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## Welfare to Work in the US: A Model for Germany?

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# Working Papers

## WELFARE TO WORK IN THE U.S.: A MODEL FOR GERMANY?

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## WELFARE TO WORK IN THE U.S.: A MODEL FOR GERMANY?

### Abstract

Social assistance in Germany reduces the incentive to work. The U. S. Welfare to Work Programme tries to avoid such disincentives. It consists essentially of two elements: the Earned Income Tax Credit (EITC) for employees in low wage occupations and a Workfare model. The EITC and the Workfare model as implemented in the State of Wisconsin are described and analysed. Conclusions for welfare reform in Germany are drawn.

JEL Classification: I38, J31, J38

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# Welfare to Work in the U. S.: A Model for Germany?

## 1. Introduction

Welfare reform is on Germany's political agenda. Besides retirement benefits and health insurance the basic provision of social security<sup>1</sup> has become increasingly an object of public interest. One reason for this is the increasing number of social welfare recipients as well as the increase in expenditure for welfare. The heavy burden on the state's finances caused by German unification has led to a feeling that welfare has become too heavy a burden. At the same time it was recognised that by setting a lower limit to wages, welfare reduces the possibilities of low wage employment. It shifts the wage structure upwards, makes labour more expensive and limits the demand for workers with low levels of qualification. And finally it became more and more apparent that welfare has negative effects on the recipients, particularly with respect to their willingness to seek work. This negative effect may be due to the small difference between disposable income in the case of accepting work and the level of welfare. The nearly full deduction of wages earned from the welfare payments actually received is also likely to weaken the incentive to accept work.

These problems have led to a series of reform proposals. They run the spectrum from a reduction in the absolute amount of welfare, the introduction of a negative income tax to granting wage subsidies in case of long-term unemployment. As alternatives to these proposals, in a number of OECD countries novel *Welfare to Work* programmes have been conceived and implemented. The US-American *Welfare to Work* programme to which the following remarks are confined consists essentially of two elements. On the one hand, it gives employees in low wage occupations an Earned Income Tax Credit (EITC). This is designed to provide an incentive to take a job. On the other hand, since 1996 the USA have pursued a Workfare model. In contrast to Germany, welfare is only granted in return for work performed. The welfare recipient is required to accept a job provided, or subsidised, by the public sector. If this work requirement is not fulfilled, the claim to welfare lapses. Moreover, the right to receive welfare payments or to take part in programmes designed to help finding a job is limited to a certain period.

This paper is structured as follows: After a short description of the system of basic social security in Germany (section 2), the EITC will be analysed (section 3). Then the American Workfare model as implemented in the State of Wisconsin is introduced (section 4). An exposition of the principles of employment assistance (section 5) and an evaluation of Wisconsin's Workfare Programme (section 6) follow. In the final section, conclusions for welfare reform in Germany are drawn.

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<sup>1</sup> The present study will focus on what is called in Germany social assistance (*Sozialhilfe*) and what is commonly referred to in the United States as "welfare"; unemployment benefits are of course part of the system of social security but will be dealt with in the present paper only in passing.

## 2. Basic Social Security in Germany

§ 1 of the Federal Law on Social Assistance (Bundessozialhilfegesetz - BSHG) assigns to the programme of social assistance, as one component of “welfare” is termed in Germany, the responsibility for ensuring that everyone can carry on a life in dignity. Hence the state guarantees the poor an income that corresponds to a “socio-cultural” existence minimum. Welfare thus serves to safeguard domestic tranquillity and, at the same time, to limit crime. It protects people against risks in life and, thus, increases their willingness to accept risks (Sinn 1996).

Social assistance is the final net in Germany’s system of social security. It becomes relevant in cases of need, when none of the other systems of protection provide help. The social assistance legislation obliges every recipient to use his own labour power to earn his livelihood (§ 18 BSHG). The social assistance organisations shall help to reintegrate the recipients of social assistance in the labour market. Thus, *de jure* there is already a system designed to help the recipients of social assistance to find work. In practice, however, up to now little has been done in this direction.

Social assistance consists of recurrent and one-off payments to provide the recipient’s means of livelihood and to provide assistance in special situations. This last category includes assistance in the case of illness, integration assistance for disabled persons, care of chronically ill people, and assistance to the blind. The recipients of this kind of assistance are generally incapable of work and for this reason are not referred to in what follows. Payments to provide the means of livelihood (*Hilfe zum Lebensunterhalt*) are made when a household’s income is not sufficient to cover a “socio-cultural” existence minimum. These payments cover the basic needs of everyday life (Grossman 1998).

The basis of calculation of social assistance payments are the so-called normal allowances. They are based on the consumption behaviour of low-income households and are regularly adjusted in the light of the development of households’ net income and cost of living developments. These normal allowances are supplemented by contributions to cover the cost of lodging and heating. Supplements based on need and one-off payments for special needs are added. In the first half of 2000 a married couple with two children (5 and 11 years old) received DM 2353 (€1203) monthly. Taking into account the child allowances to which it was entitled, this family would have had a monthly disposable income of DM 2893 (€1479) (Peter 2000, p. 59).

At the end of 1998 2.9 million persons, or 3.5% of the total population were receiving payments to provide the means of livelihood. Of these, 1.77 million were between 15 and 65 years of age. Deducting ill and unemployable persons as well as people with family responsibilities there was an estimated gross employment potential of 1.35 million persons. Deducting again people already in employment and those in training there remains a net employment potential of 1.10 million persons. Of these 709 000 were registered as unemployed (Federal Statistical Office 2000, p. 14 f.).

Gross expenditure for social assistance amounted to 45.0 billion DM (23.0 billion €) in 1998 (= 1.2% of GDP). Half of this (26.6 billion DM or 13.6 billion €) were payments to provide the means of livelihood. Between 1980 and 1998 this category of social as-

sistance payments has grown at 10.9% a year. Owing to this rapid increase, the share of this category of social assistance in GDP has increased from 0.29% in 1980 to 0.54% in 1998 (Social assistance statistics of the Federal Ministry for Labour and Social Affairs).

In addition to the burden on the state's budget, social assistance reduces the incentive to work. This is particularly the case when the difference between earned income and social assistance is small. The extent of this incentive problem can be quantified by the wage-assistance differential: it tells us by how much, in percentage terms, the social assistance received lies below the disposable income of employed persons in the lowest wage or salary categories. Abstracting from methodological questions involved in these calculations (Engels 1999, Hauser 1996), this differential varies according to type of household, type of employee, branch, and wage or salary group being examined. Tab. 1 gives this differential for an unskilled worker in industry. It shows that the differential is relatively large for households without children. For households with children, however, the differential is small.<sup>2</sup> Hence there is little incentive to seek regular work, in particular if the welfare recipient has the chance to find illegal work in the underground economy (Feist 2000 a, p. 48 ff).<sup>3</sup>

**Table 1: Wage Differentials in Germany – 1999**

Type of household	No. of children	Disposable household income of an employed person <sup>a</sup>		Social assistance <sup>b</sup>		Differential <sup>c</sup> %
		DM	(€)	DM	(€)	
Single person	0	2506	(1281)	1181	(604)	52,9
Married couple	0	3086	(1578)	1874	(958)	39,3
	1	3350	(1713)	2421	(1238)	27,7
	2	3658	(1870)	2931	(1499)	19,9
	3	4056	(2074)	3462	(1770)	14,6
Single parent	1	2646	(1353)	1941	(992)	26,7
	2	2925	(1496)	2556	(1307)	12,6

<sup>a</sup> Unskilled worker in manufacturing, Wage group 3, former FRG, as of 1 July 1999  
<sup>b</sup> Social assistance payments for means of livelihood  
<sup>c</sup> (Household income – social assistance)/ Household income

Source: Engels 1999.

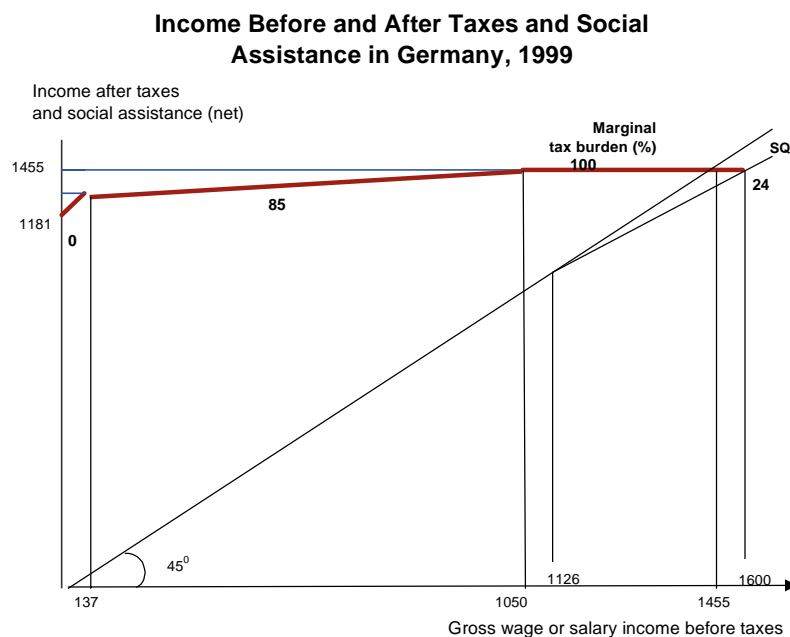
It is not only the wage differential which reduces the incentive to work: the principle of the priority of earned income over transfers results in between 85% and 100% of supplementary earned income being deducted from welfare over a broad income span (see

<sup>2</sup> Calculations made with the OECD model for simulating tax and social assistance systems show that Germany's wage differential is also relatively small when compared internationally. See Doudeijns et al. 1999

<sup>3</sup> Small monetary incentives can, however, be offset by the increase in the subjective satisfaction that employment provides (Hackenberg and Wagner 1997, p.221).

figure 1). An increase in a single person's wage or salary income from DM 200 to DM 500 (€102 to €256) will result in his or her disposable income (i. e. earned income plus social assistance) growing from DM 1327 to DM 1372 (€679 to €702). In this case the reduction of benefits at the margin amounts to 85% of the increase in income from work. Supposing that earnings go up from DM 1100 to DM 1181 (€562 to €604), then disposable income will remain unchanged, that is to say, in this case the reduction of benefits at the margin will exactly outweigh the increase in earnings (Feist 2000 a, p. 76).

**Figure 1:**



The figure refers to a household consisting of a single person. Calculations are based on the social assistance regulations in force on July 1<sup>st</sup> 1999 for the territory of the former Federal Republic. Wage or salary income is in terms of monthly income subject to tax. Marginal deduction rates and marginal tax rates based on the schedules in force in 1999, are expressed in percentage terms and printed in boldface.  
Source: Feist (2000 a, p. 77).

Summing up we can draw the conclusion that in Germany social assistance reduces the incentive to work. But what about other countries? Does the new Welfare to Work Programme of the United States avoid such disincentives?

### 3. The Earned Income Tax Credit (EITC)

When the USA introduced their Welfare to Work policy in 1996, the EITC was already available as a policy instrument with a generally very positive reputation. The Earned Income Tax Credit was introduced in 1975.<sup>4</sup> Its goal is to create financial incentives for low-wage earners and boost their incomes. The programme was modified and consid-

<sup>4</sup> The following remarks describe the programme at the federal level. Wisconsin supplements the federal EITC. Its topping up is calculated on the basis of a) 4% for the first child, b) 14% for two children, or c) 43% for three or more children, up to a maximum of \$1529.

erably expanded in 1986, 1990 and 1993. Today, it is the most important measure for combating poverty in the U. S.

The EITC is a tax credit that is granted under certain circumstances to low-income households. The beneficiaries are subject to federal income tax. If the tax credit is higher than the income tax owed, the difference is paid out to the eligible families (Walker and Wiseman 1997, p. 410). Otherwise it is deducted from the income tax. EITC is administered by the Internal Revenue Service (Alstott 1995, pp. 533 ff.).

Employment is required for eligibility and the programme is primarily aimed at working people with children. The amount of tax credit is based on gross earnings. Figure 2 illustrates the three phases of the EITC. In the first phase the increase in the tax credit is linear to the increase in income. In phase two the tax credit remains constant. And in phase three it declines until a maximum income is reached. The amount of tax credit and the income limits differ according to household type. Distinctions are made as to families with two and more children, families with one child, and people without children. The highest credit is given to families with two or more children.

**Table 2: United States Federal Earned Income Tax Credit Parameters in 2000**

Household type	Phase I		Phase II Maximum benefits (\$)	Phase III	
	Credit per- centage	Income limits <sup>a</sup> \$		Phase- out rate (%)	Income limits <sup>a</sup> \$
Families with one child	34.0	0 – 6920	2353	15.98	12690 - 27413
Families with two or more children	40.0	0 - 9720	3888	21.06	12690 - 31152
Families with no chil- dren	7.65	0 – 4610	353	7.65	5770 - 10380

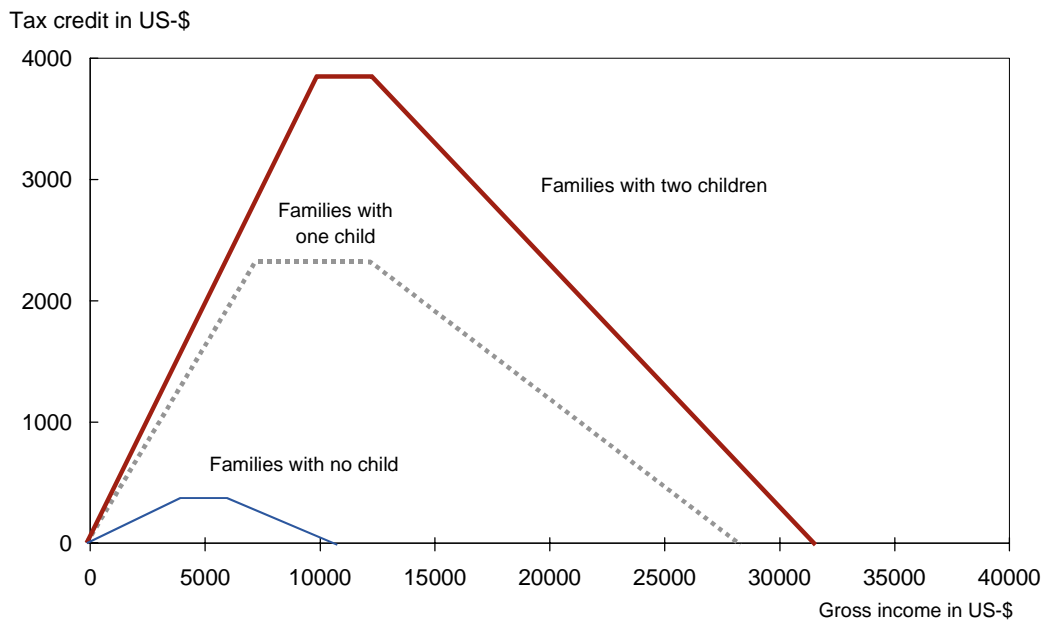
<sup>a</sup> Annual amounts for income or EITC assistance.

Source: H. Johnson, A Hand Up. How State Earned Income Tax Credits Help Working Families Escape Poverty, Nov. 1999, p. 44 (<http://www.cbpp.org/11-12-99sfp.pdf>).



**Figure 2:**

**U.S. Earned Income Tax Credit for Various Household Types in 2000**



Source: R. Zahradnik, I.J. Lav, A D.C. Earned Income Tax Credit Could Provide Tax Relief and Reduce Child Poverty, Center on Budget and Policy Priorities, February 9, 2000. (<http://cbpp.org/2-9-00sfp.htm>).

The parameters of the EITC in 2000 are shown in Table 2. For example, a family with two or more children and yearly income between \$1 and \$9,720 receives a tax credit of 40 cents on every dollar earned. With a gross income of \$9,720 the maximum credit of \$3,888 is reached. This remains constant until gross income reaches \$12,690. For every dollar earned above \$12,690, the tax credit is reduced by 21 cents. With gross income reaching \$31,152, the tax credit is reduced to zero. In the third phase in which the tax credit is reduced, the marginal charges on income are higher than the marginal rate of income tax. In this phase of tax credit reduction it amounts to about 50%, as a rule (Gern 1996, p. 292; Eissa and Liebman 1995, p. 34).

In 1999, nearly 19 million workers took advantage of EITC. The tax credit amounted to an average of \$1,632 (Economic Report of the President 2001, p. 200).

The objective in granting tax credits is to increase the net incomes in the low-income range and to increase the labour supply. The income objective is largely achieved. Half of all EITC payments go to families with incomes below the poverty level. It is estimated that EITC lifted 4.1 million people above the poverty level and made an important contribution in preventing child poverty (Economic Report of the President 2001). The withdrawal rates based on rising incomes as well as a cut-off income level assure that the benefits go to the deserving. This also keeps the target costs within limits.<sup>5</sup>

In contrast to the income effects, the impact of the EITC on the labour supply and on employment in the low-wage sector is not straightforward. One has to distinguish two

<sup>5</sup> The United States spends around 0.3 percent of GDP on the EITC (OECD 1999a, p. 156).

effects: the encouragement of participation in the labour force and the stimulation of an additional supply of working hours by those already in employment. To be sure, the increase in net incomes and the accompanying decrease in net replacement rates create work incentives and thus encourage participation in the labour force. OECD calculations show that in 1995 the net replacement rate (with EITC) of a family with two children was 63 percent. Without EITC it would have been 97 percent (Doudeijns, Einerhard, van de Meerendonk 1999, p. 32).

The effect on the supply of working hours is not so clear. As income increases due to the EITC, a household can afford to enjoy more leisure and reduce working hours (income effect). On the other hand there are substitution effects caused by changes in relative prices between leisure and working time (substitution effect). The substitution effects vary according to the phase of the EITC (see figure 3). In phase I the EITC creates an incentive for the supply of additional working hours by rewarding them. In phase II there is no substitution effect. In phase III the EITC creates a disincentive for the supply of additional working hours by implicitly taxing them. Empirical studies show that the marginal incentives to work more hours for those already in work are slightly negative (total effect) (Trabert 1999).

There is thus a trade-off between the effect on participation and the incentives for those already in work. Empirical studies show that working hours of new entrants tend to overcompensate slightly the loss of hours due to reductions in working time by those who are already in the labour force (Ochel 2000, p. 20; Schelkle 2000, p. 10).

**Figure 3:**

**Incentives for Additional Labour Supply due to the EITC**

	<b>Phase I</b>	<b>Phase II</b>	<b>Phase III</b>
<b>Substitution effect</b>	positive (additional hours rewarded)	none	negative (additional hours implicitly taxed)
<b>Income effect</b>	negative	negative	negative
<b>Total effect</b>	?	negative	negative

Source: Schelkle 2000, p. 10.

Empirical studies show that the effects on the labour supply differ according to the family situation of the beneficiaries. The EITC has given single mothers a strong incentive to work. There has been little impact on the labour-market participation of married men, and the participation of married women has declined slightly. The latter effect may be the result of the fact that the EITC is linked not to individual incomes but to the income of the family, so that because of the high marginal charges on income in the withdrawal phase it is not beneficial for married women with employed husbands to take on jobs. The working behaviour of those with jobs is affected in different ways. Whereas the hours worked by married women, and also by married men, have declined, the hours of single mothers have remained stable. The conclusion to be made is that employment levels have been increased by the EITC, average weekly working hours have been low-

ered and the total number of man-hours worked has been increased slightly (Table 3; Hotz and Scholz 2000, pp. 28 ff.).<sup>6</sup>

**Table 3: The Effects of EITC on Labour Market Supply**

Holtzblatt, McGubbin, Gilette (1994)	Increase in the number of employed, reduction in hours worked of previously employed.
Dickert, Houser, Scholz (1995)	Increase in the number of employed, slight decrease in hours worked of previously employed, slight increase in total number of man-hours worked
Scholz (1996)	The decline in hours worked by previously employed is overcompensated by the additional supply of labour resulting from EITC. However, the net increase is slight.
Eissa, Liebman (1996)	Study of the effects of expanding EITC in 1986. Relative to single women (who were not entitled to EITC), there was a slight increase in employment of single mothers (+2.8%). Hours worked of previously employed showed no relative change.
Eissa, Hoynes (1998)	Study of the effects of EITC on the supply of labour from married couples with children. In this connection it is important that the amount of EITC is not dependent on individual income, but on family income. It women's decisions on supplying labour are subsequent to their husbands', then owing to the rate of deduction in section III it may be unattractive for women to offer their labour services. The result: the supply of labour from men may be virtually unchanged; employment of women declines by one percentage point; in the phasing out period of EITC hours worked by women will decrease.
R. M. Blank, D. Card, Ph. K. Robins (1999)	Increase in employment of single mothers. In phase three of EITC, women's volume of labour will decrease due to the higher marginal tax rate.
B. D. Meyer, D. T. Rosenbaum (1999)	The increase in employment and of hours worked of single mothers can be ascribed in large part to the more liberal provisions of EITC and to a lesser degree to changes in other social policy programmes.

Source: Own compilation.

#### **4. Major Aspects of the American Workfare Model**

In 1996 the USA adapted a thorough welfare reform which obliges welfare recipients to work in return for transfer payments and which limits the length of time during which welfare can be paid. This is a reversal of the policy on basic social security which had been followed up till then (Wolfe 2000, Appendix A). Besides EITC, the distribution of food stamps to the needy, medical care for the children of poor families and for single mothers, the pillar of this approach was the programme of Aid to Families with De-

<sup>6</sup> Alongside the income and employment effects the effect of EITC on education and job training, on saving and on marriage decisions (amongst other things) should also be taken into account. Cf. on these topics the papers presented at the Conference of the Joint Center for Poverty Research at the Northwestern University in Evanston on 7/8 October 1999 (<http://www.jcpr.org>).

pendent Children (AFDC). The AFDC programme provided for direct transfer of money primarily to single mothers. This approach contributed to high divorce rates and at the same time fostered an excessively high reproduction rate amongst welfare recipients, many of the births being non-marital; it often led to a situation of dependency (Haveman and Wolfe 2000, p. 101). Two effects were even more important for our topic: the implicit encouragement thus given to illicit work and the lack of incentives encouraging the acceptance of a regular job.

The AFDC programme's negative incentives with respect to the family and labour market situation made welfare reform necessary. In August 1996 the AFDC programme was superseded by the *Personal Responsibility and Work Opportunity Reconciliation Act* (PRWORA) which provided for *Temporary Assistance for Needy Families* (TANF). Needy families with children replaced single mothers as the target group for welfare. In order to overcome the welfare dependency, the legal entitlement to welfare was eliminated and the willingness to accept work was made a condition for welfare assistance. The principle of reciprocity was firmly established: the state is obliged to provide money and jobs and in return the welfare recipient is obliged to work. In addition, the TANF programme set a limit of five years to welfare benefits during a person's whole life. Moreover, the TANF programme gave priority to work over education and training. And finally the federal government left the decisions on the final shape of the welfare programme more than in the past up to the individual states. Global subsidies to the states' budgets created an incentive for the implementation of welfare reform (Wiseman 2000; Peter 2001).

The state of Wisconsin has gone the farthest in implementing welfare reform and has thus remained true to its tradition as a pioneer in welfare policy. This state introduced its "Wisconsin Works" (W-2) programme in 1997. The strict work orientation of this programme begins on the first contact between the responsible agency and the needy person. Where under AFDC, applicants met with a 'case worker' who filled out forms necessary to establish eligibility and get the right-sized cheques out, under W-2 they meet with a 'Financial and Employment Planner' at the 'Job Center'. This person advises them of their work options and helps them make the best choice among these options.

For those whose job qualifications are the most favourable, an assignment to a regular job in the private economy is fixed as the goal, and information and advice on how to find such a job is given. If an applicant is successful, he or she will be eligible for EITC. People with fewer skills or work experience are assigned to the 'Trial Job' (TJ) level. Employers, who receive subsidies, provide full-time jobs which pay at least the minimum wage. The subsidy can range up to 80 percent of the wage (up to \$ 300 per week). The trial period covers 3 – 6 months. People in this category are again eligible for EITC. People with even fewer skills and work qualifications will be given a public service job (CSJ) requiring 40 hours of participation a week (10 hours of which may be education and training). CSJs provide an opportunity to practise work habits and skills necessary to succeed in a regular job environment, including punctuality, reliability, social skills in the work environment and the application of sustained and productive effort. Those assigned to CSJ are paid \$ 673 per month. They are not eligible for EITC. The least capable applicants are assigned to W-2 transitions. The activities can include

treatment for alcohol or drug abuse, community rehabilitation programmes, counselling, and obtaining shelter or safety if a domestic abuse situation is present. Those assigned to this category receive \$628 per month. Again, no EITC support is available (see table 4).

Wisconsin Works' goal is to have the welfare recipient move up the employment ladder and to promote this goal the period in each level is limited to twenty-four months. Anyone exceeding this limit, or the five year limit over one's entire lifetime, is obliged to leave the programme, unless certain conditions justifying an exception are met. This is also the fate of those who owing to their own mistakes fail in any of the programme's stages. For less serious infractions they have to accept a reduction in their benefits. At the present time it is not possible to say how people will be treated when their entitlements expire because the time limits have been exceeded.

**Table 4: The Wisconsin Works Placement Ladder**

<b>Placement</b>	<b>W-2 Transition (W-2 T)</b>	<b>Community Service Job (CSJ)</b>	<b>Trial Job (TJ)</b>	<b>Unsubsidised Employment (UE)</b>
Participants	Individuals who are incapacitated or disabled	Individuals who are not ready for TJ or UE	Individuals who have basic work skills but are not ready for UE	Individuals who are ready for regular employment
Work requirement				
- Work	Up to 28 hours	Up to 30 hours	40 hours	40 hours
- Education and training	Up to 12 hours	Up to 10 hours	Within working time	-
- Employer	Public organisation	Public organisation	Private firm with a subsidy up to \$300 per month	Private firm
- Income/payments (per month)	\$628	\$673	At least minimum wage	Market wage
Additional support				
- Food stamps	Yes	Yes	Yes	Yes
- EITC	-	-	Yes	Yes
- Medicaid child care	Yes	Yes	Yes	Yes
Time limit				
- per job	-	6 – 9 months	3 – 6 months	-
- total	24 months	24 months	24 months	-

Source: State of Wisconsin, Department of Workforce Development, Wisconsin Works (W-2).

The costs of W-2T, CSJ and the wage subsidies are met by TANF appropriations; however, persons who are attempting a trial job are not counted as welfare recipients. Money is also available for measures such as the provision of subsidies for transport

costs. In addition, W-2 participants are entitled to other benefits such as food stamps, Medicaid and child care, as long as they fulfil the requirements for these programmes.

The implementation of the “Wisconsin Works” programme is no longer the sole province of the welfare agencies; the 1996 welfare reform put an end to their monopoly position in this area. Today other private or non-profit organisations are involved in running Job Centers.

## **5. The Principles of Assistance to Work**

The following principles are fundamental to the Wisconsin programme: reciprocity, selection, time limitation and work first.

The reciprocity principle: whilst in Germany the state pays social assistance to provide the means of livelihood without any significant corresponding obligation being imposed on the recipient, this does not hold in the U. S. In Wisconsin the beneficiaries’ obligation takes the form of work. Refusing to work leads to a forfeiture of the entitlement (Wiseman 1999). However, there is not only an obligation to work for the recipient, there is also an obligation on the state to provide work. The logic of “Wisconsin Works” is very heavily oriented towards reciprocity (Mead 1999).

The selection principle: the obligation to work goes along with a selection mechanism which separates the truly needy from the less urgently needy amongst the welfare beneficiaries, and thus reduces abuse. Welfare agencies are often not able to fulfil this task because they are not sufficiently informed about the degree of neediness of a welfare recipient. In such a situation the assistance to work can fulfil a useful screening function.

Suppose we have two groups of welfare recipients who differ with regard to their labour productivity. Those with the lower productivity are not able on their own to earn an income covering the socio-cultural existence minimum; they receive perfectly properly welfare. Those with higher productivity could earn an income sufficient to cover this existence minimum in the private sector. They prefer, however, to abuse their welfare entitlement, working at the same time illegally. If the principle of granting welfare without requiring any sort of reciprocal obligation on the part of the recipient is abandoned, then the welfare beneficiary will have less time for illegal work. If the principle of help to work is applied, the welfare recipient will be subject to opportunity costs in the amount of what he might have earned illegally in the private sector during his working hours. These opportunity costs are higher for the productive workers than for the unproductive. It can be demonstrated that the hours of work required as well as the amount of benefits can be set such that it is more advantageous for the more productive to move into a regular job. The less productive are better off doing the work assigned to them and receiving welfare benefits in return (Besley and Coate 1992; Feist 2000 b, p. 106 ff.).<sup>7</sup>

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<sup>7</sup> If the difference between the needy and those tempted to abuse the system is not productivity but preference for leisure, then a different sort of selection occurs. People with a strong pref-

The introduction of help to work as a selection mechanism is also associated with costs, such as the state expenditure in connection with organising the help to work programmes. However, there are compensatory savings which result from the welfare payments which no longer need to be made to the more productive participants in the programme. It can be shown that the help to work programme is all the more advantageous for the taxpayer, the smaller the relative number of the less productive and the greater the difference between their income and the income received by the more productive (Besley and Coate 1992, p. 254).<sup>8</sup>

The time limitation principle: The 1996 welfare reform introduced the principle that welfare in the USA will only be made available for a limited period. Wisconsin has followed the federal government's lead in limiting participation in these programmes to a maximum of five years in any one person's life. On top of this, it imposes a two year limit for the duration of each step in the employment ladder. This limitation on the duration of welfare reduces the burden of taxation. At the same time, the limitation serves as an incentive to move up the employment ladder. Particularly strong incentives motivate to accept regular employment. A person who loses all welfare entitlements and has no wage income will feel a very strong pressure to find a source of income and to offer his labour services in the labour market. And the incentive to work more hours is greater than for a welfare recipient working part-time. While the latter has to accept a loss of welfare benefit if she earns more money, someone who no longer is entitled to welfare will, of course, not suffer any reduction in benefits. Hence in this case EITC can exert its full positive effect on net income (Wolfe 2000, pp. 17 ff.). The greater supply of labour will have an effect on wages and employment. But for those who fail to find employment in the private sector, the time limitations, if they are applied rigorously, will lead to renewed impoverishment.

The "work first" principle: a central part of the new welfare strategy is the emphasis on "work first". Instead of vocational qualification as a preparation for starting work, priority is given to getting the participant directly in some form of work. Full time vocational or training programmes stretching over a longer period, intended to achieve a better paid job, are not a part of the W-2 programme. Welfare recipients are supposed to begin to work straight away, either in the private sector or in a job in the public sector such as in the W-2 T or the CSJ programme. If the first alternative is not available, then work in the public sector is considered the best strategy providing participants an opportunity to gather experience. This will make it easier to move to the private sector later. The on the job training provided in W-2 T or CJS serves as an accelerated preparation for work in the private sector. It helps to acquire basic qualifications for success in the labour market such as punctuality and reliability.

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erence for leisure will now renounce their entitlement. This means, however, that their "socio-cultural" existence minimum will no longer be covered.

<sup>8</sup> If the opposite is true then the help to work programme will prove to be very expensive; under these circumstances the taxpayer would have to prefer the traditional welfare model.

## **6. Preliminary results from the Wisconsin Works programme**

Since the implementation of the 1996 welfare reform did not begin until 1997 it is still too early to undertake a comprehensive evaluation of Wisconsin Works. Nevertheless, some results of the reform are already identifiable.

Firstly, there has been a definite reduction in the number of AFDC/TANF welfare recipients. Figure 4 shows that the number of persons claiming welfare benefits has gone down in the USA as a whole. This decline is even more pronounced in Wisconsin. After the welfare reform in 1996 this reduction has accelerated considerably. However, other factors such as labour market developments in general, the increase in the (legal) minimum wage level etc. have also played an important role (Bell 2001; Council of Economic Advisers 1999). The decrease in the number of welfare recipients was also associated with a change in their composition. In Wisconsin, in 1994 52% of welfare beneficiaries were non-Whites; in 1998 this group accounted for 83% (Congressional Research Service 2000 a, p. 440). Most of the people still receiving welfare lived in Milwaukee.

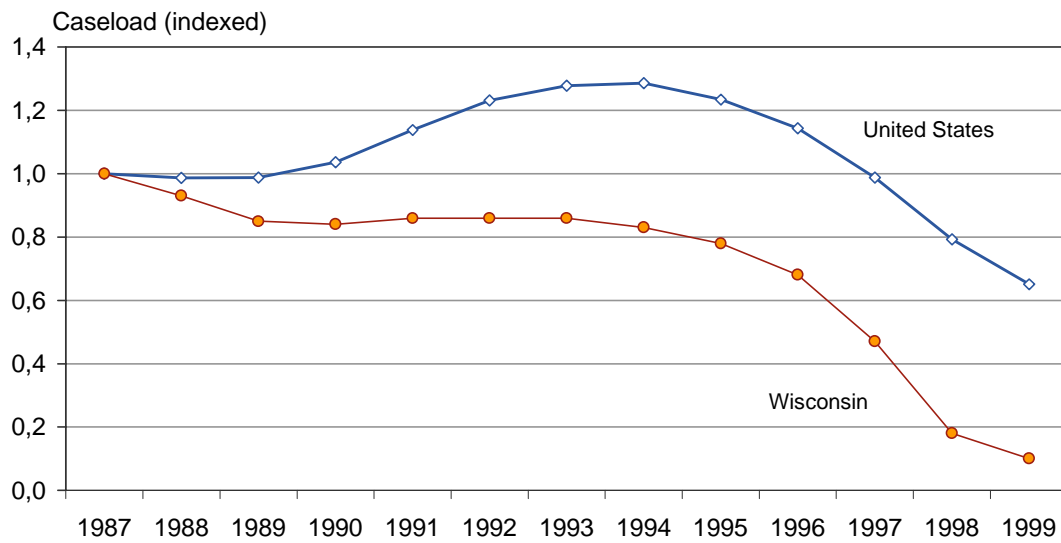
The number of AFDC/TANF welfare recipients is, however, just a part of the total number of persons claiming welfare benefits. While cash assistance (AFDC/W-2) has all but disappeared in Wisconsin, support for the working poor continued and in some cases has grown. Two new programmes (Kinship Care, SSI Caretaker Supplement) were created. Supportive services (Child care, Medicaid) which were once targeted to those on cash assistance, are now targeted to working families. These families are now eligible for case management and a host of other services aimed at helping parents succeed and advance in the workforce. If we compare the case counts for all these programmes from April 1995 to April 2000 (see table 5), the total duplicated case counts have dropped by just 31% and the total unduplicated case counts by only 3%. The total number of families served has not changed. But there has been a shift to work-support. A higher proportion of those receiving help in the year 2000 are working and using benefits to complement their earnings in the private market (Swartz 2001).

How many of the former recipients of W-2 cash assistance were successful in finding a job? A study undertaken by the Wisconsin Department of Workforce Development amongst recipients leaving the programme between September 1997 and September 1999 produced the following results. 75,9% of the 29,077 families, who were not receiving W-2 cash assistance as of October 1999, left welfare because of employment or other income. Of the 3180 families, who were receiving W-2 cash assistance again as of October 1999, 66,7% had a job after leaving welfare. Choosing not to enrol in W-2 or participate in programme requirements were the most important other reasons for termination of benefits (Department of Workforce Development 2000).



**Figure 4:**

**AFDC/TANF Caseloads, 1987 - 1999, as a Multiple of the 1987 Caseload**



Notes: Wisconsin data: calendar year monthly average. U.S. data: federal fiscal year monthly average.

Source: U.S. Department of Health and Human Services, Administration for Children and Families; Wisconsin Department of Workforce Development, Economic Support Division.

Exits from the social security system were also examined by Cancian et al. Their study showed that 70% of those single mothers who left the system in the last quarter of 1997 were in regular work one year later. These were the more productive amongst the former welfare recipients, and preferred a regular job in the context of the Help to Work programme or at least could be persuaded, more or less voluntarily, to accept such a job. Of the departees, 30% were not working one year later. These are women who are incapable of work, or have not solved the problem of day care for their children, or have a strong preference for leisure (Cancian, Haveman, Meyer, Wolfe 2000).

**Table 5: Wisconsin Family Case Counts**

	<b>April 1995</b>	<b>April 2000</b>	<b>% change</b>
Cash assistance (AFDC/W-2) cases	62,752	6,642	-89%
NLRR/Kinship Care cases	5,094	5,905	+16%
C-supp (SSI parents) cases	6,121	5,648	-8%
Case management cases	0	4,032	
Family Food Stamps cases	78,904	44,863	-43%
Family Medicaid cases	111,170	101,991	-8%
Child Care cases	9,844	18,784	+91%
Total duplicated case counts	273,885	187,875	-31%
Total unduplicated case count	118,595	114,725	-3%

Source: Swartz 2001, p. 11.

Not all leavers leave welfare permanently. Of the families who left W-2 between September 1997 and September 1999 nearly 10% received W-2 cash assistance as of October 1999 (Department of Workforce Development 2000). Of the women who left welfare in the last quarter of 1997, 15% were back on welfare a year later. Over all, 25% of these women claimed some form of welfare at some time during 1998 (Cancian, Have-  
man, Meyer, Wolfe 2000, p. 24).

A reduction in the number of people receiving welfare was a goal of the American welfare reform in 1996. That is not, of course, the same thing as improving the well-being of welfare beneficiaries. The survey carried out by Cancian et al. (2000) shows that this is not the case with regard to women no longer receiving welfare benefits. As is to be expected, their earnings have risen<sup>9</sup>, but their net income has gone down, since welfare payments have strongly declined (see figure 5). About 72% of the women have an income below the poverty line. However, it must be borne in mind that these figures do not take into account other sources of household income such as an additional income of the head of the household, or income of other household members. Hence the extent of poverty as measured by *household income* is very likely lower. In addition, figure 5 lumps together all those leaving welfare programmes, irrespective whether the departee has accepted work or not. Focussing on average incomes neglects the differences between the employed and the unemployed, or between the permanently and the precariously employed women; income developments for these different groups will surely have been very different. The survey of Cancian et al. shows that 31% of the leavers have a higher income, 12% the same income, and 57% a lower income as compared to their income as welfare recipients (Cancian et al. 2000, p. 27 ff.).

Despite these qualifications, figure 5 provides some interesting information on the effects of welfare reform. People's dependency on welfare has been reduced; more people are in a position to provide for their means of livelihood through their own work. For more than half of the former welfare recipients there has, however, been a deterioration in their income situation, since they no longer receive welfare payments.<sup>10</sup> A beneficiary of the Wisconsin Works programme is the tax payer; welfare programmes have required less tax money.

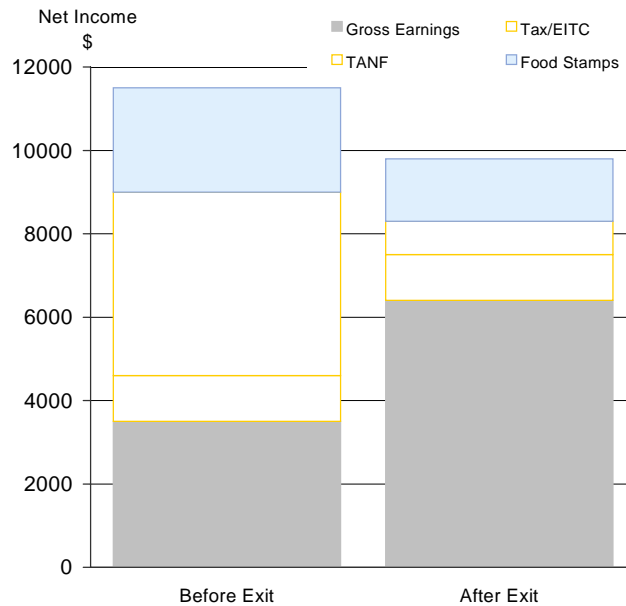
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<sup>9</sup> The data refer to mothers' earning as reported in Wisconsin's Unemployment Insurance(UI) system. Cancian et al. (2000) have no information on individuals who have moved out of the state, no measures of earnings of individuals in Wisconsin who are self-employed or in other employment not covered by the UI system (covered workers include about 91 percent of official Wisconsin workers), and no measures of partners' earnings or other earnings received by the individuals. Welfare payments like child care assistance are not included either. - On the other hand, these comparisons do not take into account earnings of welfare beneficiaries from illegal work.

<sup>10</sup> The survey of welfare recipients exiting the system between January and March 1998 found that 37% of leavers were behind in their rent or their house payments (compared to 30% of welfare recipients), 32% could not buy all the food needed (compared to 22%), and 33% could sometimes not afford child care needed in order to work (compared to 22%) (GAO 1999, p. 25).

**Figure 5:**

**Pre- and Post-Exit Income of Welfare Leavers in Wisconsin 1998**



Note: This measure of income includes only gross earnings reported to the Wisconsin Unemployment Insurance system, TANF cash payments and Food Stamps received in Wisconsin, and estimated Federal EITC and payroll taxes. All leavers are included.

Source: Cancian, Haveman, Meyer, Wolfe 2000, p. 26.

Table 6 presents figures on the decline in the burden of welfare. Between 1995 and 1999 expenditure in AFDC/TANF in the USA has gone down by 27.8%; in Wisconsin the reduction was 41.6%. Given the decline in the number of welfare recipients in Wisconsin in the same period of 73.6%, the savings in welfare expenditure would have been much higher than 40%, had welfare expenditure (payments and administrative expense) per family not increased as strongly as they have. According to the Greenbook 2000 they were an estimated \$15,975 (Congressional Research Service 2000a, p. 417); the Wisconsin Department of Workforce Development puts the figure at a more modest \$13,500 (Wolfe 2000, p. 27) (Both figures for the state of Wisconsin and for 1999). The increase in welfare expenditure per recipient is connected with the intensive counselling and attention given to applicants in the Wisconsin Works programme, but also reflects the high administrative costs involved in regions where there are few welfare recipients; the amounts budgeted did not anticipate the drastic decline in the number of AFDC/TANF recipients. The decline in welfare expenditure, however, is smaller, if the focus is not on expenditure in AFDC/TANF, but on all welfare programmes (see table 5). Between 1996 and 2000 total spending on welfare declined in Wisconsin by just 4% (Swartz 2001, Fig. II-6).

**Table 6: Federal and State Expenditures in AFDC/TANF, Fiscal Years 1995 and 1999 (in millions of dollars)**

	USA			Wisconsin		
	Federal	State	Total	Federal	State	Total
1995	16,173	13,918	30,091	306	218	524
1999	11,323	10,405	21,728	153	153	306
Percent change			-27.8			-41.6

Source: Congressional Research Service 2000 a, p. 407.

Wisconsin Works has only been in operation a short time. Hence important elements of the programme such as the emphasis on „Work first“ rather than measures to improve vocational qualification have not as yet been evaluated. Studies done by the Manpower Demonstration Research Corporation for other states in the US give support to the view that Work first strategies are superior to strategies that emphasise human capital improvement and the removal of obstacles to getting well paid jobs. The Work first approach leads to quicker re-employment, to higher earnings, and to smaller welfare expenditure. Success, however, requires that welfare agencies at the local level should adjust themselves to working efficiently with local employers, make available communal services, establish sensible work contents, and counsel and advise welfare recipients actively (Wiseman 2000, pp. 218f.).

Aside from remaining uncertainty about the efficiency of the Wisconsin Works programme, the question of the intertemporal flexibility of the programme must be raised. What will be the situation in a recession, when welfare recipients will experience difficulty in finding regular employment? Will a sufficient number of jobs in W-2 T and CSJ be made available or will the unemployed simply be abandoned to their own devices? It is also an open question how the authorities in Wisconsin will react in cases when welfare entitlements lapse because the five year period has expired and a person is still not in regular employment.<sup>11</sup> Will they accept the creation of poverty that is inherent in this situation or will they undertake compensatory action? What will be done for people who are not capable of productive work or who are uncooperative? No adequate answers to these questions seem to exist (Ellwood 2000; Haveman and Wolfe 2000).

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<sup>11</sup> The first extensions to the 24-month time limit have taken place in the meantime. From January 1999 through June 2000 of the 1551 W-2 participants who reached 21 months in one employment category, 206 (13%) had an extension to the 24-month time limit while 1345 (87%) did not have an extension as of June 2000. The most common barriers to self-sufficiency facing the extension population are depression, various physical barriers and a lack of education. The top three activities for them were physical rehabilitation, mental health counselling, and work experience. The top three activities for non-extension population were work experience, employment search and adult basic education (Mikelson 2001).

## 7. Summary and Conclusions for Germany

Through Earned Income Tax Credit (EITC), by making reciprocal work a requirement for welfare payments, and by setting a limit for maximum duration of receiving welfare, the US welfare policy creates strong incentives for employment. As a result of more persons offering labour, and being ready to work at low wages, the new policy also contributes to a decline in wages in the low wage area (the minimum wage representing a floor to this process). This increased wage spread raises demand for unskilled labour and makes it possible for a large part of the unemployed to find regular employment (Ochel 1998). The declining wage level will also affect employees with low levels of qualification. Although EITC will help to maintain net income the income of some employed people will fall below the poverty line.

American welfare reform has reduced dependency on welfare. Wisconsin Works has drastically reduced the number of AFDC/TANF recipients (but not the number of all welfare recipients). In Wisconsin, approximately 70% of W-2 welfare leavers are employed in regular jobs. They are able to live on income they earn and contribute with their labour supply to GDP. The remaining 30% do not work and the income of these former welfare recipients is on average lower than under welfare. Many people belonging to this group live in poverty. An undifferentiated view based on averages of all welfare leavers thus merges winners and losers: those who have found employment have for the most part been able to stabilise or even improve their income situation, whilst those still without work are the major losers. And the taxpayers are beneficiaries of the welfare reform, since they must contribute (slightly) less to welfare expenditure.

Wisconsin Works was introduced in a period when the labour market situation was favourable. A period of recession will be a more stringent test, and the end of the five year period for welfare entitlements will also pose a challenge.

The U.S.'s Welfare to Work policy provides important insights for the question how welfare policy in Germany could be reformed in order to reduce dependency of social assistance and to create incentives to work. The introduction of an Earned Income Tax Credit can be recommended as a way of raising income after taxes in the low wage segment. This would increase the difference between net wage income and social assistance and thus create an incentive to find employment.

A requirement calling for reciprocal work as a condition for social assistance would be welcome. This activates a self selection mechanism amongst welfare recipients which helps to limit abuses. In addition, welfare recipients are stimulated to greater activity and their ability to hold a job successfully is improved. In order for all this to happen it is important that the contents and the quality of the „Help to Work“ programme should be set adequately, that welfare agencies should be prepared for their new responsibilities and that accompanying measures such as the establishment of child care facilities should be taken. It is important to take care that „Help to Work“ should not lead to a displacement of regular employment. In order to avoid conflicts between creating incentives to work on the one hand and fighting poverty on the other, work as a condition for welfare benefits should only be required from those who are capable of work.

In reforming Germany's system of social security two principles should be borne in mind. First, the level of protection afforded to people with a low level of vocational qualification is much lower in the USA than in Germany. Owing to existing attitudes on the principles of a welfare state, the American level of protection cannot be taken as a standard. This means that social assistance in Germany must be sufficient to cover the "social-cultural" existence minimum and that the Earned Income Tax Credit must be more generous than in the USA (Sinn 2000). Second, the transition from the existing passive system of basic security to an employment oriented system must be carried out in such a way that friction is avoided as far as possible. This requires a co-ordinated compartment of employers' and employees' and workers' organisations in connection with the flexibilisation of wages. At the same time the activity of the various levels of government with respect to the introduction of EITC and the establishment of a system of Help to Work must be co-ordinated. But the limits to the state's ability to deal with increased financial burdens must be borne in mind.

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