Should A Government Allow Schooling to Fulfill Work Requirements in A Welfare Program? – The Role of Returns to Education

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Abstract

A principal-agent model shows when a government should allow schooling to fulfill work requirements in a welfare program. I focus on potential welfare recipients who would voluntarily go to school instead of work under a work requirement that allows schooling. By focusing on this group, I analyze the outcomes of implementing an alternative policy that denies welfare benefits to those who choose schooling over work. I explore the relationship between returns to schooling and the relative benefits to the government of allowing schooling to count toward work requirements. A common intuition is that the benefits to a government of allowing schooling should increase as the returns to schooling increase. This paper shows how this intuition does not necessarily apply. The model shows that the optimal policy depends on the returns to education and that different governmental objectives can lead to opposite predictions on the direction of the relationship. If the government has an objective of poverty alleviation, which aims to provide a safety net at minimum cost, the exclusion of schooling as a qualifying work activity will lead to greater savings in welfare spending and therefore be increasingly preferred as the returns to education increase. The driving mechanism of the positive association between the returns to education and the relative benefits of the schooling-excluding rule is consistent with the concept of transfer targeting. Alternatively, if the objective of the government is to maximize social welfare with a budget constraint, it may be the case that the optimal policy is to allow schooling to count toward the work requirement in societies with relatively high returns to education, and the contrary when the returns to education are very low. Consistent with the poverty alleviation hypothesis, I find that the states with greater returns to college education are less likely to allow welfare recipients to participate in postsecondary education to fulfill the work requirements after the 1996 welfare reform.

JEL classifications: H3, H7, I2, I3, J2

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