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SYMPOSIUM: WORKFARE

THE ECONOMICS OF WORKFARE: THEORY AND PRACTICE

BY BRYAN R. CLARKE

THE EFFECTS OF WORKFARE ON THE POOR

BY OLIVER GOLDSTEIN

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MOTIVATION FOR WORKFARE

While critics differ in their reasons for disliking our current federal welfare policy, most agree that Aid to Families with Dependent Children (AFDC) creates an array of odd incentives which force our nation's poor to act in an unacceptable manner. This widespread displeasure with AFDC has led to much debate concerning possible reforms. Two major reforms that have been discussed for several years now are the negative income tax and the reform that I will deal with in this paper, workfare. A negative income tax determines one's benefit level using one factor, income, rather than many different categories such as single parent and disabled. Under such a scenario, a basic grant is issued and any additional earnings are taxed at a given rate. This differs from the current system in that money earned by a welfare recipient is counteracted by nearly equal cuts in benefits. The fundamental dilemma in designing a negative income tax, however, is deciding on how large the basic grant should be and at what rate additional earnings should be taxed. If the grant is small and the tax rate on additional earnings is small, a system with good work incentives, people who really are unable to work receive very little, though they might need assistance the most. But if the grant is set high and the tax rate set high, we run into the same work incentive problems that we find in the current system. The percentage of one's earnings that is kept is so small that the incentive to work is greatly reduced.

Workfare is motivated by the assumption that government is not serving the taxpayers or the recipients of the aid, if income support is provided in a way that (1) severely discourages work effort, (2) encourages the belief that income maintenance payments are a right and not a privilege, and (3) requires no recipient obligation. (Haveman, p. 16) in order to eliminate these effects of the current system, a workfare policy would require recipients of aid to participate in education, work, and training programs in order to continue receiving the payments.

BENEFITS OF WORKFARE

In theory, the benefits of workfare are fairly straightforward. First, the disincentive to work that one finds under the current system would be eliminated. One theory claims that this installation of "proper incentives" serves two very important functions: a "screening" function and a "deterrent" function. In a society as large as ours it is extremely costly for the government to seek out those truly in need of assistance. If one is forced to work in order to receive money, they will come forth only if they are truly needy. This "self-screening" greatly reduces the government costs of performing the same function. The deterrent argument is slightly different. It asks the question of whether people are poor due to bad luck or choices they make throughout their life. Conservatives have argued that state support has become too attractive, and people have become dependent on it. The only way to avoid this is to make poor relief less attractive. By making assistance less attractive than wages, the proper incentives are restored and people who have the choice of accepting wages will be "deterred" from taking relief. (Besley & Coate, pp. 249-50)

The second reason that workfare programs are helpful in theory is that government aid should help people toward self-sufficiency. Most agree that poverty is extremely cyclical in its nature and is extremely hard to break out of. Forcing the poor to work and develop job skills is essential to increasing their chances of eventually finding work that will lift them out of poverty. The benefits of this aspect of the programs are many. They include positive effects on: recipient health, sense of participation, "worth", self-reliance, family size, participation in illegal activities, the routinization of daily activities, and development of a "work ethic." (Haveman, p. 16) Finally, the taxpayers benefit in that they see themselves paying for a system that appears more just. No longer are people receiving hand-outs. They are working for what they get, and hopefully, working towards a situation where they no longer need additional support.

SHORTCOMINGS OF WORKFARE

Opponents of workfare programs use history as their evidence. Work programs have always failed at achieving their goal of increasing the ability of poor families to become self-supporting. Many of the proposals of today are merely variations of policies which were tried and failed in the past.

Programs such as the Comprehensive Employment and Training Act (CETA) of the 1970's, the Work Incentive Program of 1967, the recent Job Training Partnership Act (JPTA), and state workfare programs have focused on improving the education, job skills, habits, and attitudes of the disadvantaged in hope of making it worthwhile for employers to hire them at competitive wages. In addition, jobs are sought out and created both in the public and private sector. Though aiming to put the poor in the workplace rather than at home waiting on their check, critics claim that the measures have not significantly increased the percentage of welfare recipients who would have found work without the programs. Proof, the critics claim, is in the figures that the percentage of American families in poverty increased from 11.4 percent in 1978 to 14 percent in 1985, a span of time in which much was spent developing these new programs. (Gideonese, p. 44)

There are basically five major reasons why these programs fail to reduce the number of families in poverty. First, the programs aim at preparing the poor for low-paying jobs. Even though an applicant might have been trained in the program, they still lack formal education, specialized skills, and job experience, assets which would lead to higher paying jobs. Thus, the poor are left in minimum wage jobs which leave the family below the poverty line. These low-paying jobs also fail to exist in many of the places where the poor live. Even when they do, discrimination based on any number of factors keeps them out of work. Second, welfare recipients often lack the literacy and math skills which allow them to benefit from the training. Thus, only the poor with the most skills are able to enter into the programs, leaving the least prepared and most in need of help out of the programs and out of work. Third, funding is inadequate to reach even a third of those who need it. It would be more expensive to help

everyone, but without a full commitment, many of these programs lose their power. Fourth, the disincentives to working past a certain level have not been eliminated. If a family earns enough to get off of welfare, they also lose food stamps, housing subsidies, and Medicaid. Thus, often if a father goes to work full-time, he ends up with a lower standard of living than he had without work. Finally, the government has been unwilling to impose sanctions on those people who do not meet work requirements. This stems from the feeling that assistance is a "right." The threat has to be made real if the desired effects are to be gained. Thus, opponents are not opposed to the theory of these programs, but feel that they simply are not accomplishing what they are supposed to (Gideonse, p. 46-7).

CONCLUSION

Poverty is such a widespread and complex problem that certainly no single reform is going to solve the problem. Workfare is no exception. Such programs do produce very real benefits, but are not the cure-all policy. In some sense what really is at stake in this situation is how our society views rights and obligations in the welfare system. How one feels about that probably best indicates on which side of the workfare issue one falls. It is nevertheless important to study the benefits and costs of these programs. It is my personal view that the benefits of workfare can be realized, with the possible exception of the "deterrent effect." Most do not choose to be poor and receiving government assistance is by no means glamorous. The costs of workfare programs, however, are quite large. If the programs are run intelligently and effectively, much of these costs can be overcome when people leave the government assistance roles for good.

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THE EFFECTS OF WORKFARE ON THE POOR

BY OLIVER GOLDSTEIN

WHAT IS WORKFARE?

The welfare system is one of our country's most unpopular social insurance programs. as evidence of its unpopularity, one need merely look to President Bill Clinton's often repeated promise to "end welfare as we know it." The controversy over welfare reflects the attempt to balance the two often competing goals of the welfare system: alleviating poverty and promoting self-sufficiency (Gueron, p. 79). Economists and laymen alike have pointed out that the traditional welfare system puts very high effective tax rates on the poor, and therefore serves to discourage people from working. This commonly perceived failure of the orthodox welfare system to achieve self-sufficiency among the poor has resulted in increased interest in "workfare" as an alternative. The desirability of workfare should be determined in large part by its effects on alleviating poverty and promoting self-sufficiency.

"Workfare" commonly requires that in order to receive full welfare benefits an able-bodied recipient either enroll in a training or work program. Chambers points out that traditional welfare programs can be thought of as special cases of workfare programs where the work required to receive government benefits is set to zero (p. 79). Peterson notes the similarity between workfare and a wage subsidy for the unemployed. The government effectively serves as the employer of last resort, hiring all those who cannot find a job below some minimum rate that the government would offer (the minimum wage). Consequently, the role of the government in this workfare scenario is to subsidize the unemployed individual's wages, by paying the workfare recipient more than the market wage he could earn on his own. To illustrate the point, the government could actually decide to put the recipient to work for a private firm and simply make up the difference between the competitive wage the firm paid and the minimum wage (Peterson, pp. 334-5).

This paper analyzes workfare as compared to the traditional welfare system from the

point of view of welfare recipients and the working poor. For this reason, arguments for or against workfare based on restoring equity in the welfare system, legitimizing transfer payments, matching rights with duties, promoting citizenship among the poor and restoring a work ethic among welfare recipients will not be addressed, except insofar as the last argument affects earning potential. These arguments are primarily based on moral, philosophical, and political views, and they often dominate the political debate on the issue. I will also not address the administrative costs of workfare, although these costs are likely to be much higher than the costs of the traditional welfare system, because these expenses do not affect the poor, and arguably would be offset by taking people off welfare dependency in the long run. The administrative costs would, however, be a significant issue in any complete policy analysis of workfare.

In addition, it should be noted at the outset that workfare systems are not the only options available for welfare reform. Another commonly discussed method of welfare reform is the negative income tax.

DOES WORKFARE ALLEVIATE POVERTY AND PROMOTE SELF-SUFFICIENCY?

Empirical studies have suggested that workfare programs are somewhat successful in alleviating poverty, at least among single-parent AFDC recipients. The reduction of poverty among this group would be especially significant, since single mothers are primary adult beneficiaries of AFDC (Gueron, p. 80). To give some idea of the benefits of alleviating poverty among this group, it should be noted that half the children born today will spend some time in a mother-only family and half of all such families are likely to be poor (Gueron, p. 81).

In San Diego, 15 months after a workfare program was completed, women who participated in the program were found to be earning 23% more, on average, than those welfare recipients who did not. Half of this improvement was because they were more likely to work, half because they were likely to be working longer hours (*The Economist*, Nov. 26, 1988, p. 20).

The data from the Minnesota Work Equity Project, a workfare program, was analyzed in

an econometric study by Dan Steinberg. Steinberg found a positive effect of the program on employment. However, after controlling for selectivity and attrition bias, the magnitude of the effect was small and had a large standard error. This results in a small test statistic and thus a good possibility that there is no significant relationship between workfare and subsequent employment. However, he also found that the women gained substantial real returns to labor market experience, indicating that workfare programs that provide jobs to welfare recipients can increase their earnings potential (p. 335).

Gueron summarized the results of seven large-scale experiments with workfare, all of which offered limited services, primarily job placement rather than skills development, at a relatively low cost. The results showed that the programs led to significant increases in both employment and earnings. These benefits were especially strong among the less employable women, which are those with little or no recent work experience (Gueron, pp. 88-94).

Gueron claims that these women were generally better off, as the projected earnings gains generally exceeded estimated reductions in welfare benefits and other transfer payments (p. 94). However, there are two troubling points that Gueron fails to fully take into account. First of all, the problem of dependency on the state remained. For example, in the San Diego Saturation program, the average earnings among women in the workfare program was only \$2,903, well below the poverty line. These women still, on average, obtained more money from AFDC than from their earnings, and thus were still quite dependent on the state. A possible reason for the observation that incomes do not rise much after the completion of workfare programs is that the programs generally do not have the resources to build valuable skills among their participants, but instead provide "jobs of last resort," with low social productivity as well as low pay.

Second, and perhaps more importantly, an examination of the data reveals that the increase in earnings plus transfers was quite small in most of these programs, and may even have been negative in some. For example, in the San Diego Saturation program, after two years the average earnings of women who went through the workfare program was a surprising \$658

more than the earnings of women who were on traditional welfare programs. Even assuming that this is pre-tax earnings, the 14% Earned Income Tax Credit (Burtless, p. 76) would increase the earnings differential to \$750. However, women who went through the workfare program had AFDC payments that were, on average, \$553 less than those of women who did not. Thus, the differential in earnings plus AFDC payments was only \$197. But even this figure overestimates the benefits to the mother who went through the workfare program, as it leaves out several factors that further reduce the benefits of working. First of all, it does not take into account the reduced in-kind benefits, such as food stamps, Medicaid, and housing and energy assistance, that the mother with more earnings could encounter. It also neglects the increase in Social Security tax, which is likely to be minimal. More importantly, this figure disregards the increase in work-related expenses, such as travel costs, and the increased need for paid child care, which are both likely to be relatively large costs of working. The net effect on the mother who has increased her work through a workfare program is quite likely to be zero or negative in this case, without even considering the utility of leisure.

Thus, although the evidence indicates that workfare increases employment and earnings, this may not result in more income for the welfare recipient when transfer are included in the measure of income. This failure of workfare is not a failure of the system itself but the result of the extremely high effective tax rates facing welfare recipients, the same cause of the disincentives to work that plague the traditional welfare system. The low wage jobs for which many of the poor are qualified simply do not pay enough to support a family. Those who succeed in workfare often lose the AFDC and in-kind benefits that they need once they take a job. According to Jencks, the best way to encourage work among the welfare poor is not through workfare as we defined it, but through a wage subsidy plan to supplement the incomes of poor, low-wage workers (p. 43). Since workfare is, according to Peterson, a form of wage subsidy, it can be inferred from Jencks' argument that he sees workfare as a step in the right direction, but feels that it does not go far enough toward alleviating the condition of the welfare poor.

Another side effect of workfare is that it may actually raise frictional unemployment, as

participation in workfare interrupts the job search process of the unemployed. This can result in a labor market inefficiency, and increased unemployment among the poor. Standing points out that evaluations by the Manpower Demonstration Research Corporation of male recipients of AFDC-UP (Unemployed Parents) who participated in workfare programs indicate that workfare delays re-entry into the labor market (p. 684).

There is an additional problem, analogous to the one raised by Burtless in his discussion of a tax rate reduction on work incentives among the poor: our analysis thus far has focused exclusively on welfare recipients, excluding the effects of workfare on the working poor. On the positive side, under a system of workfare there will be more incentive for the working poor to keep working and stay off public assistance. On the negative side, if workfare were instituted on a large scale it would introduce distortions into the lower end of the labor market. The introduction of new cheap labor into the economy would lead to substitution away from better labor and the weakening of bargaining position of the working poor. Standing observes that this has been observed in Sweden, which has a system of national workfare (p. 683).

CONCLUSION

The net effect of the workfare program on welfare recipients is ambiguous. If one ignores the utility of leisure, or assumes that the utility of work is positive for low values of work, then the evidence indicates that a workfare program will help welfare recipients. This is because the government is providing these individuals with additional benefits in form of training and work experience. Under the standard assumption of positive utility to leisure, the effect of workfare on welfare recipients is ambiguous, and will depend on individual tastes and on the magnitude of the different effects. In either case, the effects of workfare would be more advantageous to its recipients if tax rates on the poor were lower and more uniform. In contrast, workfare is likely to have an unambiguous negative effect on the working poor, as previous welfare recipients enter the labor market and drive down wages at the lower end of the labor market.

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GERMAN UNIFICATION: INEFFICIENCIES OF GOVERNMENT INTERVENTION

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