Workfare versus Welfare: Incentive Arguments for Work Requirements in Poverty-Alleviation Programs

Timothy Besley and Stephen Coate, 1992

Parijat Lal

October 11, 2019

Motivation

> *"A decent provision for the poor is a true test of civilization."*
>
> - Samuel Johnson

- Question: what form should poverty relief take?
  - Specifically, should recipients of relief be required to work in exchange for benefits?
- Precedent
  - Historical
    - England: Poor Law (1834) granted relief via residence in workhouse
    - France: relief granted in "charity workshops" during ancien régime
  - Contemporary (1992)
    - US: states requiring welfare claimants enroll in training or work program
    - India: public-works projects as a tool for providing poor relief
- **Poverty alleviation** or welfare maximization?

Conceptual Framework

- Explore incentive case for workfare by analyzing two distinct arguments

1. *Screening*: work requirements serve as means of targeting transfers
   - Developing countries typically lack capacity to evaluate eligibility for relief on case-by-case basis – self-targeting systems may be better
   - Developed countries may not always be able to determine deliberate reduction in hours worked
2. *Deterrent*: workfare encourages poverty-reducing investments
   - Welfare has reduced incentives to avoid poverty
   - Poor relief must be made relatively less attractive

- Approach: develop model to illustrate logic and assumptions
  - Attempt to comment on optimal design of workface programs

The Model

- Setup
  - Government: everyone gets at least z, at minimum fiscal cost
  - γn people with income-generating ability and wage rate a_L
  - Identical quasi-linear preferences over income y and work l
  - Poverty-alleviation program (PAP) $\{b_i, c_i\}_{i=L,H}$, where b_i is cash transfer for i and c_i is cost of public-sector work requirement

- For individual i who accepts a PAP
  - Private-sector labor supply: $l(b, c, a_i) = \begin{cases} \hat{l}(a_i) - c & \text{if } c \leq \hat{l}(a_i) \\ 0 & \text{otherwise} \end{cases}$
  - Prviate-sector earnings: $y(c, a_i) = \begin{cases} a_i\left(\hat{l}(a_i) - c\right) & \text{if } c \leq \hat{l}(a_i) \\ 0 & \text{otherwise} \end{cases}$
  - Utility level: relevant for **voluntary participation**

$$u(b, c, a_i) \equiv b + y(c, a_i) - h(l(c, a_i) + c)$$

Model's Implications

- Proposition 1 (Benchmark PAP): if abilities are observable and beyond individuals' control, cost-minimizing PAP is a welfare program
  - Offer a_L transfer just high enough to get them out of poverty, $z - y(0, a_L)$, and offer a_H no benefits

- Proposition 2 (*screening* in developing context): if both abilities and incomes are unobservable,
  1. Welfare: no work requirements and offer both groups $z - y(0, a_L)$
  2. Workfare: offer a_H^* (self-categorized) no benefits and a_L^* tied transfer of $z - y\left(c_L^s, a_L\right)$
     - Policymaker must respect **incentive compatibility**
     - c_L^s is unique, positive separating work requirement
     - Workfare more likely to be optimal if truly poor small fraction of target population and earnings potential small relative to nonpoor

Model's Implications (continued)

- Proposition 3 (*screening* in developed context): if abilities unobservable, incomes observable, and benchmark no-go,
  1. Welfare: no work requirements, offer a_H^* transfer of $z - h\left(y\left(0, a_L\right)/a_H\right) - u\left(0, 0, a_H\right)$, and offer a_L^* transfer of $z - y\left(0, a_L\right)$
  2. Workfare: offer a_H^* no benefits and offer a_L^* tied transfer of $z - y\left(\hat{c}_L^s, a_L\right)$

- Proposition 4 (*deterrent*): if abilities observable but dependent on choices made earlier, cost-minimizing PAP either imposes no work requirements and offers a_L transfer of $z - y\left(0, a_L\right)$, or imposes the maximal work requirement c_L^m on a_L and offers them transfer of z
  - Costs increasing in c_L below $\hat{l}\left(a_L\right)$ and decreasing thereafter
  - Workfare preferable when fraction of γ and a_L are low, as this implies smaller loss in private-sector earnings

Conclusion

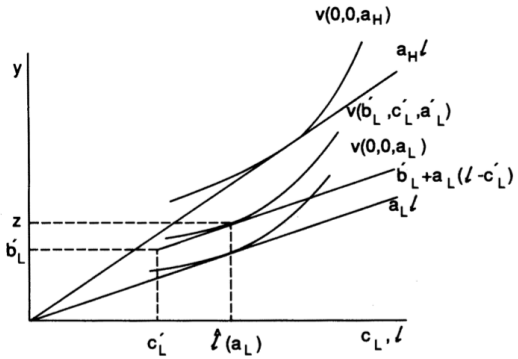

FIGURE 1. THE PACKAGE (b'_L, c'_L) SEPARATES THE TWO TYPES OF INDIVIDUALS

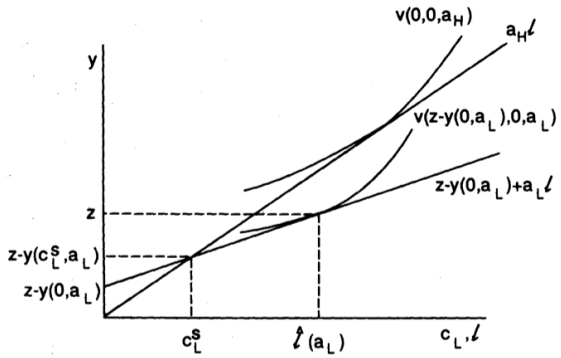

FIGURE 2. ILLUSTRATION OF THE SOLUTION DESCRIBED IN PROPOSITION 2

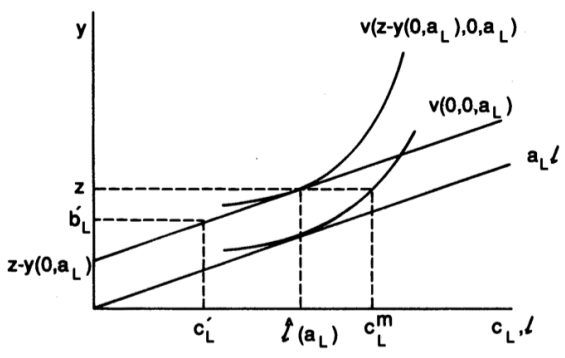

FIGURE 4. ILLUSTRATION OF THE MAXIMAL WORK REQUIREMENT, c^m_L

- Welfarist definition of poverty: *screening* robust, *deterrent* not
- Potential concerns
  - Impact of effort?
    - Assumption that $\pi(\cdot)$ is increasing and strictly concave
  - Overemphasis on potential masquerading?
- Potential extensions: evaluating UBI option, modeling capabilities approach (Sen, Nussbaum)