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President's Welfare Reform Reauthorization Plan—

Fiscal Effect on California

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President Bush's welfare reform reauthorization plan, *Working Toward Independence,* proposes substantial changes to the existing federal welfare system. This plan, if enacted by Congress, would increase the effective work participation rate requirement for California by a factor of almost ten. In order to have a reasonable chance of meeting the President's work participation mandate, we estimate that the state would incur total additional net costs of approximately $2.8 billion over the next five federal fiscal years.

INTRODUCTION

On February 26, 2002, President Bush released *Working Toward Independence (WTI)*—the federal administration's plan for welfare reform reauthorization. This plan proposes substantial changes to the existing federal welfare block grant program—the Temporary Assistance for Needy Families (TANF) program. The proposal would also make significant policy changes in the Food Stamps and child support enforcement programs. Because most of the fiscal impact of the President's proposal is on the TANF program, this report focuses on the net costs to the California Work Opportunity and Responsibility to Kids (CalWORKs) program, which is California's version of the federal TANF program.

BACKGROUND

Previous Federal Welfare Reform. The 1996 federal welfare reform legislation substantially changed the American welfare system. The centerpiece of the law—the TANF block grant program—replaced the Aid to Families with Dependent Children (AFDC) entitlement program. Under TANF, states were given significant flexibility to establish their own eligibility rules and requirements, and to spend federal funds for purposes other than cash assistance. In exchange for this increased flexibility, states were required to engage specified percentages of their caseloads in welfare-to-work activities, or face financial penalties. In order to receive the block grants, states must also meet a "maintenance-of-effort" (MOE) spending requirement. The TANF block grants were authorized through the end of federal fiscal year (FFY) 2002 (September 2002). The federal TANF block grant to California is about $3.7 billion and the state's MOE requirement is $2.7 billion.

California's Welfare Reform Program. In response to the 1996 federal welfare reform, the Legislature created the CalWORKs program, enacted by Chapter 270, Statutes of 1997 (AB 1542, Ducheny). CalWORKs is a welfare-to-work program that requires able-bodied adult recipients to work or engage in some type of work-related education or training activity in exchange for cash assistance. This county administered program serves families whose incomes are inadequate to meet their basic needs. Supportive services, such as child care and transportation, are provided to families making the transition from welfare to work.

THE PRESIDENT'S PROPOSAL

Legislation (H.R. 4090) to implement the principle elements of the President's *WTI* plan was recently introduced in the House of Representatives. We base our analysis on the published text of *WTI* and our understanding of certain clarifications made by the federal administration to the National Conference of State Legislatures and the American Public Human Services Association. Below we discuss the major provisions of the *WTI* plan and Figure 1 compares the proposed changes to current law.

Increased Participation Mandate. From both a fiscal and a policy perspective, the most significant proposed changes to the TANF program center around an increased work participation mandate. Specifically, the

President's proposal substantially increases both the number of hours for which families must participate each week, and the percentage of families who must participate. In particular, families must participate for 40 hours per week. (Currently, single-parent families with a child under age six, representing over 50 percent of California's caseload, are required to participate for only 20 hours.) In addition, under the "direct work" requirement, at least 24 of the proposed 40 hours must be in employment or community service. (Currently, a wider range of activities count as participation.)

Additionally, under the proposed "universal engagement" requirement, states must prepare welfare-to-work plans for all cases within two months of receiving aid. (Currently, California does not prepare plans for cases that are exempt from participation under state law, or for cases in which up-front job search results in immediate employment.)

Figure 1

President's TANF Reauthorization Proposal
Major Provisions

Provision	Current Law	President's Proposal
Participation hours	20 hours per week for single parents with a child under age six; 30 hours for single parents with older children; 35 hours for two-parent families.	Increases requirement to 40 hours for all families.
Participation activities	Countable activities generally include: employment, work experience, community service, job search, vocational education, and provision of child care services.	Requires that 24 of the 40 hours include "direct work" activities (employment, work experience, or community service). Gives states flexibility to count other activities towards remaining 16 hours. In addition, for three months in any two-year period, states may count other activities towards the direct work requirement.
Universal engagement	Every family must participate in welfare-to-work activities after receiving 24 months of aid.	Requires that every family participate and have a welfare-to-work plan within two months of receiving aid.
Statewide participation rates	50 percent of all families, and 90 percent of two-parent families, must participate in welfare-to-work activities.	Increases all-families rate to 70 percent by FFY 2007, and eliminates two-parent rate.
Caseload reduction/ employment credit	Statewide participation rate requirements are reduced by the percentage point decline in a state's caseload.	Replaces caseload reduction credit with employment credit, whereby recipients who exit with income may be counted towards state participation for up to three months.

Effective Participation Rate Requirement Increases Nearly Ten-Fold. As noted in Figure 1, *WTI* increases the required participation rate from 50 percent to 70 percent and phases out the "caseload reduction credit." This credit generally allows states to reduce their required rate of participation (50 percent in FFY 2002) by the percentage point reduction in the caseload since FFY 1995. For example, California's caseload reduction of 42.6 percent reduces the statutory base participation rate of 50 percent down to 7.4 percent in FFY 2002, as shown in Figure 2 (see next page).

Figure 2 also illustrates the combined effects of the President's proposal to annually increase the statewide participation rate requirement and phase out the caseload reduction credit. As the figure shows, starting in FFY 2004 the all-families rate would increase by 5 percentage points each year, until it reaches 70 percent in FFY 2007, while the caseload reduction credit would be phased out by FFY 2005. Thus, by FFY 2007, the effective participation requirement for California would have increased nearly ten-fold from 7.4 percent to 70 percent.

Figure 2

President's TANF Reauthorization Proposal Federal Work Participation Rate Requirements

	Federal Fiscal Years					
	2002	2003	2004	2005	2006	2007
All families						
Statutory base rate	50.0%	50.0%	55.0%	60.0%	65.0%	70.0%
Less caseload reduction credit[a]	-42.6	-42.6	-21.3	—	—	—
Effective rate[a]	7.4	7.4	28.7	60.0	65.0	70.0

[a] For California.

Employment Credit Replaces Caseload Reduction Credit. The President proposes an "employment credit" to replace the caseload reduction credit. Under this credit, cases that have exited with income would be considered to be meeting the work participation requirement for up to three months. Although this credit would slightly increase (by about 6 percent in California) the number of families that could be counted towards a state's rate, it does not reduce the required base rate as is the case with the caseload reduction credit shown in Figure 2.

Proposed Three-Month Flexibility Period. Under *WTI*, states would be given new flexibility to count any approved state activity toward the 24-hour direct work requirement, for each recipient, for up to three months in any two-year period. Such activities could include treatment for domestic violence, mental health, or substance abuse; education and training activities; English as a second language; or job search.

No Increase in TANF Block Grants. Despite the substantial increase in the participation mandate, the President's proposal would leave the overall TANF funding structure largely intact. In particular, the TANF block grants to states would be frozen at their current levels, as would states' MOE spending requirements. Federal child care funding would also be frozen at current levels. Finally, we note that the President's proposal includes certain provisions related to family formation (such as promoting marriage), as well as new performance measurement requirements, but these provisions would likely have no significant fiscal impact.

FISCAL IMPACT OF PRESIDENT'S PROPOSAL

The LAO Approach

To estimate the fiscal impact of the President's proposal, we attempted to answer the following question:

Based on current California law, what is the minimal set of investments in employment services and child care that California must make in order to have a reasonable chance of meeting the 70 percent participation rate requirement in FFY 2007?

Key Assumptions. Answering this question required making a series of assumptions as well as establishing a baseline from which to measure the marginal fiscal impact of the *WTI* plan. Our baseline is current state law, to which we assumed only law changes necessary to implement *WTI* would be made (that is, increasing the hours of participation and limiting the types of approved work activities). In addition, we assumed that (1) substantial investments in child care and employment services would be needed to meet the significantly greater participation mandate, and (2) such investments would result in savings in the form of lower grant payments that would partially offset the higher costs for employment services and child care. Figure 3 presents our key assumptions.

Conservative Estimating Approach. As shown in Figure 3, we assumed that the funding allocations of all relatively low-funded counties would be raised to the standard in Riverside County. We believe this key assumption may result in understating the potential costs of implementing *WTI* due to three factors. Though Riverside County has one of the highest rates of participation among California counties, its rates are still well below the higher proposed federal rates. Further, because Riverside's unemployment rate is below the state average, other counties may face a greater challenge in moving their caseload into employment. Finally, Riverside County is in a relatively low-cost region of the state. Higher-cost regions would tend to have service costs higher than assumed in our estimate. Thus, we believe our fiscal estimates may understate the potential fiscal impact of the President's proposal on California.

Figure 3

President's TANF Reauthorization Proposal
Key LAO Estimating Assumptions

- ***Current Law***. **With the exception of laws pertaining to hours of participation and types of approved activities, we assume no changes to current state law.**
- ***Current Caseload***. **Our estimates are based on holding the caseload steady at its currently estimated June 2003 level. Thus, any future changes in the caseload due to factors such as a recession or a recovery are not reflected in our estimate.**
- ***Participation Must Increase Substantially***. **California's federal participation rate in FFY 2000 was 31 percent, substantially below the rates required in FFY 2005 and thereafter.**
- ***Riverside County Is A Reasonable Starting Point***. **Riverside County—a relatively large county with moderate costs in its welfare-to-work program—has, when compared to other counties, one of the highest levels of work participation among its adult caseload. Increasing statewide participation to Riverside's current rates would require bringing all counties up to Riverside's current welfare-to-work funding standard.**
- ***Additional Investments Beyond Riverside***. **Despite Riverside's success in engaging the majority of its caseload in unsubsidized employment and other welfare-to-work activities, its participation rates are still well below the proposed requirements. Thus, additional investments in employment services, community service, and child care would be necessary. In addition, the proposed "universal engagement" requirement would result in costs associated with preparing welfare-to-work plans for the entire caseload.**
- ***Additional Investments Would Result in Grant Savings***. **Providing more cases with employment and child care services would result in some grant savings due to higher levels of employment among CalWORKs recipients.**

Estimated Fiscal Impact of Proposed TANF Changes

Figure 4 summarizes the estimated costs and savings of implementing the *WTI* welfare reform reauthorization plan in California. As the figure shows, total additional net costs would be approximately $2.8 billion over the five-year period. This net figure represents welfare-to-work services costs of about $1.9 billion and child care costs of $1.7 billion, partially offset by grant and administrative savings of $0.8 billion. Most of the costs occur in FFY 2005 through FFY 2007, when the caseload reduction credit is completely eliminated.

We believe the above costs represent the minimum investment that California would need to make in order to have a reasonable chance of meeting the plan's participation mandate. Even if the Legislature were to make such investments, it is not certain that California would meet the higher participation requirements. This uncertainty stems primarily from the difficulty in predicting recipients' behavioral response to the proposed policy changes. Given current statutory participation exemptions (for example, cases with adults over 55 or with very young children), we believe that meeting the 70 percent participation rate would require a full-time work effort among virtually all able-bodied adults. Moreover, the proposed 40-hour weekly work standard represents a doubling of the work requirement for over half of California's cases. We note that successive failure to meet the requirements could result in annual federal penalties that could exceed $750 million.

Estimated Fiscal Impact of Other Proposed Changes

As noted earlier, the President's proposal also makes changes in Food Stamps and child support enforcement. Compared to the impact on the TANF program described above, these changes would result in relatively small fiscal impacts.

With respect to Food Stamps, savings of about $100 million annually from the restoration of federal benefits for certain noncitizens will be partially offset by higher costs of roughly $50 million associated with increased eligibility due to changes in vehicle asset rules and the standard income deduction. Although the proposed changes to child support enforcement

Figure 4

President's TANF Reauthorization Proposal Estimated Fiscal Impact on California

(In Millions)

	Federal Fiscal Years					
Program Component	**2003**	**2004**	**2005**	**2006**	**2007**	**Five-Year Impact**
Employment services						
Increasing participation	—	$160	$490	$530	$570	$1,750
Universal engagement requirement	$65	15	15	15	15	125
Subtotals	($65)	($175)	($505)	($545)	($585)	($1,875)
Child care	—	$155	$465	$505	$545	$1,670
Automation	$10	5	5	5	5	30
Grant savings	—	-70	-205	-220	-240	-735
Administrative savings	—	—	-5	-5	-5	-15
Net Impacts	**$75**	**$265**	**$765**	**$830**	**$890**	**$2,825**

provide the states with many new options to "pass through" more child support collections to families, the only mandatory change with significant fiscal impact concerns the imposition of a $25 annual fee for nonwelfare families for child support services. This fee would result in approximately $3.5 million in annual revenue that would be shared equally by California and the federal government.

LOOKING AHEAD

How Might California Fund The Estimated Increased Costs?

Because the President's proposal includes no increase in the TANF block grants, California's options for funding the projected costs of $2.8 billion shown in Figure 4 are limited to using state resources. One option is to fund the increased costs from the state's TANF reserve. However, the Governor's budget projects that California will end 2002-03 with a TANF reserve of only $40 million. In addition, expenditures from the TANF reserve offer only a short-term solution (as the reserves are spent down) to an ongoing increase in costs. Another option is to fund the higher costs from the state's General Fund, and thus spend above the state's MOE requirement. Finally, the state could elect to shift funding within the program from cash grants to employment services and child care. We estimate that grants would need to be reduced by about 24 percent to fund the projected cost increases in child care and employment services in FFY 2005. With respect to the estimated $75 million cost in FFY 2003, the state is currently facing a budget shortfall of approximately $15 billion, so any General Fund increase in CalWORKs would require even deeper reductions in other programs.

Increasing California's Chances of Success

The President's proposal increases the work participation mandate, provides limited new flexibility to meet the higher mandate, and freezes federal funding levels. Below we identify four modifications to the *WTI* proposal that would ease the fiscal burden on California and increase the state's chance of meeting the higher participation mandate.

Reforming the Caseload Reduction Credit. Currently, as shown in Figure 2, the caseload reduction credit reduces California's required participation rate by about 43 percent. While rewarding states' success in moving cases off cash assistance, this credit does not distinguish between cases that leave aid due to employment and cases that leave for other reasons. We believe that the President's proposed employment credit moves federal policy in the direction of rewarding work by focusing on welfare case exits due to income. However, by limiting to three months the period for which states may take credit for successful case exits, this proposal does not fully reflect the value of states' efforts in helping former recipients make the full transition from welfare to work. We believe that extending the employment credit beyond three months would provide states an important incentive to assist recipients in achieving long-term self-sufficiency.

Eliminating Universal Engagement. The proposed universal engagement provision runs counter to the 1996 welfare reform law's thrust of greater state flexibility. This provision requires that states adopt welfare-to-work plans for all cases within two months of receiving cash assistance. As a result, California would be required to prepare such plans for families that are exempt under state law from participation (for example, families with a child under age 1) and families that immediately attain employment after job club. Eliminating this requirement would retain state flexibility to determine the best way to allocate limited resources in helping families achieve self-sufficiency.

Increasing Federal Funding. As noted earlier, under *WTI* the TANF block grants would remain frozen at the levels established in 1996. Inflation since that time has eroded the value of California's block grant by about 17 percent. Although cash assistance caseloads have declined significantly since 1996 as noted above, meeting the current federal participation mandate requires welfare-to-work expenditures that were largely not included in the costs of the income maintenance program (AFDC) upon which the block grant funding levels were based. Furthermore, many cases that have left aid still require supportive services in order to remain off cash assistance. For example, under current state law former recipients are entitled to two years of transitional child care after leaving cash assistance. An increase in TANF or child care funding would substantially ease the fiscal burden of meeting the proposed higher work participation mandate.

Improving the Proposed Three-Month Flexibility Period. The proposed three-month flexibility period described earlier in this report recognizes that some cases require services—such as treatment for domestic violence, mental health, and substance abuse; English as a second language; or vocational education and training—in order to move from welfare to work. However, one way in which this new flexibility is limited is that up-front job search, typically lasting about three weeks, would count against the three-month period. Under current federal law, up-front job search does count toward the work participation requirement. Retaining this current-law provision by counting job search as a direct work activity would enable states to take full advantage of the proposed three-month flexibility window. Given the dynamic nature of the labor market, we believe that job search is a common experience among all workers and therefore should be considered a direct work activity.

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