

**Does It Pay to Move From Welfare to Work? Reply to Robert Moffitt and Katie Winder<sup>1</sup>**  
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Revised, August 2004

Danziger et al. (2002) found that net income in 1999 for working welfare leavers increased by \$2.63 for every additional hour worked and that these leavers had higher monthly incomes than did nonworking welfare stayers. Moffitt and Winder (this issue) point out that much of this income gap in Michigan is due to a) working leavers being more likely than welfare stayers to live with another earner and b) earners residing with leavers earning more than those living with recipients. They also show that, without these additional earnings, there would be small income differences in Michigan between working leavers and working recipients (combiners).

Using data from the Three-City Study, they observe smaller income gaps between working leavers and nonworking stayers and little difference between the incomes of working leavers and combiners. Cross-state variation in welfare rules, especially differences in earnings disregards, and differences in the demographic composition of caseloads probably account for the smaller returns to work in Boston, Chicago and San Antonio than in Michigan. But, Moffitt/Winder are correct that, given the risk of nonemployment, recipients would be better off if welfare rules were modified to encourage more of them to be combiners for longer periods of time.

Moffitt/Winder also emphasize that welfare reform contributed to an increase in single mothers who find themselves without work and without welfare. Our 2002 paper did not focus on this group, but others (Loprest, 2003; Turner, Danziger and Seefeldt, 2004) have documented the increasing size and increasing hardships of these nonworking leavers.

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In this reply, we analyze additional panel data from Michigan and document that it “pays to move from welfare to work,” even when the contributions of additional earners are excluded. We also document that combining work and welfare is a transitory state for most recipients over a four-year period. We then estimate fixed-effects regressions to test Moffitt/Winder’s views on the benefits of being a working leaver relative to being a combiner and show that the hourly return to work for the former exceeds that of the latter even without the earnings of others.

### **Trends in Monthly Income for Current and Former Welfare Recipients**

Table 1 shows trends in four income measures (in constant 2001 dollars) from 1997 to 2001 for current and former recipients in Michigan; food stamps are counted as equivalent to cash.<sup>2</sup> Mean monthly earnings of respondents (including nonearners) grew by 68 percent, from \$490 to \$821 over 4 years. Net household income, defined as gross income less federal income and payroll taxes, increased by 28 percent, from \$1401 to \$1791.<sup>3</sup> When the earnings of others are excluded, incomes grew by only 11 percent.<sup>4</sup> The sum of respondents’ own earnings, TANF and food stamps shows little variation—the 2001 value, \$1054 is only slightly higher than the 1997 value, \$1018.<sup>5</sup> Thus, as Moffitt/Winder emphasize, gains from rapid growth in earnings after welfare reform were mostly offset by declining cash assistance and food stamps.

### **Transitions in Work/Welfare Status**

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<sup>2</sup> All Women’s Employment Study (WES) respondents present at a wave are included. Response rates were 86, 93, 91 and 91 percent, at waves 1-4 respectively. There is no evidence that attrition has led to a biased sample (Pape 2004). Danziger et al. (2002) used data through Fall 1999, which Moffitt/Winder reanalyze. Here we analyze 4 waves, through Fall 2001.

<sup>3</sup> Net monthly income does not count the earned income tax credit and state tax credits because most women received them as an annual lump sum payment. Danziger et al. (2002) reported net income less work-related transportation and out-of-pocket child care expenses. These expenses were not gathered at wave 1. Mean net income less these expenses increased by 13 percent between 1998 and 2001, the same rate as did the net income measure reported here.

<sup>4</sup> We do not net out taxes from this measure because it is difficult to impute taxes when we exclude the earnings of others.

<sup>5</sup> TANF income is based on administrative records from Michigan’s Family Independence Agency, not on self-reports.

Table 2 classifies all respondents into four categories. Wage-reliant women are working leavers; combiners are working welfare stayers; welfare-reliant women are nonworking stayers; the remaining respondents are neither working nor receiving cash assistance in the month prior to an interview. Between 1997 and 2001, the extent of wage reliance increased from 21.6 to 61.1 percent and the extent of combining work and welfare decreased from 44.0 to only 10.7 percent, even though Michigan did not adopt the federal five-year time limit on cash assistance. The extent of welfare reliance fell from 30.3 to 12.9 percent and the number of nonworking leavers increases from 4.1 to 15.3 percent.

Table 3 is a mobility matrix that cross-tabulates a woman's work/welfare status at one wave by her status at the next wave. Of wage-reliant women at any wave, 75 percent remained wage-reliant at the next wave, 8 percent became combiners, 5 percent became welfare-reliant, and 12 percent were neither working nor on welfare. Among combiners, 47 percent became wage-reliant, 37 percent remained combiners, 11 percent became welfare-reliant, and 6 percent were nonworking leavers.<sup>6</sup> Hence, about two-thirds of combiners at one wave were not combiners at the next wave, while three-quarters of wage-reliant women stayed wage-reliant.

Taken together, Tables 2 and 3 document that after the 1996 reform most women moved from welfare receipt to wage reliance. A typical respondent moved from nonwork to part-time work, which usually with earnings low enough to still qualify for TANF. As she accumulated work experience, her wage rate and hours tended to rise, resulting in monthly earnings above the TANF eligibility limit.

Another indication of the gains to working leavers is that their observed real hourly wage increases relative to that of combiners. For the former, the mean increased from \$7.71 to \$9.44

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<sup>6</sup> Table 3 combines observations from all waves, showing the work/welfare categories at adjacent waves. Wave t includes waves 1, 2 and 3; t+1 includes waves 2, 3 and 4.

between Fall 1997 and Fall 2001; for combiners, it fell from \$6.60 to \$6.47. Thus, combiners earned 85 percent as much as working leavers in 1997, but only 69 percent as much in 2001.

### **Moffitt/Winder's Estimates of the Hourly Returns to Work**

Moffitt/Winder report average and marginal measures of the hourly return to work for Three-City respondents who received welfare at wave 1 and were either working leavers or working stayers at wave 2, about two years later. They conclude, "...that much of the increase in earnings and income...occurring when individuals go to work or leave welfare is a flat, fixed amount that does not vary with how much they work. This implies that work "pays" more if one is going to work from nonwork, but much less if one simply works more, given that one is already working." They also show that the wage-reliant have smaller marginal returns to work than combiners when they control for demographic variables—\$2.39 vs. \$3.17 for own earnings.

We replicated Moffitt/Winder's method for measuring returns to work using four years of data, but the results differ (data not shown).<sup>7</sup> The average and marginal returns to work tend to be greater in Michigan than in the three cities. For example, the marginal returns to work for leavers and stayers are \$3.35 and \$3.76 per hour for net income in WES, but only \$0.89 and \$1.79, respectively in the Three-City Study. For the other income concepts, the average and marginal returns are greater for leavers than for combiners. For own earnings, leavers receive \$4.04 per additional hour, combiners, \$3.17; for gross income less others' earnings, \$3.14 per hour for leavers, only \$1.67 for combiners.

Contrary to Moffitt/Winder's conclusion that much of the gain "does not vary with how much they work," the gain from work in Michigan increases with hours worked. And their method suggests that the return for leavers exceeds that of combiners, even when we exclude the earnings of others.

### **An Alternative Specification of the Fixed-Effect Regressions**

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<sup>7</sup> Results can be found in an earlier version of this reply at [www.fordschool.umich.edu/poverty](http://www.fordschool.umich.edu/poverty).

Moffitt/Winder categorize wave 1 TANF recipients based on work/welfare status at wave 2; thus, only the hours of working leavers and combiners at that wave are included in their regressions. We prefer an alternative specification that includes all respondents (except those who began receiving disability benefits during the study period) at all waves and analyzes monthly income as a function of monthly hours and welfare receipt at each wave. This fixed-effects model is described as follows:

$$\text{Income}_{it} = \alpha + \beta_1 \cdot \text{Hours}_{it} + \beta_2 \cdot \text{Hours}_{it} \cdot (\text{No Welfare})_{it} \\ + \beta_3 \cdot (\text{Wage Reliant})_{it} + \beta_4 \cdot (\text{No Work/No Welfare})_{it} + X_{it}\psi + f_i + \varepsilon_{it},$$

where  $X_{it}$  represents a vector of demographic characteristics of individual  $i$  at wave  $t$ , and  $f_i$  is an individual-specific fixed effect.<sup>8</sup>  $(\text{No Welfare})_{it}$  indicates that respondent  $i$  did not receive welfare in the month prior to the wave  $t$  survey. Those not receiving TANF are classified by work status, indicated by two variables:  $(\text{Wage Reliant})_{it}$ , and  $(\text{No Work/No Welfare})_{it}$ .

For the wage reliant, the marginal hourly return is  $\beta_1$  plus  $\beta_2$ ; for combiners it is  $\beta_1$ . Hence,  $\beta_2$  reflects the additional return for working leavers relative to that of combiners. If Moffitt/Winder's three-city results held in Michigan,  $\beta_2$  would not differ significantly from zero. If it pays to be a working leaver relative to being a combiner,  $\beta_2$  will be positive and significant. We expect a positive coefficient for two reasons. First, the wage reliant worked more over the four-year sample period and have higher wage rates than combiners. Second, as combiner's earnings increase they face an implicit tax rate--the marginal reduction in welfare benefits. A welfare leaver working an additional hour does not face this implicit tax rate.

$\beta_3$  and  $\beta_4$  reflect the lump-sum loss in benefits when a respondent exits welfare; the former is the loss for working leavers and the latter for nonworking leavers. These lump-sum

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<sup>8</sup> Time-invariant demographic characteristics, such as education and prior work experience, are absorbed into the individual fixed-effect terms and their coefficients are not estimated.

losses may differ because nonworking leavers lose the maximum welfare benefit whereas those who were combiners before exiting welfare received smaller monthly benefits at the time of exit.<sup>9</sup> We expect both coefficients to be negative, with  $\beta_4$  being more negative than  $\beta_3$ .

Table 4 shows regression results for net household income, gross income less earnings of others, and the sum of own earnings, TANF and food stamps. The coefficients on the interaction terms of hours and the no welfare indicator variable are positive and statistically significant for two of the three measures. A wage-reliant woman gains \$2.56 in net income per additional hour, \$0.67 more than a combiner gains. She gains \$2.67 per additional hour in terms of gross income less others' earnings, \$0.86 more than the combiner. She obtains an \$2.84 per additional hour in the sum of earnings, TANF and food stamps, \$0.71 per hour more than a combiner.

The coefficients on the variables indicating wage reliance and no work/no welfare are both negative in each equation, reflecting the lump-sum loss associated with welfare exit. The loss is smaller for working than for nonworking leavers. For the former, the loss is \$60 of net monthly income, \$100 of gross income less others' earnings, and \$101 in the sum of earnings, TANF and food stamps. For nonworking leavers, the corresponding losses are \$272, \$486, and \$660.

Compared to a nonworking stayer, a working leaver earns \$2.56 to \$2.84 per additional hour, so she has to work 23 to 38 hours per month to compensate for the lump-sum loss, depending on the income definition. A combiner is better off than a nonworking stayer by \$1.81 to \$2.13 per additional hour, but she does not incur the lump-sum loss ( $\beta_3$ ).

In WES, wage-reliant respondents worked 156 hours per month and combiners 121 hours. Given these hours, a working leaver would have \$339 more in net monthly income than a nonworking stayer, \$316 more in gross income less others' earnings, or \$342 more in the sum of

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<sup>9</sup> A worker may exit welfare before earnings reach the phase-out level. For example, she may be eligible for a small benefit, but the amount may be less than the transactions or stigma costs of welfare participation. This suggests that lump-sum losses for working leavers would be small.

earnings, TANF and food stamps. The coefficients and these differences in hours suggest that the monthly income of a working leaver would exceed that of a combiner by \$110, \$96, and \$84 in terms of the three measures.<sup>10</sup> Again, in Michigan it pays to move from welfare to work.

The \$339 net income difference between working leavers and nonworking stayers and the \$110 difference between working leavers and combiners are smaller than the differences shown in Table 1 of Danziger et al. (2002), \$635 and \$444, respectively, for two reasons. First, the article used self-reported TANF benefits, while we now have administrative payment records.<sup>11</sup> Second, the published table reported averages that reflect uncontrolled heterogeneity among work/welfare groups. The fixed-effect regression estimates reported here control for differences in demographic attributes and unobserved, time-invariant individual characteristics among the work/welfare groups.

### **Summary and Policy Implications**

In this reply we analyzed new panel data from Michigan and found that descriptive data, estimates using the Moffitt/Winder method and our alternative fixed effect estimates all suggest that it pays to move from being a nonworking welfare recipient to being a working leaver, even if the earnings of other household members are ignored. And, working leavers earn more per additional hour of work than do combiners, even accounting for the lump-sum loss associated with leaving welfare. Nonetheless, this income advantage, as Moffitt/Winder point out, is not large and is smaller than our 2002 article implied. And, because the gains to work are higher in Michigan than in Boston, Chicago and San Antonio, we should be cautious in generalizing these results to the nation as a whole.

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<sup>10</sup> When unemployment insurance and child support are added to the sum of own earnings, TANF and food stamps, the estimated income difference between a wage-reliant woman and a combiner increases from \$84 to \$122.

<sup>11</sup> The updated table 1, based on administrative reports for TANF, shows an average \$478 difference in net monthly income between the wage reliant and the welfare reliant and a \$300 difference between the wage reliant and combiners.

Given the high risk of subsequent job loss for leavers, we agree with Moffitt/Winder on the need for policies that make it easier to combine work and welfare for longer periods of time and for policies that facilitate return to welfare when leavers lose a job. As they note, states could choose to exempt months of welfare receipt from the time limit when recipients work at least 20 hours but still have low monthly earnings.

In both Michigan and the Three-City Study, working leavers and combiners have higher incomes than do nonworking welfare recipients. This represents a major achievement of the 1996 reform and related policies implemented in the 1990s (i.e., 1997 minimum wage increase, higher Earned Income Tax Credit). However, poverty rates remain high among working leavers in these and other studies. Poverty could be further reduced either by policies that raise the net wage of workers (e.g., by expanding access to health insurance for the substantial minority of working leavers who exhaust transitional Medicaid without securing employer-provided insurance) or that make it easier for low earners to combine welfare and work.

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Table 1. Monthly Economic Well-being, 1997-2001, All Respondents (In Constant 2001 Dollars)

Mean	Wave 1 (Fall 1997)	Wave 2 (Fall 1998)	Wave 3 (Fall 1999)	Wave 4 (Fall 2001)
Own Earnings	\$490	\$660	\$763	\$821
Net Household Income	1401	1592	1671	1791
Gross Household Income Less Earnings of others	1189	1238	1215	1324
Own Earnings + TANF + Food Stamps	1018	998	991	1054
Number of Observations	713	653	595	543

Table 2. Work-Welfare Status in Survey Month, 1997-2001, All Respondents

	Wave 1 (Fall 1997)	Wave 2 (Fall 1998)	Wave 3 (Fall 1999)	Wave 4 (Fall 2001)
Wage Reliant	21.6%	44.1%	58.5%	61.1%
Combiners	44.0	28.0	16.8	10.7
Welfare Reliant	30.3	19.1	11.8	12.9
No Work/No Welfare	4.1	8.7	12.9	15.3
Number of Observations	713	653	595	543

Table 3. Mobility Matrix: Work-Welfare Status at Wave t by Work-Welfare Status at Wave t+1

Work-Welfare Status at t	Work-Welfare Status at t+1				Total
	Wage Reliant	Combiners	Welfare Reliant	No Work / No Welfare	
Wage reliant	75.2%	7.6%	5.2%	12.0%	100.0%
Combiners	47.2	36.5	10.7	5.6	100.0
Welfare reliant	24.6	21.9	40.7	12.8	100.0
No Work/No Welfare	48.3	2.8	13.1	35.9	100.0

Note: Sample size is 1791, as respondents are included for each pair of waves in which they are observed; t= 1, 2 and 3.

Table 4. Fixed-Effect Regressions Predicting Monthly Income Measures: Controlling for Concurrent Welfare Status and Interaction Term of Work Hours and Welfare Status

	Net Household Income	Gross HH Income less Earnings of Others	Own Earnings + TANF + Food Stamps
Monthly hours ( $\beta_1$ )	1.89*** (0.41)	1.81*** (0.30)	2.13*** (0.23)
Hours * No Welfare ( $\beta_2$ )	0.67 (0.54)	0.86** (0.40)	0.71** (0.30)
Wage Reliant ( $\beta_3$ )	-59.99 (81.86)	-100.39* (60.09)	-100.57** (45.46)
No Work/No Welfare ( $\beta_4$ )	-272.72*** (79.87)	-485.58*** (58.63)	-659.56*** (44.35)
Married with Husband	728.42*** (96.38)	-80.72 (70.74)	-89.42* (53.52)
Cohabiting with unmarried Partner	616.63*** (63.58)	111.52** (46.67)	27.39 (35.31)
# of Children < age 6	-68.23* (35.43)	-24.72 (26.01)	12.26 (19.68)
Household size	148.81*** (21.07)	22.31 (15.47)	6.83 (11.70)
Transportation problems	-66.91 (59.74)	-32.25 (43.85)	12.93 (33.17)
Physical limitations & fair or poor health	-18.10 (62.45)	-23.30 (45.84)	5.01 (34.68)
Child with health problems	4.12 (61.03)	14.89 (44.80)	7.38 (33.89)
Domestic violence	-21.84 (60.31)	-12.77 (44.27)	7.19 (33.49)
Mental health problems	-4.14 (48.63)	1.26 (35.70)	-2.38 (27.00)
Within R-squared	0.174	0.161	0.320

Notes: Sample includes 618 respondents, comprising 2287 observations

1. Standard errors are in parentheses

2. \* significant at 10%; \*\* significant at 5%; \*\*\* significant at 1%

3. Income variables are measured in constant 2001 dollars.