The Evolving Structure of the Means-Tested

Transfer System in the U.S.

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October, 2001

Prepared for the NBER Conference on Tax Policy and the Economy, October 30, 2001. This paper draws upon a forthcoming NBER volume on Means-Tested Transfers in the U.S.

Abstract

The system of means-tested transfers in the U.S. has evolved in important ways over the last decade, with the significant expansion of the Medicaid program and the Earned Income Tax Credit program and with significant contraction in the Aid to Families with Dependent Children program, now titled the Temporary Assistance for Needy Families program. Further, the latter has undergone a significant restructuring as an emphasis on work requirements has increased. These trends, as well as other trends in earlier decades, represents a gradual trend toward a categorical transfer system in which specific groups in the low-income population are offered different packages of benefits and services, and represents a decisive rejection of the negative income tax philosophy. The paper reviews the trends in the structure of the major means-tested programs and what economic research has to say about their effects on behavior.

The system of means-tested transfer programs in the U.S. has undergone significant transformation over the last decade. The most important changes have taken place in three programs: the Aid to Families with Dependent Children (AFDC) program--now named the Temporary Assistance for Needy Families (TANF) program--the Medicaid program, and the Earned Income Tax Credit (EITC). The generosity of the AFDC-TANF program has been significantly contracted and the conditions for receiving benefits have been markedly restricted to those who can and are willing to comply with work requirements and other new rules. The Medicaid program has been significantly expanded to cover more families and children off the AFDC-TANF program. The EITC has also been greatly expanded and now pays benefits to low-income working families that are in excess of expenditures in either of the other two programs.

To determine where we stand in our understanding of each of these programs, as well as the other major programs in the system of means-tested transfers, a volume is under preparation by the National Bureau of Economic Research that surveys the current structure and historical evolution of each of these programs and synthesizes the results of the research that has been conducted on their economic effects (Moffitt, forthcoming). In addition to the AFDC-TANF, Medicaid, and EITC programs, reviews were conducted for the Food Stamp program, the Supplemental Security Income (SSI) program, and programs for child care, job training, child support, and housing. This paper summarizes the results of those reviews and draws conclusions for the evolution of the overall system of means-tested transfers.

Trends in Expenditures in Means-Tested Transfer Programs

Figure 1 shows trends in per capita expenditures in the eighty largest means-tested transfer programs since 1968. The figure reveals that there have been four phases of spending growth: an expansionary phase beginning in the 1960s and running through the early or mid-1970s; a contractionary (or stationary) phase beginning in the mid-1970s and running until the mid-1980s; another expansionary phase running from the mid-1980s to the early 1990s; and another contractionary (or stationary) phase beginning in the mid-1990s.

The first phase included an increase in AFDC benefits; enactment of a major piece of welfare legislation (the 1967 Social Security Amendments) which raised earnings disregards in the program (i.e., lowered the tax rate on earnings); and witnessed the creation of the Food Stamp and Medicaid programs and, later in the period, the Supplemental Security Income program. The second phase included a steady decline in real AFDC benefits; enactment of a major piece of AFDC legislation (the 1981 OBRA) which effectively eliminated the earnings disregards enacted in 1967 and consequently cut thousands of families with earnings from the rolls; and saw an increasing interest in work requirements and mandatory training programs for welfare recipients among federal policy-makers. The third phase--which is not always recognized as such, for it is often presumed that the conservative trends in the second phase have continued uninterrupted--saw a dramatic expansion of the Earned Income Tax Credit (EITC); major expansions of eligibility in the Medicaid program, primarily to non-AFDC families; and sizable expansions of the caseload in the SSI program, particularly arising from increased eligibility rules for disabled adults and children. The Family Support Act of 1988, although occurring in the third phase and seemingly contractionary--it intended to mandate work and training for AFDC recipients more heavily than in the past--is best viewed as neutral, for not only was it never effectively implemented, it could also be interpreted as expansionary. The fourth phase is a result of the 1996 welfare legislation which contracted the AFDC-TANF program, as well as slowed growth in the Food Stamp and Medicaid programs, partly the result of welfare reform and partly the result of a robust economy.

Table 1 shows the sources of this growth more formally, at least since 1980. From 1980 to 1999, the largest growth occurred in Medicaid, the EITC, housing, and SSI. From 1990 to 1998, growth of AFDC expenditures essentially stopped, while EITC expenditures accelerated. Medicaid and SSI expenditures continued their strong growth. The majority of Medicaid expenditures are on the elderly and disabled, so the Table shows expenditures on single mothers--the traditional group also eligible for AFDC and TANF--separately. Both grew at substantial rates over the period. Thus indeed the three programs--Medicaid, EITC, and SSI--explain the explosive growth of expenditures in the 1990s.

Table 2 shows the ten largest programs in terms of expenditures as of 1997. By far the largest is Medicaid, with SSI and EITC a distant second and third. Food Stamps and TANF are somewhat smaller programs in terms of expenditure, while subsidized housing is somewhat smaller as well. The other programs not only have smaller expenditures but also much smaller caseloads. The largest 6 programs account for about 80 percent of all means-tested spending.

Table 2 also illustrates an oft-noted trend, which is the much greater growth of in-kind transfers relative to cash transfers. Food Stamps and Medicaid, which subsidize food and medical care, respectively, have passed up the AFDC-TANF program both in terms of expenditures and caseloads. This is a major change from the 1960s, when neither of the in-kind programs was in place, to the present, when both have grown tremendously. In-kind transfer programs are more politically popular than cash transfer programs.

What the Table also shows, however, that it is not cash per se that is unpopular with the voters but rather cash programs untied to any other behavior. The EITC is a cash program, for example, but its popularity rests with its tie to work and earnings. The SSI program is another cash program, but is targeted specifically at disability and other specific forms of need.

The most important lesson of this evolution is that the notion of a universal negative income tax, as espoused by Friedman (1962), has continued to be rejected. While the negative income tax as proposed by Friedman and others had many features--including the aim to increase work incentives, a separate issue discussed below--one of its main features was the aim to have a single universal transfer program, governed by a single benefit formula, into which the multiplicity of other programs could be collapsed. What has happened instead is that the multiplicity of different programs has grown, not declined, over the ensuring decades. Not only have the Food Stamp and Medicaid programs become more prominent since Friedman made his proposal, but the EITC and SSI have grown as well. As noted already, all four of these programs exceed the TANF program in terms of expenditures. All four are targeted on specific populations and/or on subsidizing specific types of consumption.

The idea of a transfer program that is targeted on specific eligibility groups is what is known as a "categorical" transfer system. Individuals and families in different groups--those who work, those who are disabled, and so on--are given different programs with different benefit schedules, containing different levels of benefits and different tax rates on earnings. In early discussions of the negative income tax, it was noted that categorical transfer systems had been the rule in most periods prior to the Social Security Act of 1935, which created the AFDC program. Prior to that time, states offered 'mothers pensions' which were given to low income single-mother families, which at that time usually were the result of the death of the father. The programs operated with loose eligibility rules which gave caseworkers significant discretion to choose who was "deserving" of aid and who was not. In the 1960s, economists criticized such systems not only because they allowed such discretion on the part of the caseworker, but also because putting the eligible population into predefined categories and denying aid to those in some of those categories sets up incentives for families to change their behavior to become eligible. In addition, economists criticized categorical systems which offered multiple programs for different purposes on the grounds of administrative inefficiency and duplication of effort, for in many cases the eligible populations overlapped. Also, there was also the possibility that some types of families might fall into a category where no benefits were provided.

The other dimension of categorization that has been much discussed is demographic eligibility. The clearest dimension of this type is family structure, for single mother families are still the most heavily favored group for transfer benefits. The AFDC-TANF program, while two-parent families are eligible under certain circumstances, still provides most of its benefits to single mothers. The Medicaid program, at least counting its portion supporting low income families who are not aged and not disabled, likewise is mainly directed at single mother families. There has been some lessening of this restriction with the growth of the Food Stamp program and the Earned Income Tax Credit, both of which provide benefits to other groups. The EITC mostly restricts its benefits to those with children (a small benefit is available to single individuals) while the Food Stamp program has completely unrestricted demographic eligibility.

Nevertheless, excluding the elderly and disabled, single mothers are still a heavily favored group in the U.S. transfer system.

The categorization which emphasizes single motherhood is subject to the same criticisms that negative income tax advocates made against the multiplicity of transfer programs. Assigning different benefit programs to single mothers and two-parent familes sets up an incentive to change from one status to another. In addition, as a matter of equity, many observers felt that benefits should be based solely on income and other financial characteristics, and not family structure.

The growth of the EITC, Medicaid, and SSI in the 1990s, and the subsequent further decline of the AFDC program, represents a further move toward a categorical welfare system and away from the negative income tax universalist ideal. This trend would appear to be likely to continue.

- System of means-tested transfers has evolved significantly over the last decade

- Major changes in AFDC-TANF, EITC, Medicaid, and SSI

- General trend is toward an increasingly categorical welfare system, and away from the universalist negative income tax concept

- A continuation of earlier trends toward in-kind transfers and away from cash benefits

- Forthcoming NBER volume on Means-Tested Transfers will outline issues and programs

TRENDS IN THE SYSTEM

- Figure 1: Four phases of growth of expenditures

- First phase:

  Expansion of Food Stamp and Medicaid programs

  1967 Social Security Amendments

  Introduction of SSI

- Second phase:

  Decline in real AFDC benefits

  1981 OBRA legislation

  Increased interest in work requirements

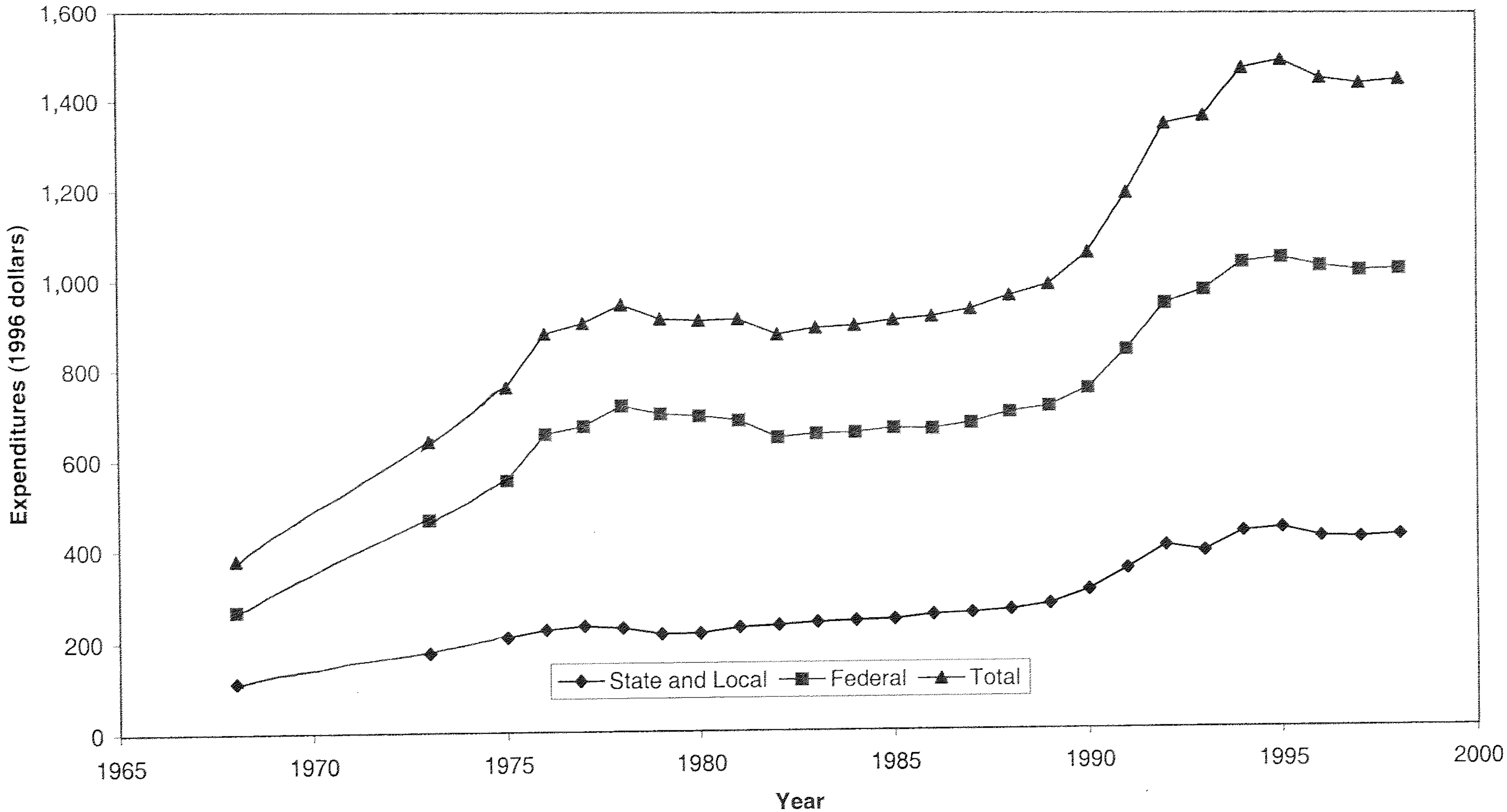
- Third phase:

  Expansion of Medicaid, EITC, SSI

- Fourth phase:

  PRWORA and slowed growth in Food Stamps and Medicaid

Figure 1: Real Per Capita Expenditures on Means-Tested Transfers, 1968-1998



Source: Burke (1999)

Sources of Growth in Third Phase

- Table 1
- Mainly Medicaid, EITC, SSI
- As a result, 10 largest programs: Table 2
- TANF is only number 5, surpassed by Medicaid and Food Stamps
- Categorical programs: EITC, SSI, Medicaid
- In-Kind programs: Medicaid, Food Stamps, housing
- Both have grown at expense of AFDC-TANF
- Moving away from a single program to cover all low income population
- Single-mother bias is still present in TANF and Medicaid; EITC and Food Stamps reduce the bias

- Criticisms of categorical systems by economists:

  Administrative ineffiency, overlap, areas of missing coverage

  High cumulative marginal tax rates

  Incentives to change categorical status

  Reintroduces caseworker discretion

Table 1

Trends in Expenditures in Five Major Programs, 1990-1998
(in millions)

	AFDC-TANF	Food Stamps	Medicaid All	Medicaid Single Mothers	EITC	Housing	SSI
1980	$13,473	$9,563	$25,781	$6,354	$4,015	$5,364	$7,490
1990	22,018	17,686	72,492	17,690	9,614	15,686	$16,599
Pct change from 980	63.4	84.9	181.2	178.4	139.5	192.4	121.6
1998	21,513	24,772	177,364	37,639	31,959	25,003	$30,216
Pct change from 990	0.9	40.7	144.7	112.8	232.4	59.4	82.0

Sources: U.S. Department of Health and Human Services (2001, Table TANF3), U.S. Congress (2000, Tables 7-15, 15-4, 15-13, 15-32), U.S. Social Security Administration (2000, Table 7.A4, 8.E2), Hotz and Scholz (forthcoming).

Table 2

Expenditures and Caseloads in Ten Largest Transfer Programs, FY 1997

	Expenditures (millions)	Caseloads (thousands)	Expenditures per Recipient
Medicaid	$167,359	40,446	$4,138
SSI	32,395	6,984	4,638
EITC	31,800	58,143	547
FS	24,772	24,200	1,024
TANF	23,179	10,936	2,120
Subsidized Housing	19,336	4,315	4,481
Medical Care for Veterans without service disability	9,220	153	60,261
Foster Care	6,794	289	23,509
Social Service	6,400	NA	NA
Federal Pell Grants	5,660	3,665	1,544

Source: Burke (1999), Hotz and Scholz (forthcoming)

AFDC-TANF

- Table 3, 4: Changes in 1996

- Time Limits, Work Requirements, Sanctions: a bundle

- Devolution and block grants

- Work Requirements: again a categorical strategy

  Exemptions

  Economics of "tagging"

  Caseworker discretion

  20% time limit exemption rule

- Earnings disregards: Table 5

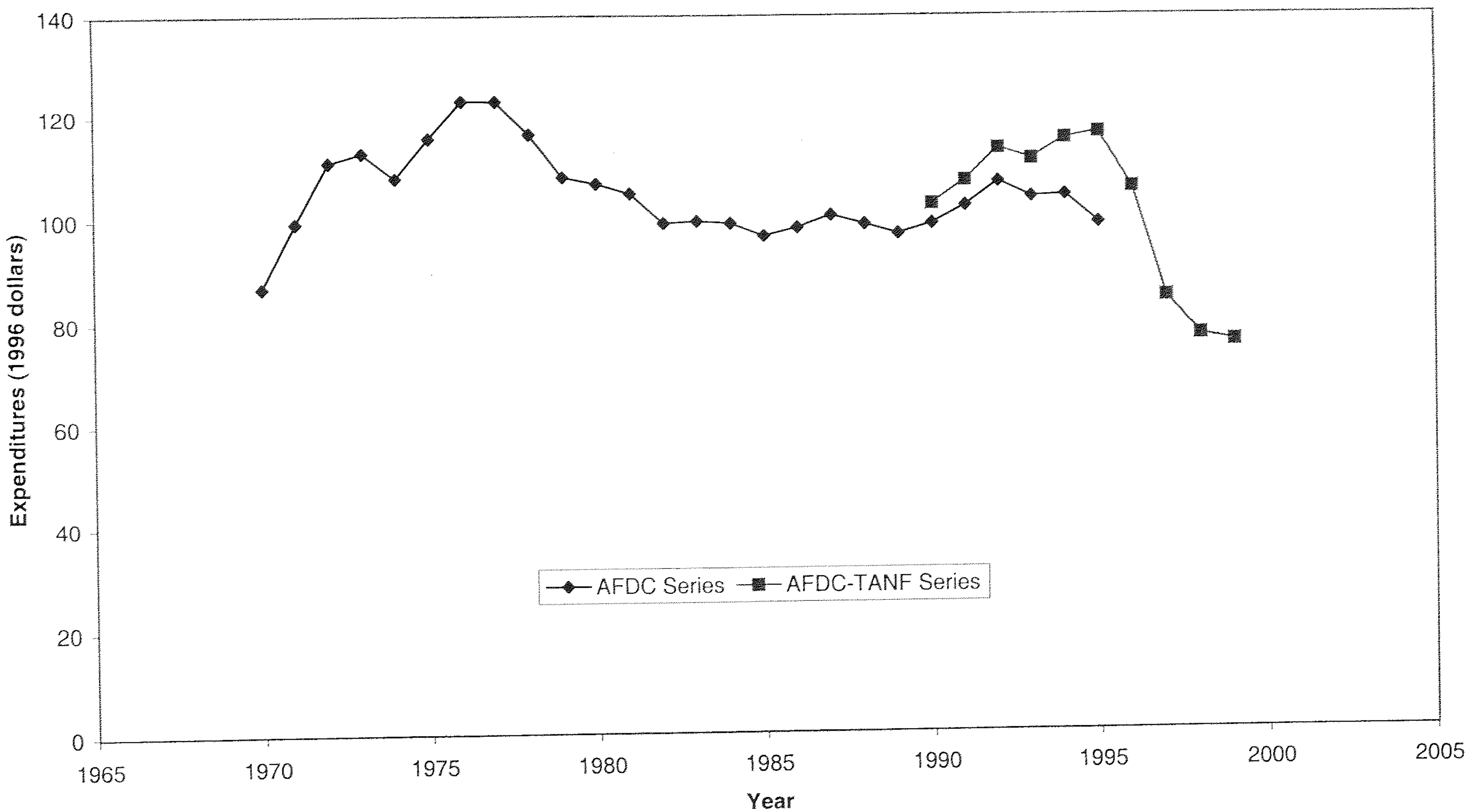
  They go with time limits

  Expand working while on welfare

  Wage progression: no agreement, but unlikely to be large

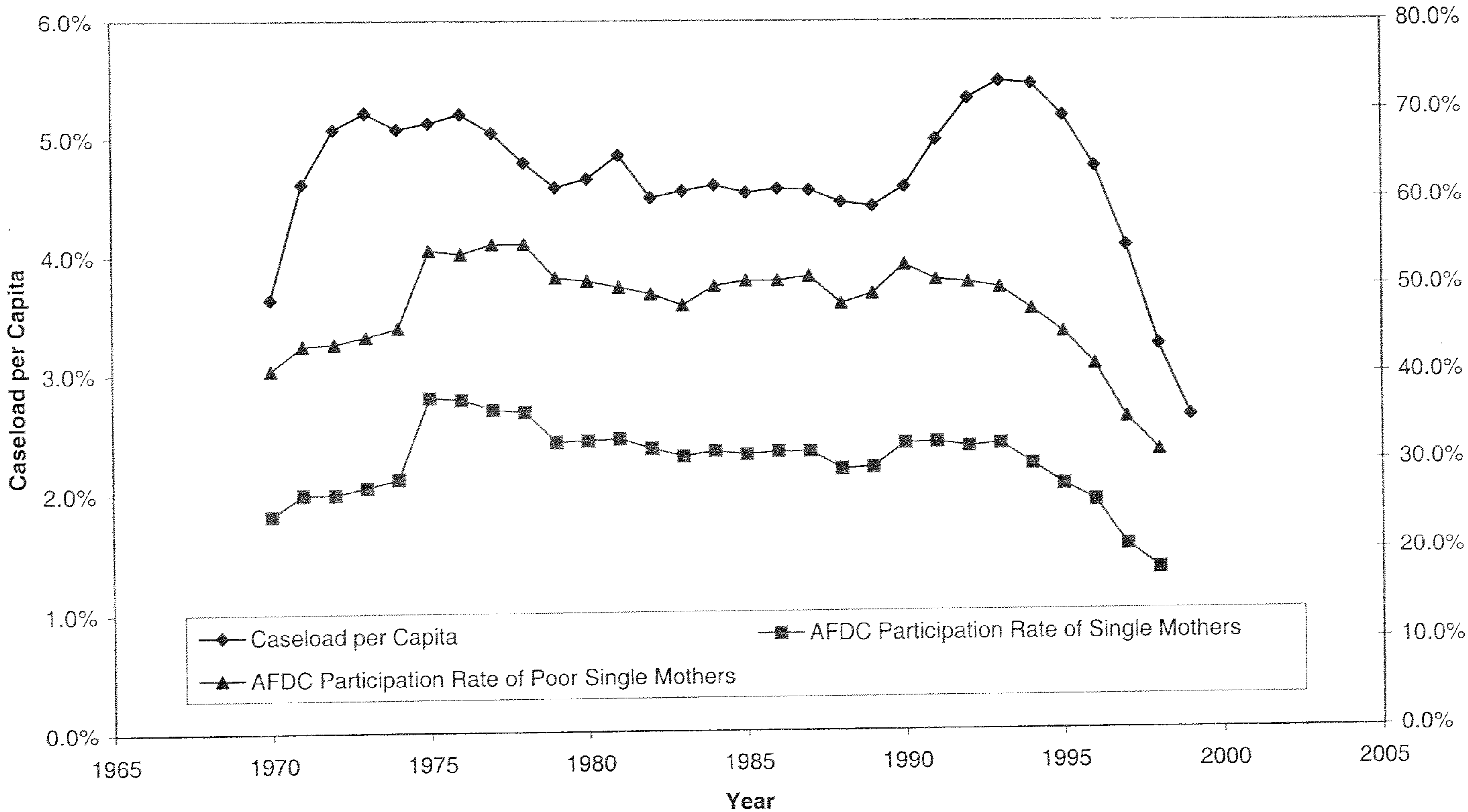
  Unlike EITC, can't take it off TANF

Figure 2: AFDC and TANF Real Expenditures per Capita, 1970-1999



Sources: U.S. DHHS (2001, Table TANF 3); U.S. Congress (2000, Table 7-15); U.S. Department of Commerce (2000, Table No. 2, Population).

Figure 3: AFDC and TANF Caseload per Capita and Participation Rates per Capita, 1970-1999



Sources: U.S. DHHS (2001, Table TANF 1); U.S. Department of Commerce (2000, Table No. 2, Population); author tabulations from the Current Population Survey.

Table 3

Comparison of the AFDC and TANF Programs

Item	AFDC	TANF
Financing	Matching grant	Block grant
Eligibility	Children deprived of support of one parent or children in low-income two-parent families (AFDC-UP)	Children in low-income families as designated by state; AFDC-UP abolished. Minor mothers must live with parents; minor mothers must also attend school
Immigrants	Illegal aliens ineligible	Aliens ineligible for five years after entry and longer at state option
Form of Aid	Almost exclusively cash payment	States free to use funds for services and non-cash benefits
Benefit Levels	At state option	Same
Entitlement Status	Federal government required to pay matched share of all recipients	No individual entitlement
Income Limits	Family income cannot exceed gross income limits	No provision
Asset Limits	Federal limits	No provision
Treatment of Earnings disregards	After 4 months of work, only a lump sum $90 deduction plus child care expenses; and nothing after 12 months	No provision

Table 3, continued

Item	AFDC	TANF
Time Limits	None	Federal funds cannot be used for payments to adults for more than 60 months lifetime (20 percent of caseload exempt)
JOBS program	States must offer a program that meets federal law	JOBS program abolished
Work Requirements	Parents without a child under 3 required to participate in JOBS	Exemptions from work requirements are narrowed and types of qualified activities are narrowed and prespecified (generally excludes education and classroom training) and must be 20 hours/week rising to 30/week for single mothers
Work Requirement Participation Requirements	JOBS participation requirements	Participation for work requirements rise to 50% by FY 2002
Child Care	Guaranteed for all JOBS participants	No guarantee but states are given increased child care funds
Sanctions	General provisions	Specific provisions mandating sanctions for failure to comply with work requirements, child support efforcement, schooling attendence, and other activities
Child Support	States required to allow first $50 of child support received by mother to not reduce benefit	No provision

Source: Burke (1996)

Table 4

State Time Limits, August 1998

States	Time Limits
27 States	60 Months
8 States	Intermittent, e.g., 24 out of 60 months; Lifetime of 60 Months
8 States	Less than 60 Months Lifetime
Arizona, Indiana	(1) 24 out of 60 months; lifetime of 60 for adults only; (2) 60 months lifetime
California	For applicants: 18 months but can be extended to 24 months if extension will lead to employment or 60 months if no job available and adults participate in community service. For recipients: 24 months but can be extended to 60 months if no job available and adults participate in community service
Illinois	(1) No limit if family has earned income and works 20 hours per week (2) 24 months for families with no child under age 13 and has no earnings (3) 60 months for all other families
Iowa	Individualized; lifetime of 60
Massachusetts	24 out of 60 months; no lifetime limit
Michigan	No time limit; will use state funds after 60 months
Texas	12,24, and 36 months lifetime for adults only, time period depends on employability of head of household

Source: U.S. DHHS (1998).

Table 5

Monthly Earnings Disregards in TANF as of October, 1997

State	Flat Disregard	Percent of the Remainder
Alabama	0	20
Alaska	$150	0
Arizona	$90	33
Arkansas	20%	50
California	$225	50
Colorado	AFDC	AFDC
Connecticut	0	100[a]
Delaware	AFDC	AFDC
D.C.	AFDC	AFDC
Florida	$200	50
Georgia	AFDC	AFDC
Hawaii	$200	36
Idaho	0	40
Illinois	0	67
Indiana	AFDC	AFDC
Iowa	20%	50
Kansas	$90	40
Kentucky	AFDC	AFDC
Louisiana	$120 - $1,020	0
Maine	differs by county	differs by county
Maryland	0	26
Massachusetts	$120	50

Table 5 (continued)

State	Flat Disregard	Percent of the Remainder
Vermont	$150	25
Virginia	0	100[d]
Washington	0	50
West Virginia	0	40 on average (varies)
Wisconsin	0	0
Wyoming	$200-$400	0

Notes:
Source: Gallagher et al. (1998, Table 14)

In cases where the disregards change with the length of the spell, those for the longest spell are shown

AFDC=$90 after 12 months

[a] Disregard is 100% as long as earnings are below poverty line; benefit goes to zero above

[b] Disregard is $90 or 20%, whichever is greater

[c] There is an additional disregard that varies with earnings and family size

[d] Disregard is 100% as long as net income is below poverty line; disregard is 0 if net income is above poverty line but earnings are below poverty line; and benefits goes to zero if earnings are above poverty line

Table 5 (continued)

State	Flat Disregard	Percent of the Remainder
Michigan	$200	20
Minnesota	0	36
Mississippi	$90	0
Missouri	AFDC	AFDC
Montana	$200	25
Nebraska	0	20
Nevada	0	$90 or 20[b]
New Hampshire	0	50
New Mexico	$150	50
New Jersey	0	50
New York	90	42
North Carolina	AFDC	AFDC
North Dakota	0	27[c]
Ohio	$250	50
Oklahoma	$120	50
Oregon	0	50
Pennsylvania	0	50
Rhode Island	$170	50
South Carolina	AFDC	AFDC
South Dakota	$90	20
Tennessee	$150	0
Texas	AFDC	AFDC
Utah	$100	50

EITC

- Refundable tax credit, expanded in 1993
- Phase-in has 40% subsidy rate, phase out has 20% tax rate, for two-child families
- Popular to public because it subsidizes earnings
- Often juxtaposed against the negative income tax, but false comparison because EITC requires accompanying categorical system
- Compliance an issue
- Work incentives: positive for men, zero or possibly negative for married women
- Marriage bonuses and penalties
- Work incentives vs lump sum refund; monthly receipt

Medicaid

- Low income women and children, public insurance for low-income elderly, low income disabled, nursing home coverage
- First group has seen expansions, decoupled from AFDC
- Second and third groups: SSI, Medically Needy, and other routes
- Issues: crowdout, effects on labor supply and savings
- Positive effects on health care utilization and health outcomes
- Reimbursement rates, long-term care
- SCHIP
- Takeup by TANF leavers

Supplemental Security Income

- Origins were in early 1970s, after failure of negative income tax
- Agedness, blindness, disability
- Began as a program for the elderly, has developed into a disability program
- Issues: work incentives and the "SGA" (now have 50% MTR)
- Definitions of disability (esp children)
- Causes of growth in adult and child caseloads; disability determination

Food Stamps

- Begun in 1965, only major program with universal eligibility
- Benefits indexed to inflation, 30% MTR
- Still federalized
- Issues:
- Fraud ("trafficking")
- Takeup by TANF leavers
- Nutritional effects
- Outreach, information
- Cashout: no longer an issue