

# Cato Institute Briefing Paper No. 27: The Value of Welfare: Cato vs. CBPP

June 12, 1996

Michael D. Tanner, Naomi Lopez

Michael Tanner is director of health and welfare studies at the Cato Institute and Naomi Lopez is an entitlement policy analyst.

## Executive Summary

In 1995 the Cato Institute released a study comparing the benefits available from entitlement programs with income available from work. In May 1996 the Center on Budget and Policy Priorities issued a critique of that study. A review of the original study published by Cato and the criticisms in the CBPP study shows that the Cato study remains an accurate appraisal of the level of welfare benefits. The CBPP study fails to account for the value of non-cash welfare benefits such as Medicaid. In addition, the Cato study's inclusion of housing benefits more accurately reflects the work vs. welfare tradeoff for long-term welfare recipients. With the exception of a small error in the calculation of the value of food stamps in five states, the criticisms of the Cato study are unfounded. Since the federal welfare benefits a typical welfare family would be eligible to receive exceed the wages for the type of entry-level job that most welfare recipients could expect, welfare remains a rational choice for many people.

In September 1995 the Cato Institute released a study by Michael Tanner, Stephen Moore, and David Hartman that determined the value of the federal welfare benefits package available to a single nonworking mother with two children in the 50 states and the District of Columbia. [\[1\]](#) The authors of the Cato study described the available welfare benefits package and offered insights into

- why almost 65 percent of welfare recipients report that they are not actively seeking work [\[2\]](#) and
- why, as welfare benefits increase, women are more likely to leave the labor force and enroll in welfare programs instead. [\[3\]](#)

That study has recently been criticized by several supporters of the current welfare system, most notably the Center on Budget and Policy Priorities. Reexamination of the Tanner, Moore, and Hartman study confirms that it is an accurate appraisal of the true level of welfare benefits.

The CBPP study, in contrast, fails to adequately account for the value of noncash welfare benefits such as Medicaid. In addition, the Cato study's inclusion of housing benefits more accurately reflects the work vs. welfare tradeoff for long-term welfare recipients. With the exception of a small error in the calculation of the value of food stamps in five states, CBPP criticisms of the Cato study are unfounded.

## Methodology and Major Findings

Because benefits vary dramatically depending on a variety of factors such as family size and composition and age of children, the Cato study used a profile of a typical welfare household consisting of a single mother over the age of 21 and two children, aged 1 and 4. No paternity was established for the children. The mother did not work and reported no outside income. Neither the mother nor either child was disabled. All were American citizens. Welfare families clearly come in all sizes and compositions, but that profile substantially conforms to the typical Aid to Families with

Dependent Children (AFDC) household. [\[4\]](#)

Although AFDC is the most widely recognized welfare benefit, it accounts for less than 6 percent of the federal welfare budget. [\[5\]](#) Even after accounting for the states' contributions to the program, AFDC represents less than 8 percent of the nation's combined federal and state welfare spending. [\[6\]](#) Politicians and the media tend to focus on AFDC when discussing welfare reform, but to focus on a single--albeit popular--welfare program is to paint a woefully inadequate picture of the nation's welfare system.

With that in mind, the authors of the Cato study computed the cash value of the total benefits package that the profile household would be eligible to receive, using data for the most current year available and taking account of those programs under which the family would be most likely to receive benefits: AFDC, food stamps, Medicaid, public housing, nutrition assistance programs, and utility assistance. Because welfare benefits are tax-free, the authors then compared the value of those benefits with the amount of pretax income that a worker would have to earn to receive an equivalent take-home income. The authors of the Cato study included taxes and tax credits for federal, state, and, in some cases, local jurisdictions.

The authors of the Cato study concluded that the combined value of the full package of welfare benefits actually provides beneficiaries with incomes above the poverty level in every jurisdiction. Because the attractiveness of welfare differs widely among jurisdictions, when the value of the total package of benefits was equated to the value of a job providing the same after-tax income, that pretax value ranged from a high of over \$36,000 in Hawaii to a low of \$11,500 in Mississippi. In eight jurisdictions--Hawaii, Alaska, Massachusetts, Connecticut, Washington, D.C., New York, New Jersey, and Rhode Island--welfare pays at least the equivalent of a \$25,000 per year job. [\[7\]](#)

The pretax value of the full package of welfare benefits substantially exceeds the amount a recipient could earn in an entry-level job in virtually every state. And, although the evidence indicates that in the long term an individual is better off in the labor force than on welfare, moving from welfare to work is likely to lead to at least a short-term decline in income and, for some, perhaps a permanent reduction in income. [\[8\]](#) The authors of the Cato study concluded, on the basis of the data, that some welfare recipients may prefer welfare to work, thus increasing long-term dependency.

Recently, however, the CBPP has released a report, by Sharon Parrott, criticizing the Cato study and suggesting that the actual level of welfare benefits is far lower than Tanner, Moore, and Hartman stated. [\[9\]](#) According to the CBPP, the typical welfare recipient receives less than \$9,000 in income, well below the poverty level and less than a minimum wage job pays. [\[10\]](#)

However, Parrott excludes from consideration certain welfare benefits, such as Medicaid. She believes that public health insurance should not be treated as a benefit because the welfare recipient does not receive a cash payment for health care. Furthermore, Parrott attacks the Cato study for allegedly underestimating the welfare benefits available to low-wage workers and their families and asserts that there is a strong financial incentive to move from welfare to work under the current system. Parrott's attack is not supported by the data, and she seriously underestimates the actual value of the available welfare benefits package.

### **What Benefits Should Be Included?**

The primary distinction between the Cato and CBPP authors' methodology is found in the types of benefits included. Of 77 major federal welfare programs, the authors of the Cato study examined only 7. The author of the CBPP study includes only 2: AFDC and food stamps. In fact, the authors of the Cato study may have understated the available welfare benefits in some cases because they did not include state and local welfare assistance programs.

The authors of the Cato study included AFDC; food stamps; Medicaid; the Special Supplemental Food Program for Women, Infants, and Children (WIC); utilities assistance under the Low-Income Home Energy Assistance Program (LIHEAP); housing assistance under a variety of programs, including public housing and Section 8 Rental Assistance; and the free commodities program.

While the Cato study's profile family is certainly eligible for numerous additional programs, Tanner, Moore, and Hartman selected, not only the most commonly used programs, but also the programs that provide things that are

commonly purchased in the private sector. For example, job-training programs are widely available, but it is highly unlikely that individuals would tend to purchase government job training if they were spending their own money. Conversely, health care insurance is often purchased in the private sector, so it is included in the study.

The authors of the Cato study carefully acknowledged that "not every welfare recipient meets our profile, and many who meet our profile do not receive all the benefits." Indeed, they included a table showing the pretax value of welfare benefits from only AFDC, food stamps, and Medicaid. [11] That table is reproduced in Appendix A. Even given that very limited set of benefits, the value of welfare exceeds the pretax value of a minimum wage job in 40 states. Moreover, welfare benefits alone exceed the poverty level in 25 states. (The package exceeds 99 percent of the poverty level in an additional five states.) In six states the wage equivalent of the benefits package is higher than 50 percent of the state's average wage.

Which benefits should be included in the welfare package is a controversial and debatable issue. There are currently at least 77 major means-tested federal programs for the poor. [12] State, county, and municipal governments operate additional welfare programs. For example, Massachusetts offers a twice-yearly clothing allowance. Obviously, no one receives assistance from every program, but most welfare recipients are eligible for a number of different programs. For the author of the CBPP study to pretend that recipients get only AFDC and food stamps is extraordinarily misleading.

A second look at the data shows that, in painting a more complete picture of welfare assistance, the authors of the Cato study are justified in including the additional programs, while the author of the CBPP study dramatically understates the available welfare benefits.

## Responses to Specific Objections

### Housing

The author of the CBPP study says that housing assistance should not be included because "more than three-quarters of AFDC families do not receive any form of housing assistance." [13] Although Parrott accuses the authors of the Cato study of "essentially ignor[ing] this fact," the study actually devotes three pages to a discussion of the issue, including a table detailing state-by-state housing assistance participation rates.

The authors of the Cato study concluded that, while nationwide only 23 percent of AFDC recipients received federal housing assistance, it was proper to include housing benefits for the following reasons.

1. The pool of AFDC recipients requiring housing assistance is actually far smaller than the total number of AFDC recipients. Focusing on the nationwide 23 percent participation rate implies that the remaining 77 percent of AFDC recipients are paying for housing out of their own pockets. In reality, however, a large proportion of welfare recipients is receiving free or reduced-cost housing from other sources, such as family or friends. For example, a study from the University of Tennessee found that 58.5 percent of AFDC households in that state spend nothing on monthly rent or mortgage payments. [14]

2. While only a minority of welfare recipients receives housing assistance, the percentage is still substantial. Nearly one-quarter of AFDC recipients nationwide receives housing benefits. If a disease were killing 25 percent of Americans, few would dismiss the epidemic as minor. Even in California, which has the lowest housing assistance participation rate, 80 thousand families participate in housing programs. [15]

3. The 23 percent figure is a nationwide average. The proportion of recipients receiving benefits in some jurisdictions, including several of the highest benefit jurisdictions, is considerably higher. For example, in the District of Columbia 50.1 percent of AFDC recipients receive housing assistance, in Massachusetts 42 percent receive housing assistance, and in Connecticut 40.5 percent do. The nationwide average is low primarily because of an extremely low participation rate in California (9.8 percent). In fact, 40 states, as well as the District of Columbia, have housing assistance participation rates higher than the nationwide average. [16]

4. Perhaps most important, there is generally a waiting list for housing assistance. The longer a person is on welfare, the more likely she is to receive housing assistance. Thus participation rates are reduced by people who may be on welfare for only a short time. Among long-term welfare recipients, the group most important to analyze, participation rates are likely to be far higher than the nationwide average. [\[17\]](#)

## Medicaid

Parrott rejects the inclusion of Medicaid as a benefit because "Medicaid is an insurance program; the payments it makes go to doctors and hospitals, not to the insured families. These Medicaid payments cannot be used to meet basic family expenses such as food, clothing, and shelter." [\[18\]](#) Parrott also argues that most experts believe that the value of public health benefits should not be included as a component of the welfare benefits package, but many policy institutes, such as the Urban Institute and the American Enterprise Institute, include public health benefits when measuring the value of welfare benefits. Even government organizations, such as the Bureau of the Census and the Congressional Research Service, acknowledge that public health benefits have value. Parrott's objection entirely ignores the fact that health care has value. [\[19\]](#)

Moreover, advocates of national health care, including CBPP, spent years trying to convince Americans that health care is a basic family need. According to CBPP's present logic, they should have no problem with cutting--or even eliminating--Medicaid, since the loss of benefits would not reduce the incomes of recipients. [\[20\]](#)

The authors of the Cato report did not simply assume that the value to the beneficiary was equal to the per recipient expenditure by the program. In calculating the value of Medicaid benefits, Tanner, Moore, and Hartman capped the benefits at the amount of premiums for an equivalent insurance policy for an average family enrolled in a health maintenance organization.

## Food Stamps

Parrott claims that "Cato assumes that the typical AFDC family simultaneously receives housing assistance and receives food stamp benefit levels that families get if they do not receive housing assistance. The typical AFDC family of three living in subsidized housing receives food stamps totaling \$209. This is \$69 less per month--\$828 less per year--than the food stamp benefit that Cato assumes the typical AFDC family gets." [\[21\]](#) To determine the validity of Parrott's claim, we recalculated the food stamp benefit levels for the 50 states and the District of Columbia. Recalculation shows that in 45 states and the District of Columbia the food stamp allowances given in the Cato study were either correct or erred by less than  $\pm$ \$5 per month. In only one state, California, can the correction be considered significant. Table 1 gives the results of the new food stamp calculations. The detailed calculations, which took into consideration housing assistance and related federal regulations, and their results can be found in Appendices B, C, and D.

**Table 1**

Comparison of Monthly Food Stamp Benefit Calculations (\$)

State	Tanner, Lopez Study (5/96)	Tanner, Moore, Hartman Study (9/95)	Difference per Month
Alaska	295	285	+10
California	186	214	-28

Colorado	282	289	-8
Connecticut	191	192	-1
District of Columbia	264	270	-7
Florida	294	295	-2
Hawaii	407	422	-16
Idaho	292	295	-3
Illinois	292	291	+1
Iowa	269	268	+1
Kansas	285	284	+1
Massachusetts	223	222	+1
Michigan	249	249	-1
Minnesota	237	236	+1
Nebraska	284	287	-3
Nevada	285	292	-7
New Jersey	277	276	+1
New Mexico	276	289	-14
North Dakota	274	273	+1
Oklahoma	294	295	-2

Oregon	294	293	+1
Rhode Island	269	268	+1
Utah	254	272	-18
Virginia	288	290	-2
Wisconsin	229	241	-12

Note: Values may appear to be inconsistent due to rounding.

According to current federal regulation, vendor payments, such as housing assistance and utilities assistance, that go directly from the government to a third party are specifically exempted as income when calculating food stamp benefits. [22] Furthermore, even though LIHEAP is a vendor payment, the LIHEAP Standard Utility Allowance is treated as a shelter expense when calculating food stamp benefits. [23] Because of the complex nature of calculating food stamp benefits, the Tanner, Moore, and Hartman study was slightly, but only slightly, off in some calculations. In no state was any error even close to the \$69 figure Parrott claims. That figure merely represents the maximum possible reduction for recipients who live in completely free housing, rather than subsidized housing, and incurs no housing expenses.

## WIC

Parrott objects to the inclusion of WIC benefits because "80 percent of AFDC recipients do not receive WIC." [24] That is true but misleading, largely because WIC eligibility is dependent on a child's age. The profile family had children aged one and four. A majority of families fitting the profile would receive WIC benefits. AFDC families with older children clearly would not. However, older AFDC children would be eligible for other nutrition programs, such as the free school lunch and school breakfast programs. The Cato authors included WIC but excluded other benefits. The author of the CBPP study simply excludes all nutritional benefits regardless of the children's ages.

## LIHEAP

LIHEAP operates heating assistance, cooling assistance, winter crisis, and summer crisis programs. Because states have discretion in the administration of those programs and climate varies by geographic location, some states do not operate all four programs and others have consolidated their programs. So, regardless of a state program's categorical breakdown of LIHEAP, AFDC recipients can receive standard assistance plus crisis assistance.

## Benefits for the Working Poor

Parrott accuses the authors of the Cato study of "ignor[ing] all means-tested benefits available to low-income working families." [25] Actually, Tanner, Moore, and Hartman not only considered the Earned Income Tax Credit (EITC), which is considered the most important transitional welfare benefit, but also included a three-page discussion of benefits available to low-income workers, stating, "Of course, moving from welfare to work does not automatically mean that an individual loses all welfare benefits. In those states where the wage equivalent of welfare remains relatively low, an individual taking a job at that wage could still retain eligibility for some benefits." [26]

Benefits vary considerably from state to state and are time limited for many programs. Families moving from welfare

to work could, in some states and regardless of income, continue to receive AFDC benefits for six months. All states are required to provide Medicaid benefits to beneficiaries for a period of one year. [27] Moreover, interviews with social welfare personnel indicated that, regardless of eligibility, actual participation rates for all programs drop once individuals enter the workforce. A recent study indicates that "most (68 percent) of the working poor who qualified for food stamps did not receive them; 36 percent of the working poor who were eligible for AFDC and 17 percent of those eligible for Medicaid did not receive benefits." [28] In part, that may be because an individual often must re-apply for benefits. Also, available funding for programs such as WIC, utilities assistance, and free commodities is allocated on the basis of need. Therefore, benefits may not be available for an individual who remains technically eligible. Finally, many working poor families are simply too proud to apply for government assistance.

Any additional welfare benefits available to the working poor are likely to be at least partially offset by additional costs associated with going to work, such as those of child care, transportation, and clothing. [29] The authors of the Cato study chose not to include such work-related costs. However, it should be understood that earning an income clearly entails additional costs that are not faced by the welfare recipient.

Finally, it should be noted that, even if the final income level remains unchanged, an individual moving from welfare to work will perceive some form of loss--if only a reduction in leisure time. Thus, as the Congressional Research Service has pointed out,

Leisure is believed to be a "normal good." That is, with a rise in income, people will "purchase" more leisure by reducing their work effort. . . . Thus, the increase in [the value of welfare benefits] is expected to cause people to reduce work hours. [30]

In short, if people can receive the same income by either working or not working, most of them will choose not to work.

## **The Tax Burden**

Parrott does not consider the fact that welfare benefits are tax-free, while an equivalent wage would be subject to taxes, including the FICA payroll tax and federal, state, and local income taxes. In lower benefit states those taxes would be offset by the EITC, but in higher benefit states a worker would have to earn considerably more than a welfare recipient to take home the same amount of income.

## **Conclusion**

Parrott portrays welfare as barely providing subsistence help to the needy. But that conclusion is based on the faulty assumption that welfare recipients receive only two forms of public assistance, AFDC and food stamps. In reality, few welfare recipients receive aid from only those two programs.

The Cato study authors' original conclusions remain unrefuted. The pretax value of the total welfare benefits package exceeds the wages for the type of entry-level job that most welfare recipients can expect.

Finally, although it is important that the actual level of welfare benefits be used in debate, quibbling over a few dollars' worth of benefits is unimportant. Welfare recipients are not comparing work with welfare down to the last penny of benefits. Rather, it is the general impression of the relative generosity of welfare that is the key to their decisionmaking. As long as they perceive that welfare is more generous than work, it will remain rational to choose welfare.

Clearly, many welfare recipients have that perception. A reexamination of the evidence shows that their perception is justified. Welfare remains a rational choice for many welfare recipients.

## **Notes**

The authors of this study are deeply indebted to Dana Berliner, staff attorney at the Institute for Justice, for her time and assistance in reviewing the food stamp benefit regulations. We also appreciate tax research provided by Dean



Stansel, fiscal policy analyst at the Cato Institute.

## Footnotes

[1] Michael Tanner, Stephen Moore, and David Hartman, "The Work vs. Welfare Trade-Off: An Analysis of the Total Level of Welfare Benefits by State," Cato Institute Policy analysis no. 240, September 19, 1995.

[2] U.S. House of Representatives, Committee on Ways and Means, 1994 Greenbook: Overview of Entitlement Programs (Washington: Government Printing Office, 1994), Table 10-28, p. 404.

[3] M. Anne Hill and June O'Neill, "Underclass Behaviors in the United States: Measurement and Analysis of Determinants," Baruch College, City University of New York, March 1990, Table 5.9, p. 78.

[4] U.S. Department of Health and Human Services, Administration for Children and Families, Office of Family Assistance, "Characteristics and Financial Circumstances of AFDC Recipients, FY 1992," 1993, pp. 1-4.

[5] Calculations based on data in Robert Rector and William F. Lauber, America's Failed \$5.4 Trillion War on Poverty (Washington: Heritage Foundation, 1995), pp. 47, 93.

[6] Ibid., pp. 47, 93.

[7] That assumes that the full value of the compensation for the jobs is \$25,000 a year. The \$25,000 could be provided entirely in cash salary or be made up of a combination of salary and benefits, such as health care insurance.

[8] See, for example, Richard Vedder and Lowell Gallaway, "The War on the Poor," Institute for Policy Innovation, Lewisville, Texas, June 1992. According to Vedder and Gallaway, holding other factors constant, individuals below the poverty line who do not receive welfare are nearly two and a half times more likely to be out of poverty the following year than are individuals who do receive welfare.

[9] Sharon Parrott, "The Cato Institute's Report on Welfare Benefits: Do the Numbers Add Up?" Center for Budget and Policy Priorities, Washington, April 22, 1996. An op-ed by Bob Herbert in the New York Times on April 22 also criticized the Cato Institute and the Cato study.

[10] Parrott, p. 1.

[11] Tanner, Moore, and Hartman, p. 30.

[12] Rector and Lauber, Appendix 1, pp. 45-87.

[13] Parrott, p. 3.

[14] William F. Fox et al., "Aid to Families with Dependent Children: 1995 Case Characteristic Study," Center for Business and Economic Research, Knoxville, Tennessee, 1995, p. 173.

[15] Derived from U.S. House of Representatives, p. 391.

[16] U.S. Department of Health and Human Services, p. .

[17] Tanner, Moore, and Hartman, p. 28.

[18] Parrott, p. 4.

[19] According to Parrott's logic, any noncash benefit has no value to the recipient. After all, food stamps cannot be used to pay for clothing or shelter.



[20] The United States has spent more than \$800 billion on Medicaid since the program's inception in 1965. Executive Office of the President, Historical Tables: Budget of the United States Government, Fiscal Year 1997 (Washington: Government Printing Office, 1996), Table 8.5, pp. 113-17.

[21] Parrott, p. 6.

[22] See 7 CFR 273.9 (b)(2)(i) and 7 CFR 273.9 (c)(1)(i).

[23] See 7 CFR 273.10 (d)(1)(i) and 7 CFR 273.10 (d)(6).

[24] Ibid., p. 3.

[25] Ibid., p. 6.

[26] Tanner, Moore, and Hartman, p. 31.

[27] U.S. House of Representatives, pp. 369-81; and National Governors' Association, "Final Report: The National Governors' Association Survey of State Welfare Reforms," Washington, July 1994, pp. A1-A9.

[28] Marlene Kim and Thanos Mergoupis, "The Working Poor and Welfare Reciprocity," Summary Working Paper no. 151, Jerome Levy Economics Institute, Bard College, Annandale-on-the-Hudson, N.Y. December 1995, p. 4. The authors of this study attribute nonparticipation to lack of awareness, administrative problems, inaccessibility, and lack of need.

[29] See Jerry Hausman, "The Effects of Wages, Taxes, and Fixed Costs on Women's Labor Force Participation," *Journal of Public Economics* 14 (1980): 161-94.

[30] Thomas Gabe and Gene Falk, "Welfare: Work (Dis)Incentives in the Welfare System," Congressional Research Service Report for Congress 95-105 EPW, January 10, 1995, p. 9.