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The Fiscal Impact of the Administration's Welfare Reform Proposal on State and Local Governments

Madame Chairman, I am pleased to have this opportunity to discuss with the task force some of the fiscal impacts that the Administration's welfare reform proposal would have on state and local governments. To put this discussion in context, I would first like to review the fiscal burden that welfare represents for these governments now and how this situation has changed over the past decade and one half.

The Current System

Welfare has long been a significant and growing expenditure of states and some local governments. These governments are required to share with the federal government the benefit and administrative costs of the Aid to Families with Dependent Children (AFDC), medicaid, and emergency assistance programs and the administrative costs of the food stamp program. Some states have chosen to supplement the basic benefits provided by the federal Supplemental Security Income (SSI) program and some have general assistance programs that are supported entirely from state and local revenues. Through these programs, state and local governments spent roughly $31.4 billion on welfare in fiscal year 1976, $14.2 billion of their own revenues and $17.2 billion in federal grants. This represents a vast increase from a decade ago.

During the first half of the 1960s, welfare expenditures amounted to between $4.5 and $6.3 billion and accounted for about 8.5 percent of the general expenditures of state and local governments (see Table 1). Welfare expenditures grew in the early 1960s at about the same pace as total state and local spending.

Table 1. State and Local Government Welfare Expenditures: Selected Fiscal Years

Fiscal Year	State and Local Welfare Expenditures ($ in billions)	Federal Welfare Grants as a Percent of State and Local Welfare Expenditures	State and Local Welfare Expenditures as a Percent of Total State and Local General Expenditures	State and Local Welfare Expenditures from own Revenues as a Percent of all Government Welfare Expenditures a/
1976	$31,435	54.8	12.7	31.5
1975	27,191	52.8	12.2	32.6
1974	24,745	51.9	13.0	38.4
1973	23,582	51.3	13.0	42.6
1972	21,070	62.9	12.6	33.2
1971	18,226	53.6	12.1	41.4
1969	12,110	52.5	10.4	39.0
1967	8,249	51.3	8.8	41.7
1965	6,315	49.1	8.4	50.1
1962	5,097	48.0	8.5	51.3

SOURCE: Bureau of the Census, Government Finances, various years.

a/ State and local welfare expenditures minus federal intergovernmental welfare grants, divided by federal, state, and local direct welfare expenditures.

A number of dramatic changes occured during the last half of the 1960s and the early 1970s that substantially increased the welfare expenditures of state and local governments. Public assistance caseloads expanded rapidly, almost doubling between 1965 and 1971. This, together with increases in benefit levels that outpaced inflation, caused the categorical cash assistance expenditures of state and local governments to increase by 165 percent between fiscal years 1965 and 1972. In 1965, the medicaid program was enacted causing state and local welfare-related vendor payments to rise by 343 percent over the 1965 to 1972 period. The growth of medicaid was so rapid that by fiscal year 1974 state and local expenditures for this program exceeded those for the categorical cash assistance programs and general assistance.

During the 1965 to 1972 period welfare spending grew fifty percent faster than total state and local general expenditures; as a fraction of all state and local spending, welfare increased from 8.4 to 12.6 percent. No other major category of state and local spending grew more rapidly than welfare. From the state and local perspective, reducing the fiscal burden of welfare then became a major rationale for reforming the welfare system.

Since about 1972, a different set of forces has been at work. State and local expenditures for the categorical cash assistance programs have remained almost unchanged; in fact, in fiscal year 1976

spending on these programs was slightly lower than it was in 1972. One reason for this was the slowdown in the caseload growth. The number of AFDC recipients during the first quarter of 1977 was only 1.6 percent higher than it was in 1972. A more fundamental reason for this situation was the creation of the federal Supplemental Security Income (SSI) program which in 1974 replaced the old state-administered categorical programs for the aged (OAA), blind (AB), and disabled (APTD). SSI removed some 3.2 million recipients from the state and local caseload and reduced state and local welfare expenditures by over $3 billion.

While the categorical cash assistance programs have not been the problem that they once were for state and local governments, the fiscal burden of the medicaid program has continued to increase at a rapid pace. Between fiscal years 1972 and 1976, state and local welfare-related vendor payments (primarily medicaid) doubled. This expansion kept total welfare expenditures growing at roughly the same pace as total state and local spending. Therefore, as a fraction of total state and local spending, welfare remained roughly unchanged at between 12 and 13 percent over the 1972 to 1976 period.

Even though the recent growth in state and local welfare spending has been concentrated in the medicaid program, policies designed to increase the federal share of cash assistance expenditures could offer a measure of fiscal relief to state and local governments. The Administration's welfare reform proposal is designed in part to provide such relief, particularly to those jurisdictions with high cash assistance expenditures. I would now like to summarize how the Administration's plan goes about doing this.

The Administration's Proposal

The Administration's Better Jobs and Income program holds out the promise for significant fiscal relief for state and local governments. The extent of this relief, however, depends both on factors over which state and local governments can exercise little control and decisions that must be made by the states themselves.

The new program would replace the AFDC, food stamp, SSI and emergency assistance programs and thus eliminate state and local expenditures on these programs. It also would obviate much of the need for state general assistance programs, thus saving additional state and local government resources. The new program, however, would have a set of very complex requirements that would ensure the continued financial participation of state and local governments in welfare. State and local governments would be required to contribute 10 percent of the costs of the basic federal benefit. Assuming no other family income these benefits would be $3,750 for an aged couple; $4,200 for a single parent with three children, the youngest of whom is under the age of 7; and $2,300 for a family of four, with an employable member who refused to take a job. 1/

Because these benefit levels would be lower than those that can be received from cash assistance and food stamps in most states, it is expected that many states would want to supplement the basic federal benefit. The plan would encourage such supplements by requiring states to pay only a portion of the cost of state supplements if they followed the same eligibility rules as the basic federal program (i.e. were congruent) and did not exceed certain maximum benefit reduction rates.

1/ All figures are expressed in 1978 dollars.

For families with children and no adult expected to work, the state would be required to pay one quarter of any supplement that, when combined with the basic benefit, did not exceed roughly three quarters of the poverty line. The state would have to pay three quarters of any additional supplement up to that family's poverty threshold. The cost of state supplements above that threshold and noncongruent supplements would be borne entirely by the states. For the elderly, blind, and disabled -- whose basic federal benefit would be nearly equivalent to their poverty thresholds -- the federal government would share one quarter of the additional cost of the supplement up to roughly 150 percent of the poverty level and nothing thereafter.

States that chose to provide congruent supplements to the cash assistance benefits would incur an additional cost in that they would be required to supplement up to ten percent the wages paid by the program's public service jobs. While the cost of the minimum wage public service jobs would be borne entirely by the federal government, the cost of these wage supplements would be solely the responsibility of the states.

The Administration's proposal also contains incentives for another type of continued -- if ever diminishing -- state and local welfare expenditure. This is the "grandfathering" or supplementing of existing SSI and AFDC recipients up to the payment levels in existence before the implementation of the new program. While the federal government would not contribute to these supplements, state expenditures on this "grandfathering" would be considered in calculating any federal hold-harmless payment.

Finally, the Administration's welfare reform proposal envisions the creation of state emergency needs programs to provide living expenses for needy families and individuals who either temporarily or permanently are denied aid or sufficient aid under the Program for Better Jobs and Incomes. To this end the federal government would allocate a block grant of $600 million among the states. Judging from the experience of the current emergency and general assistance programs, it is possible that some states would want to supplement their block grant with state revenues to provide a more generous emergency needs program, others would use it to pay state supplements, while still others would find the block grant more than sufficient for any welfare-related spending they envisioned.

To summarize, if the Program for Better Jobs and Income were implemented, a state's welfare expenditures would depend upon one factor over which it could exercise little control, if any, -- namely, ten percent of the basic federal benefits paid in that state -- and a series of decisions concerning benefit and wage supplementation, grandfathering, and the emergency needs program over which each state could exercise a great deal of discretion.

Were the story to end at this point some states would be denied any fiscal relief while others would find that under the reformed system their required expenditures were but a small fraction of their previous welfare burden. For example, in ten states (Alabama, Arkansas,

Florida, Georgia, Louisiana, Mississippi, New Mexico, South Carolina, Tennessee, and Texas) ten percent of the cost of the basic federal grant would exceed the amount currently being spent from state and local funds on AFDC, SSI state supplements, and general assistance benefits 2/. At the other extreme, seven states (Alaska, California, District of Columbia, Hawaii, Massachusetts, Michigan, and New York) would incur costs after reform that were less than one eighth their current benefit costs if they chose not to supplement the basic federal payment or to grandfather existing beneficiaries. To ensure that neither of these situations developed, the Administration's proposal contains a complex set of hold-harmless and maintenance of effort provisions that in large measure would determine the fiscal burden that the new system would place on state and local governments.

Two hold-harmless provisions guarantee that every state would receive at least a modicum of fiscal relief in the short run. The first of these provides a hold-harmless payment to the state equal to the difference, if any, between the state's allowable expenditures under the new program and its previous effort. In this calculation allowable expenditures are defined to include the state's share of the basic federal benefit, state expenditures for matching supplements up to the benefit levels available under previous cash assistance and food stamp programs, wage supplements, SSI grandfathering cost, three quarters of AFDC grandfathering costs, and the emergency needs block grant. The state's previous effort is defined to encompase 90 percent of the

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2/ The CBO has not yet made an independent analysis of the state-by-state fiscal relief afforded by the Administration's welfare reform proposal. The figures in this testimony are taken from HEW's "Notes: State Fact Sheets Covering the Better Jobs and Income Program," October 13, 1977.

state's own or nonfederally supported benefit payments for AFDC, SSI state supplements, emergency assistance and general assistance plus the state's emergency needs block grant.

Because one quarter of the cost of AFDC grandfathering and the state costs of AFDC administration are excluded from this hold-harmless calculation, some states would not experience much, if any, financial relief even after application of the first hold-harmless provision. A second hold-harmless provision would guarantee each state fiscal relief equal to at least 10 percent of its previous welfare burden by paying the state the amount needed to ensure that its allowable expenditures under the new program (counting 100 percent of the AFDC grandfathering) less its first hold-harmless payment and its emergency needs block grant amounted to no more than 90 percent of its previous effort including administrative expenses.

The Administration estimates that during the program's first year hold-harmless payments would be paid to 34 states but would amount to less than 2 percent of all federal spending on the new program. In subsequent years the protection offered by the two hold-harmless provisions would diminish, ending entirely after five years. 3/ It

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3/ For the first hold-harmless provision the fraction of the state's previous effort that could be offset against its allowable expenditures would rise from 90 percent in the first year to 100, 110, 130, and 150 percent in the second through fifth year. For the second hold-harmless provision, the guaranteed savings would fall from 10 percent in the first and second years to 5 percent in the third, fourth, and fifth years of the new program.

is possible, therefore, that after this period some states could actually experience a greater fiscal burden under the new system than they experienced under the old welfare system. However, it should be noted that a state's fiscal exposure from the basic federal program would be partially limited forever. The ten percent state share of basic federal benefit would never rise above 90 percent of the state's pre-reform effort adjusted for inflation. Because this pre-reform effort would increase at the same rate as the Consumer Price Index, some states could wind up after a few years spending more dollars on their share of the basic federal program than they spent in pre-reform days on the various cash assistance programs.

The maintenance-of-effort provisions in the Administration's proposal would act to put a floor under the fiscal relief that is available to states in the short run. States could satisfy the maintenance-of-effort requirement in one of two ways. The first of these would be to spend an amount equal to at least 90 percent of its pre-reform effort (defined as spending on AFDC, SSI supplements, emergency assistance and general assistance) plus its emergency needs block grant on a selected group of expenditure categories. These categories include the state's share of the basic federal benefit, matching benefit and wage supplements, state administered and financed means-tested programs, increased day care expenditures (under Title XX-A), emergency needs spending (including that not financed by the block grant), and the increased cost of administering day care and emergency needs programs. This list should offer states a good deal of flexibility. It should not constitute a hard test for many states to meet especially if state

programs aimed at the low-income population, such as propoerty tax circuit breaker programs and refundable sales tax credits, are considered eligible means-tested programs along with the grandfathering costs and non-matching state supplements.

Nevertheless, a number of the states with significant current welfare expenditures would be able to accomplish all of the activities the Administration wishes to encourage for far less than 90 percent of their previous efforts plus their emergency needs block grant. Such states would be deemed to have met the maintenance-of-effort requirement if they contributed ten percent of the cost of the basic federal program, supplemented families with children and the aged, blind, and disabled up to the pre-reform benefit levels (cash assistance plus the bonus value of food stamps) available in the state, provided any implied wage supplements, and grandfathered SSI recipients and three quarters of the AFDC families. The maintenance-of-effort provisions would phase out after three years, leaving states free, in theory, to reduce their financial participation to their ten percent share of the basic federal program.

Together the hold-harmless and maintenance-of-effort provisions define the maximum and minimum fiscal exposure of the states under the new program. If states supplement the basic federal program up to the benefit levels currently paid under cash assistance and food stamps, make the requisite wage supplements, and grandfather all SSI and AFDC recipients, the total fiscal relief offered to the states would be in the neighborhood of one quarter of their current effort under the

program's replaced by reform. 4/ Counting in current medicaid expenditures, the relief would be equivalent to roughly 15 percent of their current effort. Of course, there would be considerable variation among the states. Making the same assumptions concerning supplementation, some states would experience a reduction in their current welfare burden of over one third while others would reap only the minimum ten percent relief. For the most part the states that would be capable of receiving the largest relative amounts of fiscal relief would be those that currently make the greatest effort. With time, the extent of the relief would diminish principally for states with low current efforts.

Indirect Fiscal Impacts

As well as offering direct welfare savings to state and local governments, the Administration's proposal could provide some indirect fiscal assistance to these governments. The major source of this assistance would be the jobs component of the Program for Better Jobs and Income.

Under the Administration's proposal up to 1.4 million minimum wage public service jobs would be funded by the federal government. To the extent that the public service employees performed useful tasks that would not have been preformed in the absence of the welfare program, the level of state and local services would be increased without a comensurate increase in state and local taxes. However, in all likelihood, some of the tasks performed by these workers would have been

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4/ These are the assumptions used in the Administration's estimates. Supplements are assumed only for families with children and the aged, blind and disabled in those states where the federal basic benefit would be below current benefit levels.

accomplished in the absense of the program by regular state and local employees paid from state and local government revenues. To the extent that such substitution occurred, state and local governments would be able to reduce their payroll costs without reducing their service levels, thus gaining a measure of fiscal relief.

The net fiscal effects provided by the jobs component of the Administration's proposal might be less than the gross effects. To the extent that the minimum wage jobs were developed at the same time as funding for current public service employment programs were declining, the net number of state and local employees supported by federal dollars would be less than the gross number. If the state-by-state allocations of the new public service jobs were significantly different from those of current programs, some states might actually have fewer federally financed job slots and fewer federal "employment" dollars after implementation of the reform than before.

No matter how it is funded, a program as large as the Better Jobs and Income program would be likely to have an additional indirect fiscal impact on many state governments through the state economies. If the net cost of the new program resulted in a larger federal budget deficit (or smaller surplus), the economies and tax revenues of states would be strengthened, although not without some inflationary costs. If other federal spending programs were reduced or federal taxes increased to pay the net cost of the new program, the indirect fiscal impact on states would be mixed. In some states, such as Florida, Mississippi, South Carolina, Tennessee, and Texas, the level of spending on income maintenance by the federal, state, and local governments would more than

double. It is difficult to conceive of any set of federal tax increases or program cuts that would take more out of the economies of such states than would be injected by the welfare reform proposal. Moreover, from the narrow perspective of state governments, the shifting of resources to low-income families should act to raise consumption and hence sales tax collections. Of course, under a financing arrangement that relied on higher federal taxes and reduced expenditures to finance welfare reform, some states could be adversely affected.

Conclusion

The Administration's welfare reform proposal holds out the prospect for significant amounts of direct and indirect fiscal relief to state and local governments at least in the short run. However, a number of uncertainties remain that preclude a final judgment with respect to whether the plan's overall, long-run effect will be to reduce significantly the burden that welfare expenditures represent for state and local governments.

In the first place the proposal does not address the most rapidly growing welfare cost of these governements, namely, the medicaid program. Although the Administration's forthcoming National Health Insurance proposal promises to deal with this problem, thought should be given to what would happen if welfare reform becomes a reality while National Health Insurance legislation founders. In such a situation any fiscal relief gained by the states from welfare reform could quickly be dissipated if they felt the need or were required to provide medicaid coverage to significant numbers of persons covered under the expanded cash assistance and jobs programs. Even without significant program changes, medicaid administrative costs could rise considerably because

medicaid eligibility determination, much of which is currently done through the AFDC program, would have to be accomplished by the medicaid program.

Second, the long run fiscal implications of the Administration's proposal are largely unknown. After five years, when the hold-harmless and maintenance-of-effort provisions have expired, some states may find their fiscal exposure far different from what it was during the program's first few years. In addition, the emergency needs block grant could turn out to be less than required to fill in the cracks and holes created by the new system's retrospective accountable period and other facets.

Finally, the Program for Better Jobs and Income does not include an automatic cost-of-living adjustment for benefits. While the Administration has indicated its intention to keep the real level of benefits from falling, it is possible that other pressing national priorities will preclude this. In such circumstances states may feel pressure to fill the void by increasing the level of state supplements and thereby markedly increasing their fiscal exposure under the new program. For these reasons, it would be premature to conclude that the Program for Better Jobs and Incomes guarantees significant long-run fiscal relief for state and local governments. But it is certainly a first step in that direction.

Thank you.