

Statement of Gary D. Alexander
Secretary of Public Welfare, Commonwealth of Pennsylvania
Before the Senate Budget Committee, United States Senate
February 13, 2013

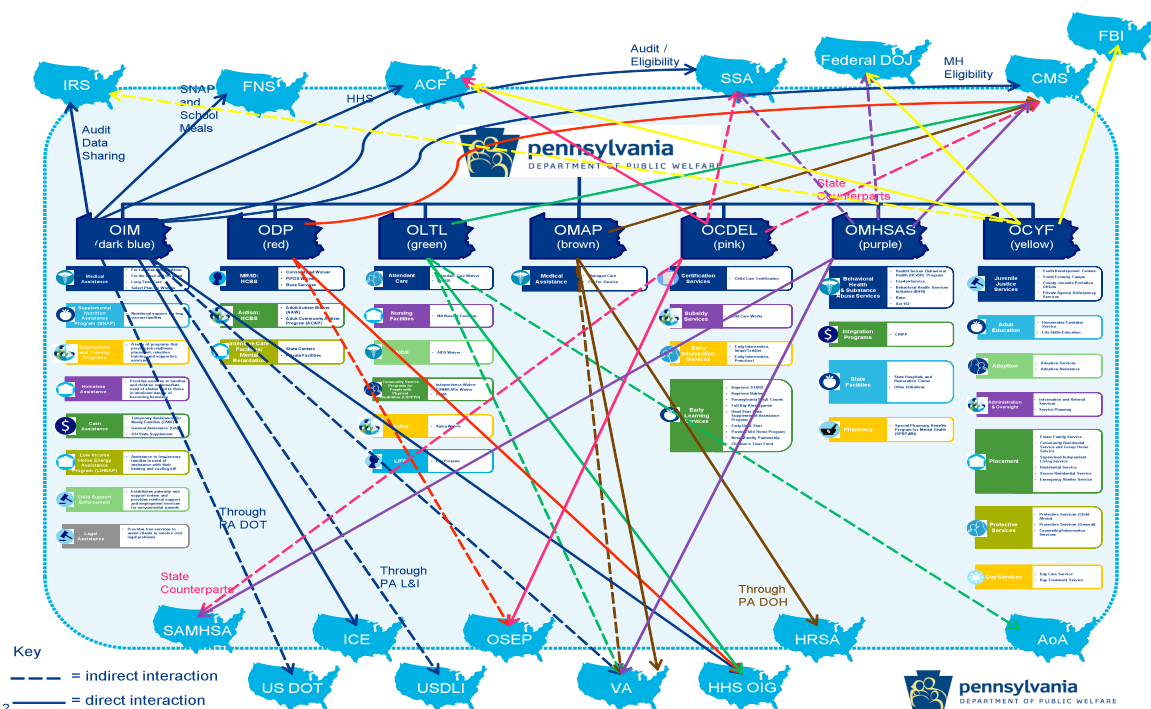
I would like to start with a quote from the *Concise Encyclopedia on Economics*.¹

“The U.S. welfare system would be an unlikely model for anyone designing a welfare system from scratch. The dozens of programs that make up the ‘system’ have different (sometimes competing) goals, inconsistent rules, and over-lapping groups of beneficiaries.”

This assessment is an understatement. Over the years we have created program after program in a haphazard manner without regard to the actual ineffectiveness or effectiveness of the entire whole. The net result is a “means-tested” welfare system that is not only disjointed and dysfunctional but also a bureaucratic mess. Both the hidden and known cost of the system, which lacks the “reciprocity” of earned-benefit social-insurance programs like Social Security and Medicare, places unsustainable burdens on the Federal budget and is creating a fiscal migraine for the states.

Welfare programs represent a complex web of multiple federal agencies acting in a manner that are rarely coordinated; more often than not the programs, regulations, and actions are independent and conflicting. It’s an alphabet-soup array of federal bureaus, offices, and departments that are overwhelming and confusing: FNS, ACF, CMS, HUD, DOJ, FBI, IRS, VA, SSA, DOT, and SAMHSA. These federal agencies interact with multiple state agencies and a large array of local entities.

This description understates the complexity. The federal government also bypasses the state on numerous welfare-related programs that are disconnected from state efforts to serve the welfare population. Public housing, Section-8 housing vouchers, Supplemental Security Income, and earned-income tax credits are examples of federal programs that completely bypass the states.



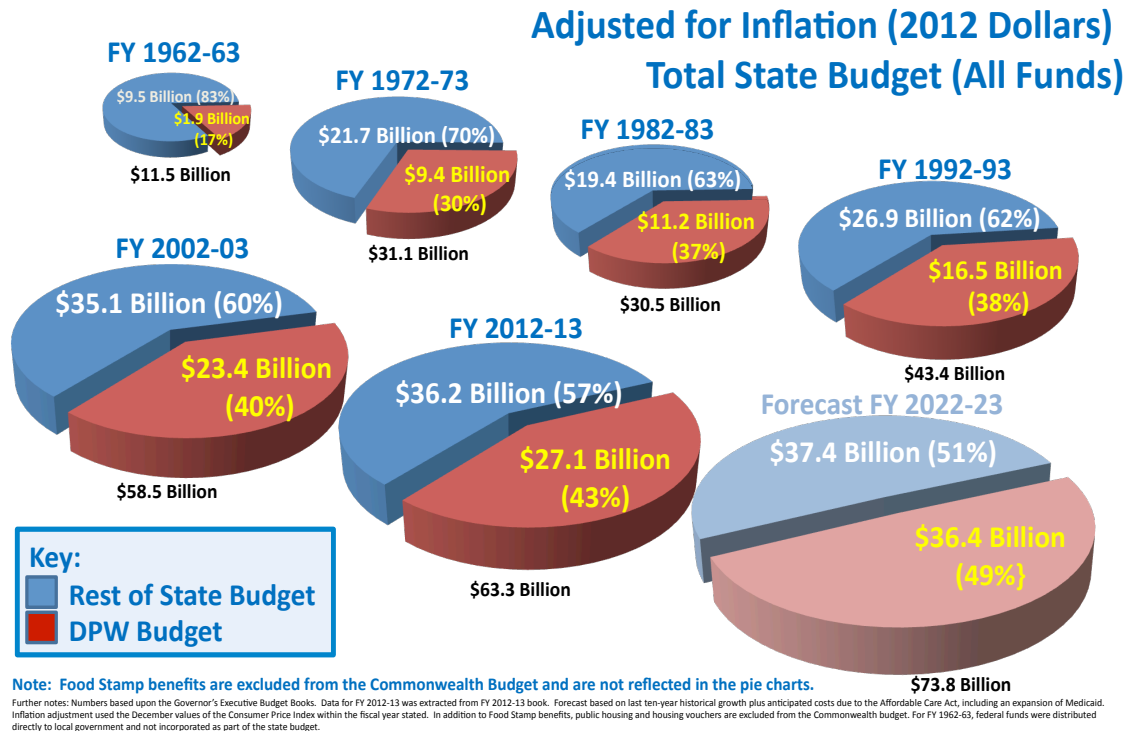
This a snapshot of what a state has to deal with from the federal government: a myriad of conflicting rules and regulations from a massively disorganized bureaucracy.

Moreover, welfare recipients are not generally well served. Yes, advocates for specific programs will always find isolated examples of a person or household in need and make a case for a particular assistance program. However, if we take a more informed view beyond the immediate emotions of selected anecdotes, for the majority of families and individuals, we will find a system that entraps parents and children in dependency while not improving their overall well-being or their chances of joining the middle class. The system needs reform.

Growth in the System Beyond a Safety Net

Like many other states, the Commonwealth of Pennsylvania is struggling with the unprecedented growth of Medicaid and other public welfare expenditures, which constitute increasingly larger portions of the Commonwealth's budget. Fifty years ago, the Department of Public Welfare constituted 17 percent of the total Commonwealth Budget. Today that cut is 43 percent. If the ACA Medicaid expansion is implemented, it will grow to more than 50 percent.

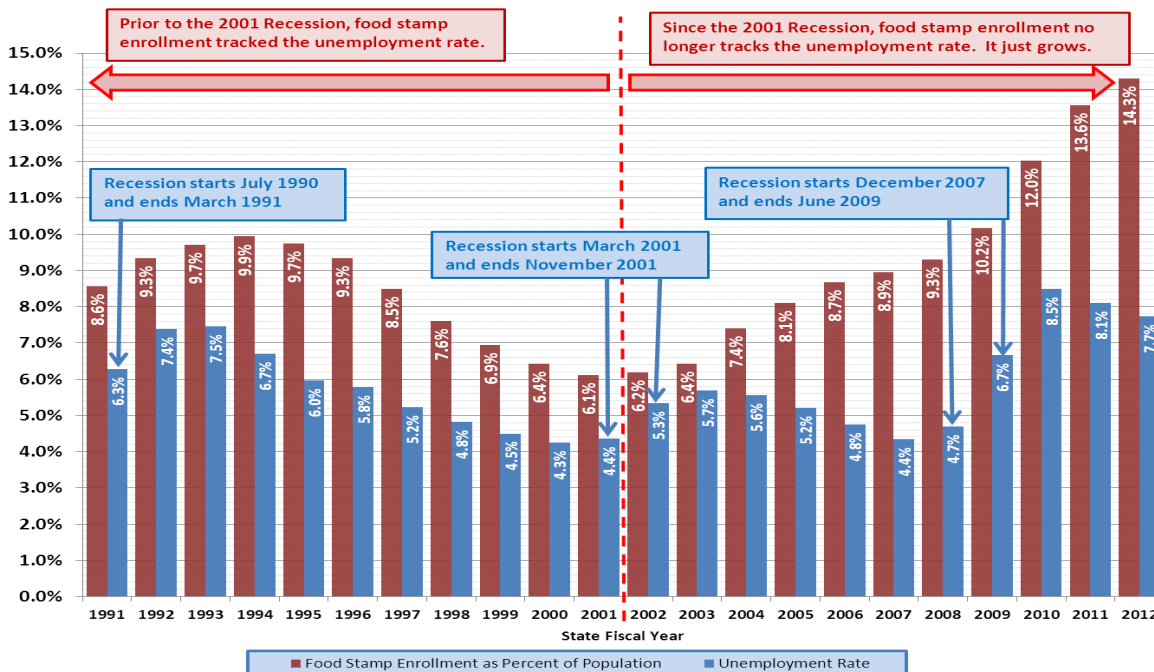
Real PA Budget Growth in Magnitude and Percent



Data by the National Governor's Association and the National Association of State Budget Officers shows that this is now true for all states as a whole. States are now spending more on Medicaid and welfare than any other priority, including education. So here's the bottom line: Welfare spending exceeds revenue growth and is forcing the states to abandon other funding priorities, including education and infrastructure. This type of welfare expansion will not help spur economic expansion and grow jobs.

Look at one specific program: food stamps. A common misperception is that economic conditions were solely responsible for the dramatic increase in the food-stamp caseload. Empirical data shows otherwise. The percent of the U.S. population on food stamps has grown despite a reduction in unemployment prior to the last recession.

The forces driving this growth are policy and statutory changes. The Farm Bill of 2002, for example, contained provisions that gave states the option to expand "categorical eligibility," making it easier for households to qualify for food stamps. The American Recovery and Reinvestment Act of 2009, another example, suspended food-stamp work requirements among able-bodied adults without dependent children. That 2009 legislation also increased the dollar value of food-stamp benefits.



This slide demonstrates that the growth in the food stamp program since 2001 is not totally linked to the 2007-09 recession. We expect, of course, enrollment to increase during recessionary times, but this growth predated the 2007-09 recession and had abnormal growth beyond the simple impact of the recession. We know for a fact that policy and program changes changed the rules of the game that made food stamp enrollment grow faster than it would have otherwise. Policies were eased or not enforced in the earlier part of the decade and then the asset test was removed in 2008.

Fraud, Abuse and Inefficiency

The expansion of any program, whether food stamps or Medicaid, also increases the opportunity for fraud and abuse. Please hear what I am saying. Not every recipient on welfare cheats. However, all benefit systems run by bureaucracies attract certain people, both on the provider side and the recipient side, who will find ways to fraud and abuse the system.

I am stating this from years of experience running welfare systems. On a daily basis, our auditors and inspectors uncover incidences of fraud and abuse, despite the fact that we have put systems into place to prevent such cheating. In 2011, 178 convenience stores in Pennsylvania were banned from the food-stamp program. We have estimated that more than a quarter-billion dollars in food-stamp payments that should not have been made. Applicants and recipients do not properly report income, and we do not catch it. Recipients sell EBT cards for cash so they can buy tobacco, alcohol, or illegal substances.

To make matters worse, most states have abandoned asset-limit tests in regards to food stamps. This is why a news story every now and then arises about a person winning a

large payout from a state lottery but nonetheless still qualifies for food stamps. This is one reason Pennsylvania reinstated its food-stamp asset test last year.

Medicaid is by far the largest welfare program. For years, states have been struggling with the costs of Medicaid, a program that has supplanted other funding priorities to become one of the largest single expenditures for states. Essentially, we have concluded that Pennsylvania cannot expand Medicaid under the current rules. If we expand under the current system, we would be expanding an inefficient system.

Burden on the Taxpayers

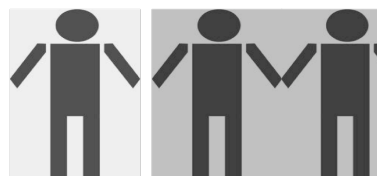
In Pennsylvania today, every 1.8 privately employed persons support 1 person on welfare. Ten years ago, 2.8 persons privately employed supported 1 person on welfare. This already represents a significance increase in the tax burden on every working man or woman. If we were to expand Medicaid, that already heavy burden would increase further.

Taxpayers to Welfare Recipients in Pennsylvania

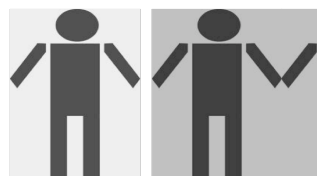
SFY 2002 Estimate:
2.8 to 1



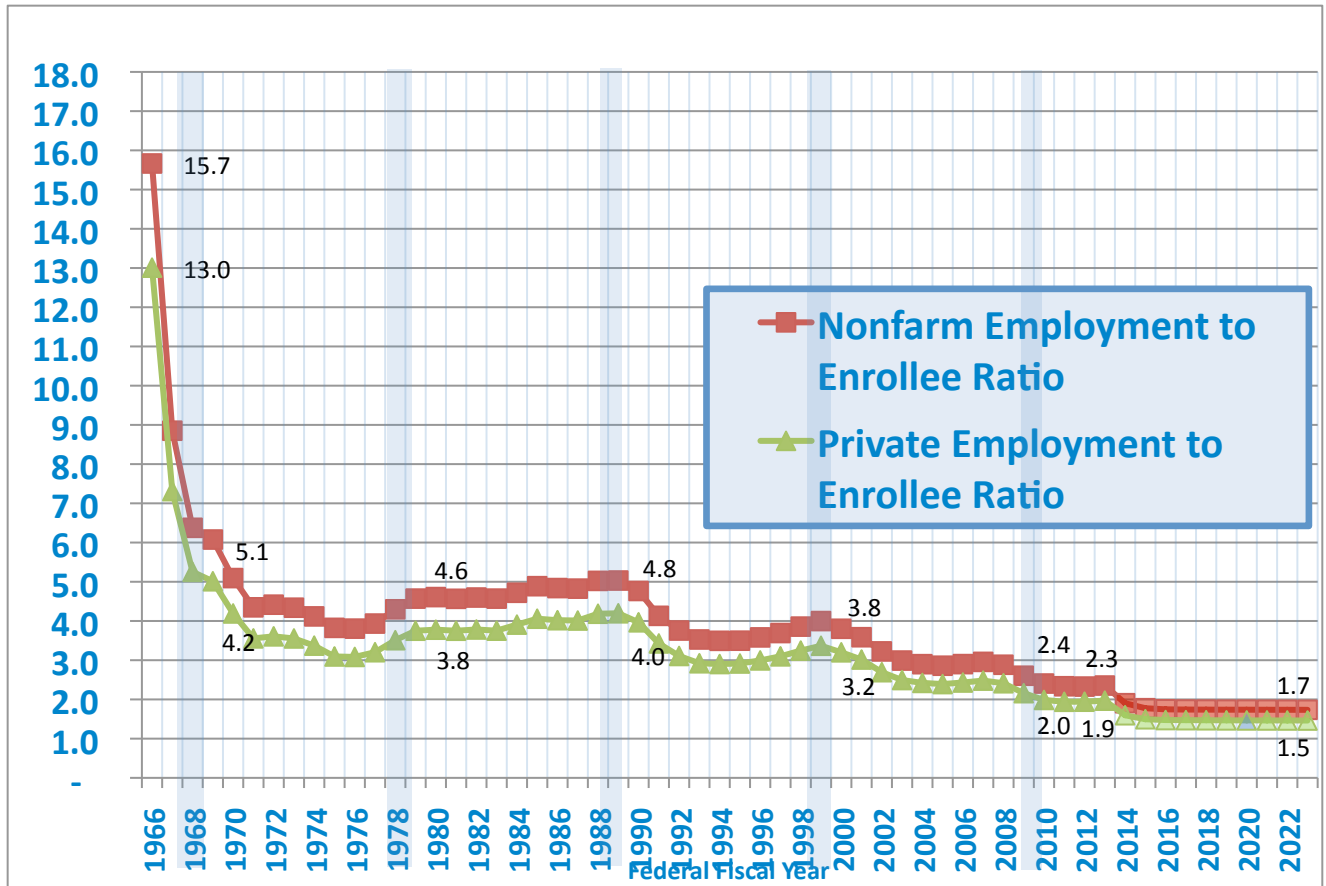
SFY 2012 Estimate:
1.8 to 1



SFY 2022 Forecast:
1.4 to 1



For every 1.8 persons employed in the private sector in Pennsylvania, there is one person on welfare. The ratio was 2.8 to 1 in SFY 2002, and the projection for SFY 2022 is 1.4 to 1.



This slide compares Medicaid enrollment to employment overtime. The purpose of this slide is to demonstrate the societal burden to carrying Medicaid. The comparison being is used the number of person employed relative to the number of persons on Medicaid: the higher the ratio, the lighter the burden; the lower the ratio, the heavier the burden. Two numbers were used for employment: total nonfarm employment and private employment, as published by the U.S. Bureau of Labor Statistics. Private employment was also chosen to be displayed because that is where wealth is being created. With minor and insignificant exceptions, the public sector relies on taxation to exist. If other words, without a private sector to tax, the public sector could not exist. As is demonstrated in the graph, the ratios over time keep getting worse

The Welfare Cliff

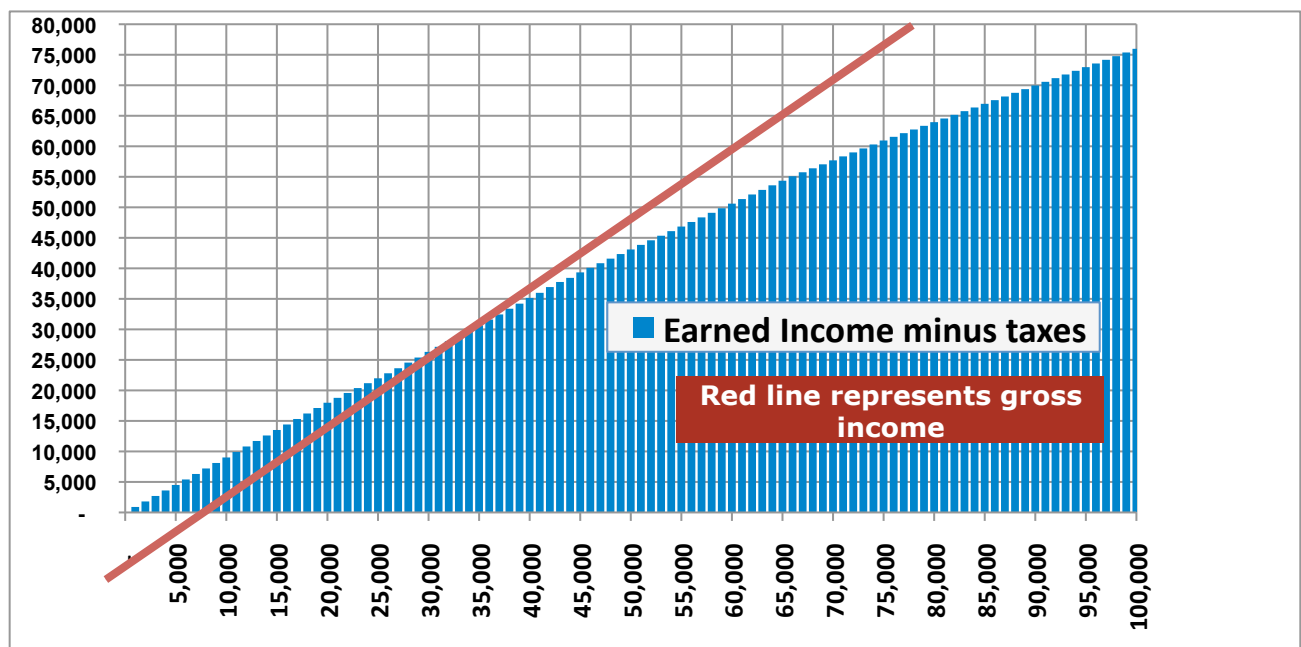
Let's move to outcomes. It has long been documented that the welfare system can trap recipients in poverty.

Many Americans either know this intuitively or possess personal experience with the system. The phenomenon is often called the welfare-cliff effect. If a typical single mother on welfare earns just a little bit more income, or if she marries a man with a job, the household stands to lose far more in benefits than what the marginal income is worth.

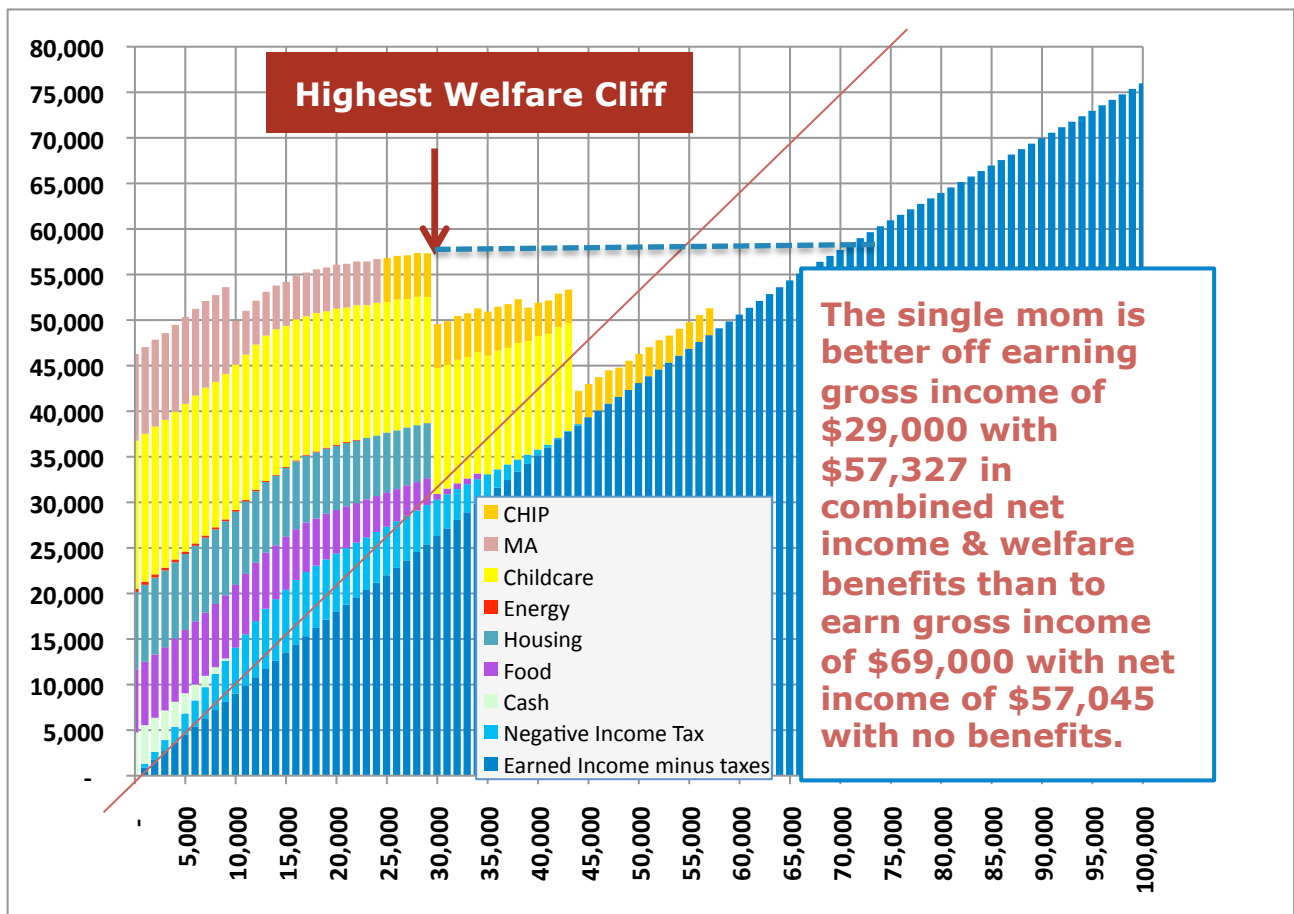
The model presented today here is based on actual rules of receiving benefits in Pennsylvania. Other states will have similar results, because most assistance programs are based on eligibility criteria established by the Federal government.

Sample runs of the model demonstrate that when welfare-assistance benefits are added onto net income, not one but several welfare cliffs emerge. A welfare cliff is defined as a point along the range of increasing gross income where the sum of net income and welfare-assistance benefits decrease. These are points where a household would be worse off financially if that household were to increase its gross income. “Worse off financially” is measured by the sum of net income and welfare-assistance benefits.

For example, a welfare recipient with two children earning gross income of \$29,000 would receive the sum of \$57,327 in net income and welfare-assistance benefits, if you count the value of the housing-choice voucher, food stamps, daycare subsidies, and medical assistance. The same household would have to earn a gross income of \$69,000, with a net income of \$57,045 to enjoy a comparable standard of living. In other words, if the welfare recipient were earning a gross income of \$29,000, the household would turn down an opportunity to earn a gross income of \$30,000 because the benefits begin to fall off, making that household financially worse off. Therefore, the recipient gets trapped at the gross income of \$29,000. A scenario like this might make a hardworking American earning a median family income of \$50,000 per year think about applying for welfare rather than working.



In the U.S. today, despite the progressivity of the income tax, a family is always better off taking a better job and making more money.



If we stack on welfare benefits, you can quickly see what happens. Welfare cliffs crop up in several spots, trapping people in a life of poverty and low-income. With a job that offers no health benefits, the single mom is better off earning gross income of \$29,000 with \$57,327 in net income & welfare benefits than to earn gross income of \$69,000 with net income & benefits of \$57,045. That family is dependent. As the mom looks over the horizon, she realizes she must find a job worth \$69,000 in order to maintain her current quality of life. Taking a job that makes less than \$69,000 will actually hurt her family.

This sample demonstration represents just one outcome of the model. The model is capable of altering assumptions, such as the household type, quality and cost of the daycare, and county of residence. Alternative scenarios produce different numbers, but they show the same pattern of perverse incentives against work and upward mobility.

By looking across the broad spectrum of welfare programs, the model validated what many Americans suspect: a parent on welfare faces built-in disincentives to earn more income because the household would face the potential loss of benefits even greater than the potential increase in income. In economic terms, the opportunity costs of earning

more marginal income or marrying were greater than the benefits of that marginal earned income.

A real example might put this into perspective. Linda, a single mother with two dependent children loses her job. She possesses an associate degree and worked in banking. After she lost her job, she applied for welfare benefits. After 24 months of being without work she obtained a lower paying job without medical benefits at a retail store. This retail store offered management training that would certainly increase her pay. Although working, she still obtained a myriad of federal means-tested benefits. She claimed that while on welfare, she felt no incentive to attempt the management-training class offered through the retail business because increasing her income would decrease her benefits and she would lose thousands of dollars. She decided the management training was not in her best interest financially.

This was a real example. Is this the best that we can do?

But this is not the only problem with the welfare system. The system is also inequitable to those households who want to join the vast middle class. Parents that want to follow the family-formation and employment route end up with less income in real terms than the welfare households that they end up subsidizing through their taxes. Consequently, our system discourages not only work and family formation for those stuck in the system but also for those who barely live above the poverty line.

Redesign the Federal Welfare System

So where do we go from here? The only way to solve the problem is to reconstruct and redesign the entire system. There is no other way. The system must be rethought so that programs not only dovetail together but that the total benefits package, when added onto net income, has an upward slope as income increases for recipient households. In short, programs should reward work because employment is the best anti-poverty remedy.

For every extra effort, for every opportunity to earn more income through employment or marriage, the person deserves to be better off. It is only fair.

Redesigning the system is a major undertaking. It will require congressional action. After having managed the welfare system in two states and having worked on these issues at the state level on both sides of the aisle for close to twenty years, I have designed a comprehensive redesign of the system that would solve much of the problem, but we do not have the time to dive into the specifics. Without diving into what I have created, here are some positive first steps that should be taken to enable state innovation:

Provide states generous latitude and flexibility to redesign and run welfare programs in a manner that makes sense so that we can “smooth out” the welfare cliffs and ensure that households obtain “upward” mobility and become motivated to benefit from employment.

Such latitude can be offered to states in one of two ways.

First, Congress can streamline all welfare programs into block grants and allow states to braid or combine funding streams. The programs that will need to be “block granted” are SNAP, Medicaid, housing-choice vouchers, and public housing. Currently, TANF and federal daycare programs are block grants, but any redesign should also allow states to include these two programs in any block-grant reform. Of course, the Federal government should provide broad performance measures to the states surrounding health, safety, employment and education -- and then allow each state to design appropriate programs and services as each state deems best and then compete among each other. This will spur creativity and ingenuity – both hallmarks of our republic. Let the states function as laboratories of democracy.

A second, although less desirable option is to allow states to obtain federal waivers, giving them maximum flexibility for all of the programs utilized in the redesign. Waivers would be needed for Medicaid, SNAP, housing-choice vouchers, public housing, and daycare. Federal law should be written that such waivers are easily obtained and not micromanaged by the Federal bureaucracy. Both of these options might just leave the Federal government out of the business of micromanagement and in the business of oversight only.

Both of these options might just allow states to redirect some of these funds to focus on a pro growth agenda that would decrease welfare spending and dependency and help generate economic expansion.

My fundamental point is this: rely on the strength of our federal system. We are blessed in this nation to have fifty states that have been called the laboratories of democracy. We need to unleash the power of competition and innovation of the states, instead of relying on a top-down approach where everything is determined in Washington, D.C.

Conclusion

The vast majority of welfare recipients would prefer a system with the right incentives rather than face the cliff. The current American welfare system is failing them and their chances of realizing a true opportunity to obtain self-sufficiency and independence. Redesigning the system to focus on incentivizing upward mobility for the people we

serve rather than the feeding a massive bureaucracy of overlapping programs that discourage work and independence might just help us to eradicate the welfare cliff.

I will be happy to answer any questions you might have.

¹ <http://www.econlib.org/library/CEE.html>. Written by Thomas MaCurdy and Jeffrey M. Jones. MaCurdy is the Dean Witter Senior fellow at the Hoover Institution and a professor of economics at Stanford University. He is a member of standing committees that advise the CBO, the U.S. Bureau of Labor Statistics, and the U.S. Census. Jones is a research fellow at the Hoover Institution.