Testimony before the
Subcommittee on Human Resources of the Ways and Means Committee, and the
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U.S. House of Representatives

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Thank you for inviting me to testify today on the topic of how welfare benefits can interfere with the incentive to work. It is an honor for me to be here today, and I am very pleased to share with you my recent work in this area.

My name is Erik Randolph. I am a senior fellow with the Illinois Policy Institute and also provide analytical services to organizations as an independent consultant.[2] Last year, the Illinois Policy Institute sponsored me to develop a computational model specifically for the state of Illinois. The model examined federal, state and local welfare benefits available to two typical households with children across a range of incomes to determine the impact of those benefits on economic incentives relative to employment. The Illinois Policy Institute published a report on this model on Dec. 29, 2014.[3]

Astounding results on the welfare cliff

The results of the study are nothing short of astounding. Imagine you are a single parent with two children living in Lake County, Illinois, which is a suburb of Chicago, and you have a full-time job earning $12 an hour. You receive an offer to work a full-time job earning $18 an hour, and the new job is more convenient with a more pleasant work environment.

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[1] Opinions stated within belong to the witness and are not necessarily those of the Illinois Policy Institute.

[2] A biography can be found on erikrandolphconsulting.com.

[3] Erik Randolph, "Modeling Potential Income and Welfare-Assistance Benefits in Illinois: Single Parent with Two Children Household and Two Parents with Two Children Household Scenarios in Cook County, City of Chicago, Lake County and St. Clair County," Illinois Policy Institute, December 2014: https://d2dv7hze646xr.cloudfront.net/wp-content/uploads/2014/12/Welfare_Report_finalfinal.pdf.

Should you accept the offer? Under the scenario studied, you would be crazy to accept the higher-paying job. Instead, you should keep the $12 per hour job.

At first glance this makes no sense. Of course someone would prefer to make $18 per hour instead of $12 per hour. But as a single parent managing a household with children, you are concerned with maximizing all your sources of potential income, whether it is earned through work or given to you in the form of welfare benefits. So as a rational person, you will evaluate your potential loss in welfare benefits against your potential gain in earned income.

A single parent in Lake County who earns $12 per hour brings home just over $22,000 in net pay. However, that same single parent is eligible for an array of welfare benefits as follows:

- Refundable tax credits from the Earned Income Tax Credit, or EITC, the Additional Child Tax Credit, and the Illinois Earned Income Tax Credit
- Food assistance, including the Supplemental Nutrition Assistance Program, or SNAP, food packages for the Women, Infants and Children program, or WIC, and the National School Lunch Program
- Housing assistance from the Housing Choice Voucher Program
- Subsidized child care services
- Medical assistance for both the parent and her children

When you add up the value of those potential benefits, it comes to an astounding $39,534, bringing the total net receivables – in terms of earned income and benefits – to $61,655.

In comparison, suppose you earn $18 per hour, bringing home about $33,000 in net pay. That is a gain of about $11,000 in earned income. However, your potential welfare benefits will drop drastically to $5,236 from $39,534, for a loss of more than $34,000. Why would any sane person voluntarily give up $34,000 in benefits to gain only $11,000? (See Appendix A for a chart demonstrating this scenario.)

Welcome to the American system of welfare benefits. It can trap families in low-income living, which is unfair and wrong. America is about opportunities to get ahead, succeed and improve oneself. This cruel phenomenon of facing a greater loss in benefits than any gain in income from employment is called the welfare cliff.

The Illinois Policy Institute study examined three counties in Illinois – an urban county, a largely suburban county and a county downstate, and the results are essentially the same. Single-parent households and two-parent households are eligible for an array of benefits just previously mentioned, which have varying eligibility rules and ways of determining benefit amounts. These welfare programs are typically uncoordinated, and there is no consideration of the cumulative impact of those programs on economic incentives for recipient individuals and families.

Everyone should agree on the basic point that there ought to be an income ladder such that when someone earns more money, he or she is in fact better off. However, this is not the system we—as a nation—have created, as demonstrated by my computational model.

Lack of integration and coordination

If you have taken an introductory course in economics, you may remember being taught on the very first day, or perhaps the second day, something called the fallacy of composition. I used to explain it this way: Suppose I discovered that if I left work one hour early, I miss the rush hour driving home. Now if we all left an hour early, we all would miss the rush hour driving home. Students usually would laugh at this example because it was obviously false, but it illustrated the point well. What might be true for one is not necessary true for a larger group.

The same principle applies here. There are dozens of welfare programs all designed to help people. They are all well-meaning. In isolation, they may be helpful. But when they are examined in the aggregate – their impact as a group – they assume a composition that acts differently.

Just look at the number of federal agencies that deal with welfare programs and the congressional committees that oversee them. The EITC is administered by the IRS, food stamps by the Department of Agriculture, child care by the Administration for Children and Families, and Medicaid by the Centers for Medicare and Medicaid Services.

There is no integration and little coordination at the federal level among the various welfare programs. States try to provide some coordination, but the general inflexibility at the federal level prevents them from ever coming close to solving the problem of the welfare cliff.

Additional background

I began looking at this issue professionally four years ago when I was a special assistant at Pennsylvania's Department of Public Welfare.[4] The secretary at the time was Gary Alexander. There was a lot of discussion about the welfare cliff but I found very little in the way of adequately quantifying the phenomenon, so I used resources available to me at the department to develop a model showing the welfare cliff.

Alexander released preliminary results of a scenario from that model on July 11, 2012, at an American Enterprise Institute event (see Appendix B). It was further circulated on Capitol Hill and in several state capitols, and received media attention.

Alexander commissioned a project-management team, which I headed, that worked on a prototype solution to the welfare-cliff problem. The team included, among others, an eligibility-systems expert, a case-worker supervisor and a manager in charge of all county-office operations. We developed a prototype solution that would be incorporated into the

[4] The Pennsylvania General Assembly renamed this department in 2014. It is now referred to as the Department of Human Services.

eligibility system and would require a series of waivers from the federal government. After a change in leadership in 2013, the project was abandoned.

In 2014, the Illinois Policy Institute sponsored its study on the issue, and the result is a more sophisticated model that maps out the economic disincentives already described. Furthermore, the Illinois report is transparent, laying out the algorithm, eligibility rules and sources, allowing anyone to examine the model and results and offer peer review comments.

General conclusions

We—at the Illinois Policy Institute—drew five general conclusions from the Illinois computational model.

First, potential welfare benefits are large in magnitude and wide in scope. For example, the scenario examined for Cook County showed that a single parent with two children can gain $47,894 in benefits, or a two-parent household can gain $41,237.

Second, welfare cliffs are significant and it is difficult to recover from a loss of benefits. For example, the scenario of the Cook County single parent with two children showed there is no point in earning more than $12 per hour. At $18 per hour the loss in benefits can be a staggering $35,742. This single parent would have to earn $38 per hour to recover the value of the lost benefits.

Third, the economic disincentives are real, major and trap families. Consider the Cook County scenario. Why would a single parent agree to earn more than $12 if that parent stands to lose as much as $35,000 in benefits? It is unlikely that this single parent could jump from $12 per hour to $38 per hour to preserve her standard of living.

Fourth, the welfare system is inequitable. Consider again the Cook County scenario. A similarly situated single parent earning $18 would be worse off than a single parent earning between $8.25 and $12 per hour. This conclusion also demonstrates a reason why raising the minimum wage can be harmful.

Fifth and finally, the greatest problem areas are those programs that do not taper off benefits. Assistance programs for housing, child care and health-care benefits have the steepest cutoffs, significantly amplifying the welfare-cliff effect. Food-assistance programs are mixed. WIC food packages as well as the National School Lunch Program have hard cutoffs. SNAP benefits, however, do taper off and do not add significantly to the welfare-cliff problem when viewed in isolation.

Forging a solution

So where do we—as a nation—go from here? First, we must recognize that we cannot continue doing things the same way if we are serious about solving the problem. The welfare-cliff problem exists because the system has been developed in a piecemeal, fragmented and haphazard manner. We cannot expect to derive a solution is we continue down this same path. Therefore, the solution must be derived from a systemic approach.

The systemic approach must integrate and coordinate all welfare programs. Here are two general directions we can take. First, the federal government could attempt to do it all itself and cut out state governments altogether. The second option is the federal government could grant more flexibility to the states allowing them to be innovative. This course of action does not mean the federal government loses accountability. Instead, the federal government can establish goals and broad parameters but still allow states flexibility to meet those goals.

The first direction is a one-size-fits-all approach. The second direction recognizes and respects the laboratories of democracy and benefits from competition among the states as they work to find the best solutions.

Here are a couple of recommendations: Because states are responsible for administering most of the programs, give them flexibility to adopt solutions to solve the welfare-cliff problem. Allow states to combine, integrate and coordinate programs. In the areas where states currently play no role, such as housing, it is crucial to repackage those programs so states can integrate them into their plans to eliminate the welfare cliff. Flexibility can be given to states by incorporating those purposes into the federal rules, creating explicit waivers for those purposes or creating well-designed block grants.

Expanding opportunity

I had the opportunity to review the document "Expanding Opportunity in America."[5] The Opportunity Grant proposed in Chapter 1 would move things in the right direction and potentially provides one way to solve the welfare-cliff problem. It is good that the proposal encourages innovation among the states and combines many of the welfare programs, especially housing. Here are some preliminary suggestions based upon my experience:

- Add Medicaid and the Children's Health Insurance Program, or CHIP, to the list of programs, or at least have a parallel effort to address reform in Medicaid and CHIP that provides more flexibility to states so that they can integrate them into their overall plans on creating pathways from poverty to self-sufficiency.
- Encourage states to save money by allowing them to keep and utilize for public purposes a portion of the federal money that they save for a limited period of time.
- Specify that state plans adhere to the principle that anyone who earns more money should be better off for it. Any exceptions should be extraordinary and temporary.
- Describe the goals and broad parameters for the states, but steer away from being too prescriptive on how states should meet those goals.
- Pay closer attention to the disabled population and its role within the welfare system. They, too, can become trapped within the system. Also, there is a wide range in severity of disabilities, and case studies have shown how disability income can become a substitute for traditional income-maintenance programs.

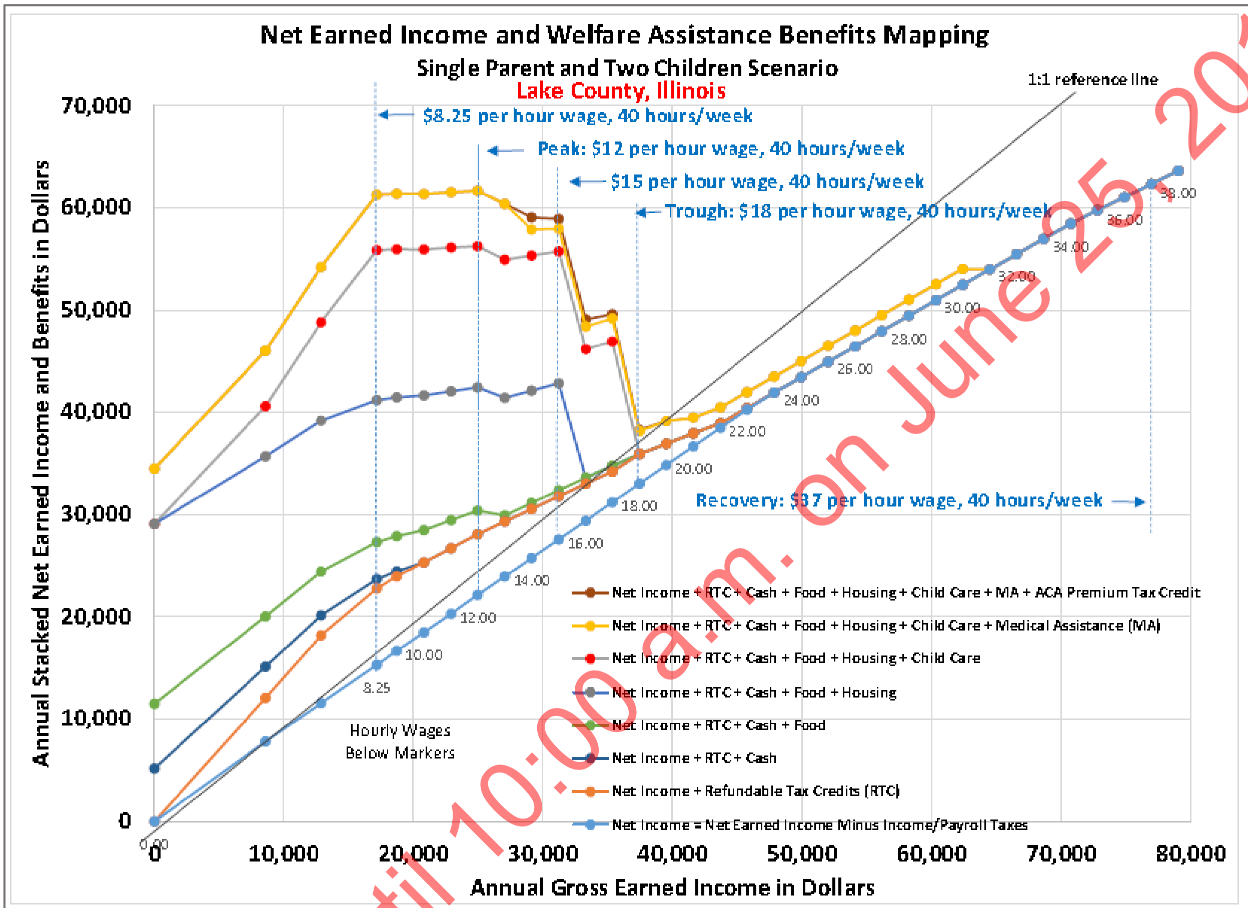
[5] "Expanding Opportunity in America: A Discussion Draft from the House Budget Committee," prepared by the House Budget Committee Majority Staff for Chairman Paul Ryan, July 23, 2014, at

Questions

Thank you for allowing me to testify today, and I will do my best to answer any questions that you may have.

Appendix A

Chart 11 from "Modeling Potential Income and Welfare-Assistance Benefits in Illinois …": Net earned income and welfare-benefits mapping for a single parent with two children in Lake County, Illinois.



Appendix B

Below is an image of the slide used by Gary Alexander when – on July 11, 2012, at an event sponsored by the American Enterprise Institute – he first released preliminary results of work being done at the Pennsylvania Department of Public Welfare. The author of this testimony was the primary and lead developer of the model used in this slide. Because of variances among the states, the welfare cliff will look somewhat different for each state.