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Small Business and Welfare Reform

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During the summer of 1996 the federal government enacted the Personal Responsibility and Work Opportunity Reconciliation Act—the most sweeping reform of welfare since its inception in 1935. For the first time the duration of welfare benefits is limited and those qualifying for benefits are required to work or participate in some type of job assistance or training program. Welfare's federal entitlement status is ended and states are offered, at least temporarily, block grants to develop their own programs. To receive the grants, the states must meet some federally mandated regulations, but the specifics of the "new" welfare are defined and implemented at the state level. States are free to develop programs as extensive as they like, perhaps including job service programs such as training and job search assistance. They are also free to develop programs as limited as they like, perhaps little more than channeling former recipients into the low-skilled labor market.

The new welfare rests on certain assumptions. One is that states are better able than the federal government to establish welfare programs to meet their own needs and that block grants to the states will enable them to do that. Another assumption is that welfare recipients should be moved off the welfare rolls and into the labor market and that time limits on benefits will accomplish that. Reform initiatives of the past assumed that the transition from welfare to work depended on the creation of more jobs and the development of recipients' skills. The new welfare assumes that there are jobs out there that will provide people currently on welfare with incomes sufficient to support themselves and their families and that welfare recipients have the requisite skills to fill those jobs, which are mostly at the low end of the wage scale (Burtless 1995). What they need, then, is to be properly socialized into patterns of work.

There are, however, several questions about the assumptions underpinning the new welfare. Where are these jobs—in the public sector or the private sector? In the private sector, will the jobs come from small or big businesses? If jobs do exist, do welfare recipients possess the skills necessary to fill them? Small business already employs more than half of private sector workers (Wiatrowski 1994) and some research finds it to be the biggest generator of new private sector jobs (Birch 1987). Although there is a vast literature on the role of small business in the economy, little is known about small businesses' hiring practices. The Levy Institute conducted a survey of small businesses designed to elicit information about their hiring practices and specifically their response to changes in the welfare law and their willingness to hire former welfare recipients. Survey results show that small businesses have been hiring, but they have been hiring few former welfare recipients. If jobs do exist and new workers are being hired, why are former welfare recipients not being hired and what conditions would make small businesses willing to do so?

In this brief, I attempt to find answers by analyzing small businesses' responses to questions about worker characteristics that affect employability, the impact of changes in the minimum wage, and the role of government subsidies in hiring and providing on-the-job training. What emerges from the analysis is that

employers consider welfare recipients to be lacking the education and experience they expect in their potential employees. This deficiency will not be remedied simply by imposing work requirements and time limits on benefits. The analysis also suggests that there is a serious role for small business in successful welfare reform that has perhaps been overlooked. What is necessary for an effective and long-lasting transition from welfare to work is a process of human capital development that can be accomplished through active cooperation between government and small business.

The Survey

The purpose of the survey was to test some of the assumptions underlying the 1996 welfare reform, mainly that small business may be doing some of the heavy lifting when it comes to moving welfare recipients into the labor market. The survey was based on a stratified sample of 560 small businesses (defined as businesses with less than 500 employees) across industries, randomly selected from a national directory. Over a three-week period during the winter of 1998, respondents were contacted by telephone and asked a series of questions about their hiring practices and preferences, effects of increases in the minimum wage on employment decisions, and response to different types of government wage and training subsidies.

Fewer than one in six businesses that had hired since the new welfare law took effect had hired former welfare recipients (see Table 1). These findings are curious for two reasons. First, if small businesses are major creators of new jobs and jobs will accrue to all in a strong economy, we would expect there to be no difference between the responses to the two questions. Second, if, as pundits would like us to believe, state welfare caseloads have been reduced because the economy overall has been doing exceptionally well, we would expect many of those who have been hired to be former welfare recipients. If they are not being hired by small businesses, they are being hired by either big businesses or the public sector (most likely in temporary workfare jobs) or they are simply being pushed off the rolls to fend for themselves. Even if a sizable number of former welfare recipients are working in public sector jobs as partial fulfillment of their requirements for the continued receipt of temporary assistance, that is not the same as saying these people have successfully found employment.

Table 1 Hiring Since the New Welfare Law Took Effect (Percentage)

Question	Yes	No
Have you hired any new workers since August 1996?	69.7	30.0
If you have hired, have you hired any former welfare recipients?	16.2	83.8

Note: *Of the 560 firms surveyed, 390 hired new workers; of the 390, only 63 hired former welfare recipients.*

Why are small businesses not hiring former welfare recipients? Is there something about them that makes them less attractive to prospective employers relative to other workers in the labor market? Respondents were asked a series of questions related to the skills, training, education, and experience they expect new employees to possess. Because a goal of the survey was to determine the factors that influence hiring decisions, all respondents, regardless of whether they had hired or not, were asked whether they were most interested in the training or the experience workers had or both and then about what type of experience and training they thought was most important (see Table 2).

Overall, small business employers appear to be most interested in experience when making a hiring decision, followed by a combination of experience and training. A relatively small percentage of those sampled indicated that training alone was most important to them; of those who did, the largest percentage indicated that technical or vocational training was most important for potential employees to have. Of those who were most interested in both training and experience, there was an almost even split between a preference for general education and a preference for technical or vocational training. Of those who were most interested in experience, slightly over half thought that specific experience was most important. The percentage that felt specific experience was most

important was slightly higher for those who initially indicated that they were most interested in both experience and training than for those most interested in experience alone.

Table 2 Employers' Preferences for Training and Experience (Percentage)

Question 1: When hiring new employees, are you most interested in the training or the experience they have?

Training	8.9
Experience	39.6
Both	32.0
Neither	13.9
No response	5.6

Question 2 (asked of employers who responded "training" or "both" to question 1): What kind of training do you feel is most important for potential employees to have?

	Training	Both
General education	34.0	31.8
Technical or vocational training	44.0	34.6
Other	18.0	27.4
Both	2.0	0.6
No response	2.0	2.8

Question 3 (asked of employers who responded "experience" or "both" to question 1): What type of experience is most important to you?

	Experience	Both
Specific experience	54.1	54.7
General employment history	37.8	25.1
Both	4.5	11.2
No response	0.9	3.4

Note: *Question 1 was asked of all 560 firms in the sample; questions 2 and 3 excluded firms that responded "neither" or did not respond to question 1, leaving 451 firms. Of these, 50 considered training alone to be the most important, 222 considered experience to be the most important, and 179 considered a combination of training and experience to be the most important.*

We next attempted to determine if there were any differences in responses to questions about training and experience between employers who hired new workers other than welfare recipients and those who hired welfare recipients (see Table 3). The most interesting findings pertain to those employers who considered either experience alone or a combination of experience and training to be the key determinant of a job seeker's employability. Of employers who hired former recipients and indicated that they were most interested in a

combination of experience and training, two-thirds thought general education to be the most important type of training; strikingly, less than a third of the employers who hired new workers and indicated that they were most interested in a combination of experience and training thought general education to be the most important. This difference in preference for general education may reflect a belief among employers that former recipients are lacking in general education relative to other potential employees. Equally stark, when employers were asked what type of experience was most important, is the discrepancy in preference for general employment history between, on the one hand, employers who were interested in a combination of training and experience and hired workers other than former recipients and, on the other hand, employers who were interested in a combination of training and experience and hired former recipients. This pattern also holds, albeit less strongly, for employers who considered experience alone to be the most important determinant of employability.

Overall, the results reported in Table 3 show that a large percentage of the firms that hired former welfare recipients considered general education and general employment history to be highly important factors. If this observation is also true for the firms outside the sample, then some of the assumptions underlying the new welfare do not add up. Time limits and work requirements may socialize recipients into patterns of work, but the experience they obtain cannot compensate for basic deficiencies in their education. It appears that more is needed than allowing states to force recipients into the labor market through time limits and to offer only limited job search assistance. Such minimal steps will not result in recipients' being hired if employers do not want to take a chance on them because they lack education and employment history.

Table 3 Preferences of Employers Who Hired New Workers Other Than Former Recipients and Employers Who Hired Former Recipients (Percentage)

Question 2 (asked of employers who responded "training" or "both" to question 1 in Table 2): What kind of training do you feel is most important for potential employees?

	Training		Both	
	New Workers	Welfare Recipients	New Workers	Welfare Recipients
	(22)	(2)	(121)	(17)
General education	31.8	0	29.8	66.7
Technical or vocational training	45.5	0	37.2	16.7
Other	22.7	50.0	28.1	16.7
Both	0	50.0	4.1	0
No response	0	0	0.8	0

Question 3 (asked of employers who responded "experience" or "both" to question 1 in Table 2): What type of experience is most important to you?

	Experience		Both	
	New Workers	Welfare Recipients	New Workers	Welfare Recipients
	(120)	(28)	(119)	(17)
Specific experience	57.5	35.7	59.7	47.1
General employment history	37.5	46.4	25.2	41.2
Both	4.2	14.3	11.8	5.9
No response	0.8	3.6	3.4	5.9

Note: *Figures in parentheses indicate the number of firms in each category. The combined total of firms in the three categories (training, experience, and both) will not add up to the total number of firms that hired (390, see Table 1); the difference is accounted for by the employers who hired and responded "neither" or did not respond to question 1 in Table 2. The number of firms in the category "Both" is different in questions 2 and 3 because of nonresponse.*

In response to questions about the minimum wage (see Table 4), few indicated that increasing the minimum wage would affect their willingness to hire former welfare recipients. An even smaller proportion indicated that the 1997 hike in the minimum wage (to \$5.15 per hour) had affected their overall hiring and employment practices. Even though the percentage of businesses who replied that their decisions would be affected by an increase to a \$6.00 minimum is somewhat larger, responses overall indicate that minimum wage increases will not necessarily have the dire employment consequences often predicted (see, for example, Kusters and Welch 1972; Neumark and Wascher 1992). This is good news for those looking to the small business sector to absorb former welfare recipients and suggests that small businesses may not align against proponents of a so-called living wage for former welfare recipients.

Table 4 Responses to Basic Questions about the Minimum Wage (Percentage)

Question	Yes	No	No Response
1. Would an increase in the minimum wage alter your decision to hire former welfare recipients?	9.6	85.2	5.2
2. Did the recent increase in the minimum wage affect your overall hiring or employment decisions?	6.6	89.1	4.3
3. If the minimum wage were raised to \$6.00 per hour, would it affect your overall hiring or employment decisions?	20.7	75.4	4.9

If what the poor need is education and general employment history, pushing them off the welfare rolls alone will not ensure that they will find jobs. Policies such as hiring subsidies are needed to get them through the door in the first place. As our survey shows, many employers (76.3 percent) would be willing to hire recipients and provide on-the-job training for them if government offered a subsidy for training. Moreover, more than half of them (55.4 percent) would still be willing to hire former recipients even if subsidies were tied to on-the-job training requirements.

Policy Implications

The goal of any welfare-to-work program ought to be to make people who have not had the experience of working into productive members of the labor force. In accomplishing successful welfare reform, there are essentially two issues. The first has to do with getting former recipients into the labor market. This is where wage and training subsidies become necessary. The second has to do with keeping recipients in the labor market. Wages that are high enough so that recipients are better off working than on welfare would be an incentive for them to stay in the market. A policy intended to get workers a job has to go hand in hand with a policy aimed at keeping them there. Employers may recognize the benefits of on-the-job training, but they may be reluctant to provide it because of high turnover, particularly in the low-skilled sector of the labor market (Freeman 1994; Lynch 1994). Higher wages might reduce turnover, thereby reducing the reluctance of employers to provide training.

An argument can be made that the minimum wage ought to be raised to a level that allows those who earn it to live above the poverty line. At the very least, it ought to be increased until it reaches its "tipping point"—the point at which it begins to have some unemployment effects. The effects of a mandated increase imposed on business could be mitigated somewhat with larger subsidies to employers who hire former welfare recipients

and provide on-the-job training. Given that those businesses that have hired former welfare recipients are businesses that tend to be more affected by increases in the minimum wage, larger subsidies would make sense from the standpoint of both efficiency and fairness.

Former recipients can be moved from welfare to work when government works in partnership with business, not when government simply mandates a course of action. Responses to questions about subsidies clearly indicate that were government and business to split the costs of hiring and training workers, many small firms would be willing to create jobs for them. Survey data reveal the weaknesses of some of the new welfare's underpinning assumptions and also point to substantive changes that might achieve more effective welfare reform. With the right mix of incentives and mandates in place, small business could effectively become the focal point of an employment strategy aimed at hiring the most disadvantaged members of society.

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