstration have led many observers to conclude that temporary earnings supplements are unlikely to have long-lasting impacts. Although the financial incentive offer did result in a large decline in welfare receipt and a substantial increase in employment during the supplement period, by the end of the SSP demonstration there were no significant differences between treatments and controls in employment or welfare receipt (Michalopoulos et al., 2002). However, our results suggest that providing a financial incentive for full-time employment can have both positive and negative effects on human capital accumulation of welfare recipients. The former arise from additional work experience, and the negative impacts arise from reduced investment in formal education. Whether the overall impact is positive or negative depends on the magnitudes of these offsetting effects. This new interpretation of the lessons from the SSP follows from the unintended consequences on educational upgrading of providing incentives to work full-time.

Our examination of SSP data indicates that increases in educational attainment among current and former welfare recipients are quantitatively important. Based on our preferred sample, about 19% of those who were high school dropouts at the time of the baseline survey had completed secondary school by the 54-month survey. Among those who had graduated from high school at the baseline, substantial educational activity is also evident in the form of enrolment in community colleges and universities. The extent of educational upgrading suggests that this is a phenomenon worthy of investigation.

The key finding of the paper is that the offer of a financial incentive to exit welfare and take full-time employment reduced educational upgrading among SSP participants. The impact of the supplement offer on educational activity was largest in the first 18 months after random assignment, when the difference in full-time employment between the treatment and control groups was the largest. We conclude that encouraging full-time employment has potentially adverse consequences for the long-term earnings capacity of single parents on welfare.

Another conclusion is that the SSP experimental impacts may have caused observers to reach incorrect conclusions about the long-term effects of temporary earnings supplements, and the mechanisms by which such effects occur. Those who upgraded their formal education achieved gains in employment and reductions in welfare receipt relative to their counterparts who did not acquire additional education. The gains experienced by "upgraders" appear to be principally a consequence of their investments in education rather than being due to unobserved factors that are correlated with both the propensity to acquire education and individual outcomes. We simulate the impacts of the SSP financial incentive on welfare receipt in the absence of any impact on educational upgrading. Our simulation results suggest that in these circumstances the temporary earnings supplement could have long-lasting effects.

The paper is organized as follows. The next section provides background on the SSP demonstration. Section 3 outlines a simple economic model that motivates the empirical analysis and helps to interpret the results. The fourth section describes the data used in our investigation. Section 5 analyses the impact of the SSP financial offer on educational upgrading, utilizing the random assignment feature of the research design. Particular focus is given to high school completion among secondary school dropouts. This part of the analysis examines whether encouraging recipients to work full-time reduces the amount of formal educational upgrading that would have otherwise occurred. Section 6 examines the extent to which our empirical results lead to a re-assessment of the implications of the SSP experiment. The final section concludes.

2. Background

Alternative welfare-to-work strategies have been extensively debated. A particularly contentious issue is whether to encourage welfare recipients to enter the work force with their existing skills or to help them to acquire additional human capital. As discussed by Blank (2002), evaluations indicate that the work-first strategy increases earnings and reduces welfare receipt to a greater extent than does the human capital strategy, at least in the short run (two to three years after entry into the program). However, human capital strategies may be superior over longer time horizons. For example, using data from California's GAIN program – a program that adopted a variety of welfare-to-work strategies – Hotz et al. (2006) find that recipients who participated in human capital programs did as well as or better than those in work-first programs in years 7 to 9 after the program.

[1] The principal exception is Miller and Saunders (1997) who examine the impact of state-level generosity of welfare on high school completion. Kesselman (1976) makes the point that, for those expecting to remain on public assistance, welfare reduces the incentive to invest in education.

[2] See Moffitt (2002) for a survey of the literature on welfare programs and labor supply.