



Policy Note 1998/4

Small Business and the New Welfare

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To what extent have small businesses hired former welfare recipients and what might induce them to hire more? The Levy Institute conducts a national survey of small firms in many industries to find out.

During the summer of 1996 the federal government enacted the most sweeping welfare reform since the law's 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 educational or training program. Although the federal government has established minimum criteria, the specifics of the "new" welfare are defined and implemented at the state level. Among the more critical reforms are the end of welfare's federal entitlement status and the offer, at least temporarily, to the states of block grants to develop their own programs. States are free to develop programs as extensive as they would like, which might include training or other job service programs. And they are also free to develop programs as limited as they would like, which might entail little more than channeling former recipients into the low-skill labor market.

The new welfare rests on certain assumptions. The first is that states are better able than the federal government to establish welfare programs that best meet their own needs. Block grants to the states will enable them to do that. The second assumption is that welfare recipients need to be moved into the labor market, and the best way to do this is to require them to work under the gun of benefits time limits.

Contrary to reform initiatives of the past, which assumed that more jobs and the development of training and skills were needed for recipients to move into the labor market, the third assumption of the new welfare is that jobs exist; that these jobs can support recipients' families either through earnings or through a combination of earnings and work-based subsidies, such as the earned income tax credit; and that many welfare recipients possess the requisite skills to fill available jobs and therefore require only to be socialized into patterns of work. However, this assumption is open to question, and it may be that welfare recipients will qualify for jobs only at the low end of the wage scale (Burtless 1995).

A fourth assumption of the new welfare is that businesses that have not hired welfare recipients in the past can be induced to do so through the offer of subsidies, as is already done in such notable cases as Wisconsin, Massachusetts, and Minnesota. The subsidy structure is, of course, left up to the states.

Since small businesses employ roughly half of private sector workers (Wiatrowski 1994), we might expect these businesses to add a large share of welfare recipients to their staffs. But little is known about small business hiring practices. In this and another policy note (Levin-Waldman and McCarthy 1998) and in a forthcoming Public Policy Brief, we present data obtained through a survey of small businesses conducted at the Levy Institute. One goal of the survey was to find out how small businesses might respond to changes in the welfare law and what types of programs might encourage them to hire former welfare recipients. For the most part, the data suggest that although small businesses have been hiring workers, they have not been hiring many welfare recipients.

In hiring, small businesses are looking for certain characteristics that recipients are likely to lack. What they lack most is job experience and training, and this is a key reason given by firms for not hiring them. It is clear that this mismatch between the requirements of potential employers and the attributes of welfare recipients could be addressed through policy measures. What is not clear is whether ad hoc responses by the states is the

best way to address the mismatch. A policy more likely to be successful in moving recipients into the labor market would be for the federal government to make a serious commitment to offering subsidies to employers for providing on-the-job training.

Federal intervention would be preferable to individual state responses because it would ensure uniformity across state lines. Under current law, states are not required to pursue the most expensive strategies (which wage subsidies often are considered to be), even if such strategies prove to be the most successful at moving people into the workplace. Instead, states are free to do as little (or as much) as they please. Subsidies enacted at the federal level would ensure that all states have some form of wage subsidies in place and that the targeted population receives them, even those workers who reside in states with seemingly less commitment to developing self-reliance in former beneficiaries over the long run.

The Survey

The purpose of the small business survey was to get information about the hiring and employment practices of small business, particularly as those practices relate to welfare reform and changes in the minimum wage. Over the course of three weeks during the winter of 1998, a stratified sample of 568 small businesses (businesses with no more than 1,000 employees) across industry types was randomly selected from a national directory. They were contacted by telephone and asked a series of questions concerning their hiring practices in light of the recent changes in the national welfare law. They were asked whether they had hired at all since the new welfare law took effect and whether they had hired any former welfare recipients. They were also asked what they look for in terms of education, skills, and other traits when making hiring decisions and whether government subsidies would be a positive inducement for them to hire former welfare recipients.

Of the 70.4 percent of the small businesses that had hired new workers, 84.0 percent had not hired former welfare recipients. To find out why, respondents were asked about the skills, training, education, and experience they expect new employees to possess (Table 1). These characteristics may well serve to differentiate former welfare recipients from other workers in the labor force. In response to another question, one about employee skills, 69.9 percent of small businesses indicated that they required specific skills for entry-level jobs and 27 percent indicated that they did not. Many earlier efforts at welfare reform were based on the assumption that welfare recipients could not make a successful transition into the labor market unless programs were in place to develop "hard" skills, such as specific experience and technical training; it was thought that training programs would yield greater success than the "tough love" approaches in recent years of simply requiring recipients to go to work. But if recipients lack "soft" skills, such as ability to take direction and to be at work on time, it is not clear that traditional training programs would have much of an impact. The responses by small businesses about what skills and traits they think are important indicate that they expect a mixture of soft and hard skills.

Table 1 Skills and Traits Expected by Employers in Hiring New Employees (Percentages)

Types of skills	
General experience	27.0
Specialized (e.g., certification, licensing)	26.3
Clerical (typing, phone)	17.2
Computer and technical	14.9
"People," communication, personal	13.4
Administrative	0.8
Types of traits	
Neatness, dress, appearance	36.1
Positive attitude, personableness, ability to communicate	25.3
Dependability, reliability, ability to take direction	20.7
General work experience, education	17.9

Note: Types of skills and traits overlap because the questions asked were open-ended and respondents categorized the skills and traits differently.

Respondents were then asked whether they were more interested in workers' training or their work experience. Overall, small business employers appeared to be more interested in experience when making a hiring decision, followed by the combination of experience and training. Only 8.8 percent of those sampled indicated that they were more interested in training alone, and a large percentage of these employers (40.0 percent) thought technical or vocational training was more important than general education. Of the 39.6 percent who indicated that they were more interested in experience, most (51.6 percent) thought that specific experience was more important than general employment history. Among employers who indicated that they were

interested in both training and experience (32.0 percent), there was an almost even split between those who thought general education was more important (33.6 percent) and those who thought technical or vocational training was more important (32.9 percent).

The data were then divided to compare the responses of small businesses that hired former welfare recipients to the responses of those that hired workers other than former recipients. It appears that experience is important regardless of whether a potential employee is a former welfare recipient. In reference to the types of training employers feel are important, those who had hired former welfare recipients were more interested in general education, while those who had hired other new workers were more interested in technical or vocational training. (In reference to types of experience, the differences in responses by employers who had hired former recipients and those who had not were not statistically significant.)

Why the difference in preferences? It may be that those who hire workers with technical and vocational training assume them to have a general education, whereas the same assumption cannot be made in reverse. The combined facts of a large majority that consider general education to be such an important factor and the small percentage of businesses that hired former welfare recipients might imply that many former welfare recipients are assumed to be lacking a general education. To the extent that it is true that many recipients do lack education, it would also suggest that any number of the assumptions underlying the new welfare do not hold. Insofar as time limits and work requirements may socialize recipients into patterns of work, the experience they obtain (assuming they can and do find a job) cannot compensate for basic deficiencies in their education. That general education is not as important among those who hired new workers would suggest a perceived gulf between the two populations in terms of their educational levels, and one that is not being addressed in current policy.

Policy Implications

What do these findings suggest about the assumptions underlying the new welfare legislation as they apply to small businesses? That most small businesses have not been hiring former welfare recipients even though they have been hiring generally would seem to suggest that something other than what is currently being done is necessary if former beneficiaries are to obtain employment. The data from this survey do not necessarily point to training programs as the answer, although in some cases that would clearly be of assistance. The biggest deficit former welfare recipients have (at least in the minds of small businesses) is a general education. When this deficit is coupled with a deficit they may have in general work experience and specific training, it becomes clear that the current policy of simply allowing the states to devise their own plans without national minimum standards for training and education is not going to have the result of successfully moving welfare recipients into the labor market.

The best policy would be to provide recipients with a general education, and, of course, a way to prevent poverty in the first place is to strengthen school systems, especially in inner cities where a disproportionate number of poor people live. However, essential though they may be, educational reforms are long-term solutions, and what is needed for the short term is a policy course to solve the immediate problem of helping today's recipients find a job now. Given the evidence that in addition to a basic education, they need a combination of experience and training, policy needs to center on those areas.

Edmund Phelps (1997) has suggested that the best way to get people to work is to offer subsidies to employers to hire them. Indeed, the states that have been most successful in moving their welfare recipients to work have been those that have offered such subsidies (Levin-Waldman 1997). Subsidies have the obvious advantage of helping to get recipients in the door so they can begin to obtain the experience that will make them marketable. Subsidies also have the advantage of encouraging employers to provide on-the-job training, especially if such training is required to receive the subsidies. The main disadvantage of subsidies is that once they are phased out, employers may choose to lay these workers off. However, if the goal of subsidies is to get people in the door so they can obtain work experience, this concern becomes irrelevant. Once they gain experience, it will be easier for them to find other jobs. Also, if subsidies are tied to a training requirement, employers might have an incentive to retain the trained workers because they will have made an investment in human capital that might be of greater benefit to them than the subsidies.

Responses in the survey indicate that subsidies would be a powerful incentive for small business employers to hire former welfare recipients. When asked if they would hire any or additional former welfare recipients were

the government to pay all or a part of their wages, 74.9 percent said yes and only 10.8 percent said no. When asked whether they were willing to provide on-the-job training, 84.9 percent said yes and only 9.7 percent said no. When asked questions to ascertain what they thought benefits of on-the-job training might be, responses suggest that the greatest benefit from the perspective of employers is that workers will be better able to perform tasks according to employers' preferences and will be more productive.

The goal of any effective welfare-to-work program ought to be turning people who haven't had the experience of working into productive members of the workforce. Government training programs may not be the most effective means to reach this goal (O'Neil and O'Neil 1997). Subsidies to employers to provide on-the-job training that meets their needs might make more sense (Levin-Waldman 1996, 1997; Phelps 1997), and the data from the survey suggest that this course might be at least partially effective. When asked whether they would provide on-the-job training if the government offered a subsidy, 71.8 percent of the small businesses we surveyed said yes, 6.9 percent said no, and only 1.7 percent indicated it would depend on the size of the subsidy. On the other hand, when asked if they would hire former welfare recipients if the government offered subsidies for on-the-job training, the percentage of those who said yes dropped to 54.7 percent while the percentage of those who said no more than doubled to 14.7 percent (the remainder did not respond). Although subsidies tied to on-the-job training requirements might not result in the willingness of all or nearly all employers to hire former welfare recipients, over half of the small firms we spoke to would be willing, which suggests that this policy tool could have some effect in moving welfare recipients into the workforce.

Successful welfare reform might depend on government's working in partnership with businesses, rather than mandating a course of action. What is revealing is how much of a subsidy employers say they would need to make them willing to provide on-the-job training. The largest percentage response (28.9 percent) was for a subsidy of 50 percent; 7.4 percent said they would need 25 percent, 5.2 percent said 10 percent, and 6.4 percent said 100 percent. Some firms (15.8 percent) said they needed "something else," but did not specify exactly what else they needed. (The remaining 37.0 percent did not know.) The responses imply that if government were to split the costs of hiring and training workers with small business, a number of small businesses would be willing to hire more former recipients.

Ultimately, responses to the survey reveal weaknesses in the new welfare's underlying assumptions and point to the type of changes that could prove more effective in achieving true welfare reform. To the extent that the findings from this survey may be representative of business practices generally, it could be the case that unless some minimum subsidy is offered, welfare recipients will not be hired by many firms. There is a fundamental difference between getting people off of welfare and successfully moving them from welfare to work.

By all indications, many states have reduced their rolls significantly since the new welfare law took effect in August 1996, with the average reduction being around 30 percent. However, in a number of states that have the most significant reductions in caseload (reductions in excess of 30 percent), the percentage of small businesses hiring former welfare beneficiaries has been small. Among small firms in the sample in states that reduced their caseload more than 30 percent (a mixture of state type and population size), 7.5 percent hired former recipients, 55.3 percent hired new workers other than former recipients, and the remaining did not hire anyone. In comparing the responses of firms in these states to the responses of all firms in the survey, we might expect that hiring in the states with reduced caseload would have a higher percentage of former recipients. In fact, there was no statistically significant difference between the responses in the two sets of states.

If former welfare recipients are entering the labor force, they are being hired either by big businesses or the public sector (the most likely case, as these jobs include various types of temporary workfare jobs) or are 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. Even if employers do not retain the workers they train under a subsidy program, those workers will have acquired experience and other characteristics that appeal to employers. Therefore, a program of national subsidies tied to on-the-job training requirements would appear valuable if policymakers are serious about achieving a successful welfare reform.

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