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Report to Congressional Requesters

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WELFARE REFORM

Challenges in Maintaining a Federal-State Fiscal Partnership

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Accountability * Integrity * Reliability

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August 10, 2001

The Honorable Nancy L. Johnson
Chairwoman, Subcommittee on Health
Committee on Ways and Means
House of Representatives

The Honorable Wally Herger
Chairman, Subcommittee on Human Resources
Committee on Ways and Means
House of Representatives

The upcoming reauthorization of the Temporary Assistance for Needy Families (TANF) block grant presents an opportunity to re-examine the fiscal balance between the federal government and the states in providing services to needy families. TANF was created by the Personal Responsibility and Work Opportunity Reconciliation Act of 1996[1] (PRWORA, or the act) which ended families' entitlement to cash assistance by replacing the Aid to Families with Dependent Children (AFDC) program with the Temporary Assistance for Needy Families (TANF) block grant, a $16.5 billion per-year fixed federal funding stream to the states. PRWORA coupled the block grant with a strong maintenance-of-effort (MOE) requirement[2] in order to ensure that states remain a strong fiscal partner. The MOE requires states to maintain a significant portion of their own historic financial commitment to their welfare programs as a condition of receiving their full TANF allotments. Since both the amount of federal TANF funds and the required MOE remain fixed regardless of the number of people states chose to serve with these funds, and because the number of families that receive basic cash assistance has declined dramatically since the mid-1990s (by more than 50 percent nationally), states have additional budgetary resources available for use in a variety of ways to help

[1]Most appropriations for TANF expire at the end of fiscal year 2002 (Public Law 104-193, Title I).

[2]States' MOE requirements are based on their own spending in federal fiscal year 1994 on AFDC, Job Opportunities and Basic Skills (JOBS), Emergency Assistance (EA), related administrative costs and AFDC-related child care programs: AFDC/JOBS child care program, Transitional Child Care, and At-Risk Child Care programs. A state that does not meet the act's work participation rates must maintain at least 80 percent MOE. A state that meets its work participation rate must maintain at least 75 percent of its MOE. For more information see *Welfare Reform: Early Fiscal Effects of the TANF Block Grant* (GAO/AIMD-98-137, August 18, 1998).

people avoid dependency on public assistance. At the same time, the fixed nature of the federal contribution means that states now bear most of the program's fiscal risks in the event of an economic downturn or increase in caseload.

In the 5 years since enactment of federal welfare reform, there has been much discussion of the fiscal implications of these sweeping changes in national welfare policy. A particularly contentious issue has been the extent to which states have replaced, rather than supplemented, their own spending with federal TANF dollars thereby freeing up state funds for other budget priorities. This practice is often referred to as "supplantation" or "substitution."[3] Other important intergovernmental fiscal issues surrounding PRWORA include whether states are setting aside funds for costs associated with increased caseloads they may experience during a recession and why some states are leaving large reserves of unspent TANF funds at the U.S. Treasury.[4]

Concerns about how states were spending their TANF funds prompted you to ask us to examine:

- the degree to which states have used the flexibility afforded in the federal TANF grant to supplant, rather than supplement, state spending for low-income families;
- the changes that have occurred in states' use of different funding sources (including their TANF funds) on programs that help the poor;
- the effect state funding choices have had on the amounts of TANF funds they have left unspent at the U.S. Treasury; and
- the measures states are taking to save a portion of the TANF grant or set aside state funds for a rainy day.

Background

The change in the federal role in financing state welfare programs has provided both greater flexibility and greater uncertainty for the states. They have greater flexibility in how to administer and implement their welfare programs; however, they also face increased fiscal risk. Before

[3]For more information, see *Federal Grants: Design Improvements Could Help Federal Resources Go Further* (GAO/AIMD-97-7, December 18, 1996).

[4]For more information, see *Welfare Reform: Challenges in Saving for a "Rainy Day"*(GAO-01-674T, April 26, 2001).

1996, under the AFDC program, any increased costs were shared by the federal government and the states. Under TANF, however, if costs rise, states face most of the burden of financing the unexpected costs. States must handle these costs in the context of any budgetary limitations—including those imposed by legislation, balanced budget requirements, and scrutiny of the municipal bond market—on their ability to increase spending, especially in times of fiscal stress. This uncertainty highlights the importance of contingency planning, or "saving for a rainy day."

At the same time, when caseloads drop, as they have since the mid-1990s, states can reap large fiscal benefits. A particularly contentious issue has been the extent to which states used this flexibility to replace, rather than supplement, state spending with federal TANF dollars thereby freeing up state funds for other budget priorities—a practice allowable under TANF. At the same time Congress consolidated the funding streams from the previous welfare programs into the TANF block grant, it broadened the programs goals and gave states flexibility to use federal funds on a wider array of programs. Specifically, states can use TANF funds on programs and activities to

- provide assistance to needy families so that children may be cared for in their homes or in the homes of relatives;
- end the dependence of needy parents on government benefits by promoting job preparation, work, and marriage;
- prevent and reduce the incidence of out-of-wedlock pregnancies; and
- encourage the formation and maintenance of two-parent families.

Many states are in a position to supplant state spending because given large, recent cash assistance caseload declines, the fixed TANF funding formula provides them with more budgetary resources for their welfare programs than they would have had under prior law. However, TANF's MOE limits states' ability to supplant funds because states face strict penalties unless they largely maintain their prior fiscal commitment to low-income families. Therefore, states' ability to divert state funds to other priorities is somewhat constrained.

In theory, federal grants serve purposes beyond simply returning and reallocating resources to taxpayers in the form of state services. As we have previously reported, they have also served as vehicles through which the federal government attempted to achieve a variety of national goals by providing funding to other levels of government to carry out specific national priorities. Grants can also serve as a tool to encourage states to spend federal funds for nationally important activities for which they otherwise would have spent less. The amount of additional spending is affected by the degree to which federal grants actually supplement, rather than supplant, state spending on these activities.[5]

[5] *Federal Grants: Design Improvements Could Help Federal Resources Go Further* (GAO/AIMD-97-7, December 18, 1996).

Paradoxically, at the same time questions are being raised as to whether states have replaced their own spending with federal funds, the states have been under considerable scrutiny for not spending their TANF funds more quickly. There has also been much discussion about whether states are "saving for a rainy day."[6] If states choose to engage in this sort of contingency budgeting, they have several options. They can (1) use general-purpose state "rainy day funds," (2) establish a state reserve specifically intended for welfare programs, (3) plan on using PRWORA's two safety net mechanisms—the $2 billion Contingency Fund for State Welfare Programs (Contingency Fund) and the $1.7 billion Federal Loan Fund for State Welfare Programs (Loan Fund),[7] or (4) save an unlimited amount of their TANF allocation for use in later years.[8] If states choose to save all or part of their unspent TANF balances, laws governing the exchange of funds between the federal government and the states require that these resources be left at the U.S. Treasury until they are needed.[9]

Scope and Methodology

To address the four objectives of this report, we studied TANF-related budget decisions and collected data on social service expenditures in 10 states —California, Connecticut, Colorado, Louisiana, Maryland, Michigan, New York, Oregon, Texas, and Wisconsin. These 10 states were the same states we studied in 1998, thereby providing a continuing perspective on fiscal issues among a common group of states as the program unfolds. These 10 states were selected because they represent a diverse array of socioeconomic characteristics, geographic locations, experiences with state welfare initiatives, and state fiscal and budget issues.

[6]See *Welfare Reform: Challenges in "Saving for a Rainy Day"* (GAO-01-674T, April 26, 2001).

[7]The Adoption and Safe Families Act of 1997 reduced the Contingency Fund by $40 million over the remaining life of the fund. (P.L. 105-89, §404, 111 Stat. 2134.) Loans from the Loan Fund are to have a maturity of no more than 3 years at an interest rate comparable to the average market yield on outstanding marketable federal obligations with comparable periods to maturity.

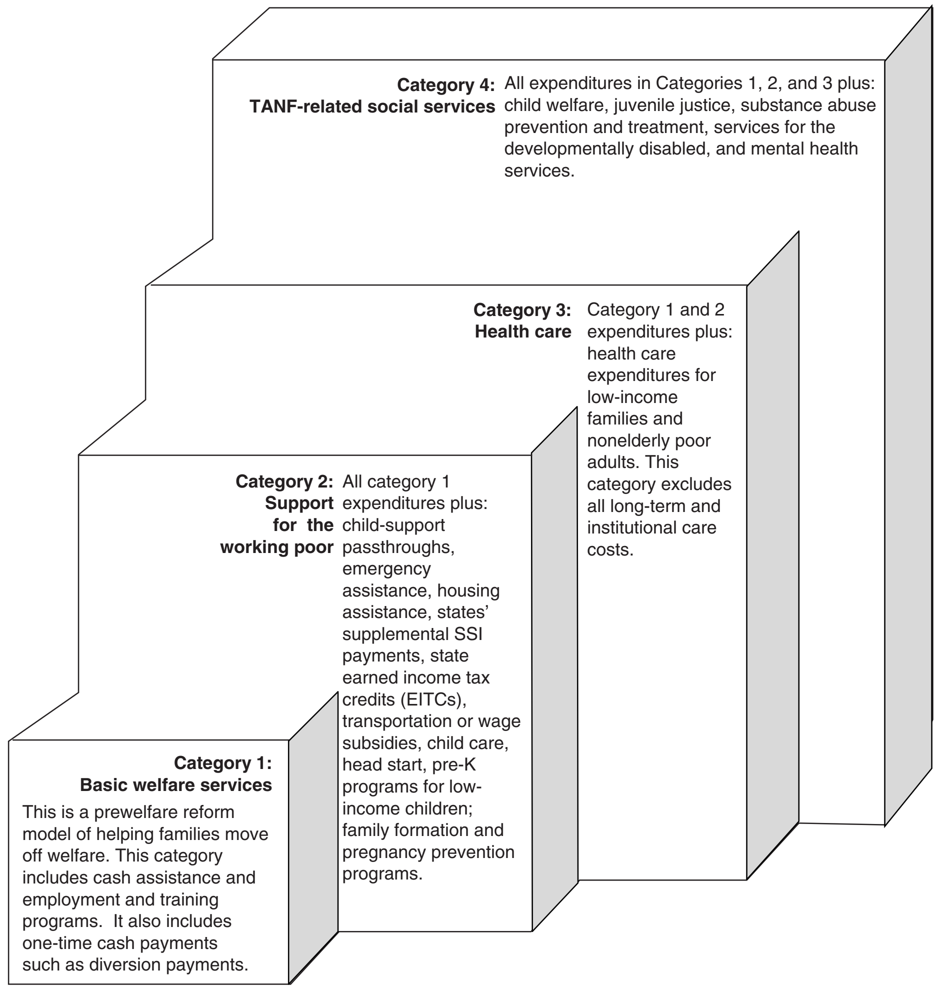
[8] HHS regulations restrict the states' use of these prior year funds to benefits and basic services to help families meet on-going needs.

[9]Federal regulations prohibit grantees from drawing down funds in advance of expenditure in order to assure compliance with the Cash Management Improvement Act of 1990 (CMIA). CMIA settled a long-standing dispute between the federal government and the states over disbursement of funds for federal programs administered by the state; it helps to ensure that neither party incurs unnecessary interest costs in the course of federal grant disbursements.

- In order to gauge the extent to which a state used TANF funds to free up state funds, we analyzed state budgets and supporting budget documents and interviewed key program budget officials, state budget officers, state auditors and legislative staff.
- To measure post-PRWORA changes in the mix of federal and state funding across TANF-related social services, we asked the 10 states to provide expenditure data on programs that provide social services to the needy. To do this, we adapted a fiscal survey developed by the Nelson A. Rockefeller Institute of Government.[10] Specifically, we asked for state and federal expenditures on a variety of programs that targeted assistance to low-income families and individuals in state fiscal year 1994-1995 and estimated expenditures in state fiscal year 1999-2000, and we verified the data they reported to us against their own accounting records. To improve the alignment of our survey data with TANF's goal of ending the dependence of needy parents on government benefits, we excluded expenditures on the elderly and those services that were not transitional in nature. In our analysis, we aggregated state expenditure data by program category, allowing us to group programs into four categories—Basic Welfare Services (Category 1), Support for the Working Poor (Category 2), Health Care (Category 3), and Other TANF-related Social Services (Category 4). The analysis is cumulative; that is, all expenditures in Category 1 are included in Category 2, and so on. See figure 1 for a description of programs that are included in our spending categories.

[10] "Changes in State Spending on Social Services Since the Implementation of Welfare Reform: A Preliminary Report." Ellwood and Boyd, February 2000.

Figure 1: Four Categories of Welfare-Related Spending



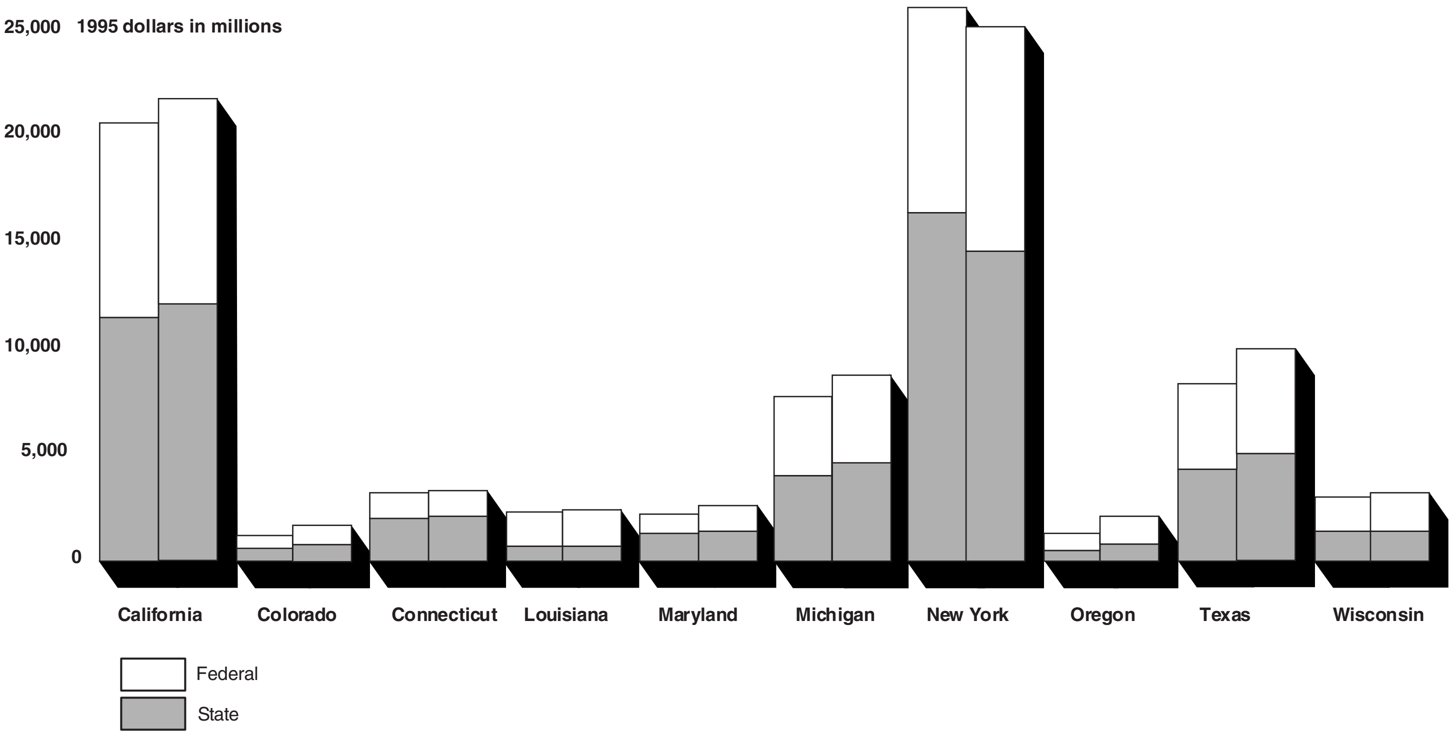
- To describe the measures states are taking to "save for a rainy day" and to analyze the impact these actions have on TANF reserve balances at the U.S. Treasury, we analyzed the 10 states' budgets. To obtain a broader view of the levels of unspent TANF funds in all 50 states, we reviewed financial data reported by the states to the U.S. Department of Health and Human Services (HHS). (States report key TANF financial information on their quarterly ACF-196 reports.)

Results in Brief

The combination of a precipitous drop in caseloads and fixed grant funding levels provided states with additional budgetary resources they could use to finance their new welfare policies. States faced many challenges determining the appropriate mix among several policy options: saving for the future, investing in programs serving current beneficiaries, and addressing fiscal pressures in the states' budgets. Examining states' choices in allocating federal and state funds for specific activities is an important first step in understanding financing changes ushered in by the TANF program. While addressing whether federal funds replaced or "supplanted" state funds for specific activities—which is legal under TANF—is one key issue, it is equally important to understand how states used this new-found fiscal flexibility to support the broader goals of the TANF program. For example, if a state replaced its own funds with TANF funds and then shifted the freed-up state funds into other programs that serve the working poor, the net impact of these shifts would be the same as if they used the federal funds to fund these other programs. Therefore, it is more informative to view the impact of supplantation in a broader fiscal context consistent with the new objectives and goals of TANF.

In examining specific state funding decisions, we found that supplanting was a common budget practice among the 10 states in our study. At the same time, looking at the broadest level of TANF-related social services shows that over time most states have maintained or even increased their own investment to address the overall needs of low-income families. The effect of state budgetary decisions on the fiscal balance between federal and state governments differed depending on the range of programs we analyzed. The greatest impact was felt in basic welfare services—most states reduced their own spending and shifted more federal funds into those programs. However, since welfare reform, the effect of states' decisions has been to shift resources from this narrow category to support the broadest array of programs addressing the goals of the TANF program; nearly all states increased total funding in real dollars for these programs, including health care and child welfare services. (See figure 2.)

Figure 2: TANF-Related Social Service Expenditures (Category 4) in 10 States for State Fiscal Years 1995 and 2000



Source: GAO survey and analysis of state expenditure data.

An analysis of state budgets shows that the degree to which states supplanted state spending varied considerably, ranging from about 25 percent of the annual block grant in Connecticut and Oregon to 5 percent or less in Colorado, Louisiana, and Michigan. State officials noted that supplanting had the effect of allowing them to use federal and state funds more flexibly to support a wide range of programs supporting needy families. Moreover, state officials noted that supplanting enabled the states that had initiated major social welfare programs prior to TANF to use federal funds to support these efforts. However, in many cases, the MOE requirement limited the extent to which states could use their federal funds to replace state funds. This MOE requirement has led to a situation in which many state officials say they are spending more than might be expected in the face of the large caseload drop.

Some states report that their decisions on how to use federal TANF funds were influenced by their concerns about the vulnerability of accumulated unspent TANF balances to rescissions at the federal level. While many view the balances held in reserve at the U.S. Treasury as the de facto safety net for states to draw on in the event welfare costs rise, the potential risk of losing these balances to competing priorities at the federal level prompted some states to draw down these balances for current program needs or fiscal relief. As of September 30, 2000, all 50 states reported leaving a combined total of $8.6 billion in TANF funds unspent at the U.S. Treasury, or 13.5 percent of the total TANF funds that have been made available since 1997. Little is known about whether these accumulating balances represent (1) actual commitments states made but have not yet liquidated, (2) balances the states are holding in reserve as rainy day funds, or (3) funds the states do not need. This uncertainty is largely the result of variations in the way states report allocations to subgrantees and counties. The lack of transparency regarding states' plans for their unspent TANF funds continues to weaken the effectiveness of congressional oversight over TANF funding issues.

Our review suggests widespread disparities among all 50 states in their use of TANF funds to prepare for the impact of an economic downturn on this program. Some states report spending all their federal funds—essentially holding nothing in reserve—while others report accumulated reserves totaling more than their annual block grant. The level of these reserves was not determined through a fiscal planning process analyzing potential future draws on program resources caused by a downturn in the economy. Furthermore, the design of PRWORA's two safety net mechanisms for states—the $2 billion Contingency Fund for State Welfare Programs (Contingency Fund) and the $1.7 billion Federal Loan Fund for State Welfare Programs (Loan Fund)—is complex and restrictive. Therefore, neither one is likely to be used by states in a fiscal crisis to obtain more resources for their welfare programs.

The upcoming reauthorization of TANF presents Congress with an opportunity to re-examine the new federal-state fiscal partnership it established with enactment of PRWORA. In particular, Congress has the opportunity to consider the design of the block grant including (1) how it has affected the balance of fiscal responsibilities between federal and state governments to address the goals of the program and (2) whether the program promotes the savings of both federal and state funds to address a future "rainy day." TANF provided states with increased flexibility; this flexibility combined with falling caseloads has allowed many states to obtain fiscal relief while maintaining or increasing their support for the broad purposes of the act. The addition of a nonsupplant provision might help ensure that all federal funds supplement existing state spending, but it could also have the adverse effect of penalizing those states that took the initiative to begin new programs before TANF, and it might limit the intended breadth of the block grant by locking states into pre-established funding priorities. From this perspective, a broad-based MOE calling for states to maintain spending across a wide range of relevant programs might limit substitution while preserving state discretion.

The shift from the open-ended match of AFDC to PRWORA's fixed-dollar TANF block grant also increased the states' exposure to fiscal risks in the event of an economic downturn or increased program costs. Recognizing that both the federal government and the states have an interest in contingency planning, we have testified on ways to improve the federal contingency mechanism as well as strengthen states' incentives to "save for a rainy day." For example, Congress could realign the contingency fund MOE and eliminate the monthly payment limitation on contingency fund access. There are other options that might strengthen states' incentives to save. Congress could amend the law to (1) allow states to count rainy day funds toward a portion of their MOE and/or (2) allow states to draw down their entire TANF grant and save these funds in their own treasuries. There are pluses and minuses to each of these ideas—the exact design and implementation will be important in determining the actual impact of any change.

In keeping with the intent of the block grant, federal oversight needs to focus not only on the use of TANF funds specifically, but also on how states use multiple federal and state funding streams to support the broad-sweeping goals of the TANF program. Going forward, the overall fiscal balance portrayed in this report may shift over time, particularly under different economic conditions. Accordingly, we have recommended that the Secretary of Health and Human Services consult with the states to initiate periodic reporting on the entire federal-state fiscal effort relevant to goals of the program.

State Budget Actions Shift Federal and State Support for Specific Activities

Much of the debate over whether—and if so, to what extent—states used federal funds to replace their own funds has hinged on the definition of supplantation. Under our most limited definition of supplantation—replacing state dollars with TANF dollars for specific activities that are allowable uses of TANF dollars—we found that all 10 of the states in our study except California used TANF funds to replace some state funds from existing programs.[11] However, the extent of the supplantation varied considerably across states, as did the reasons given for supplantation. Moreover, as discussed in a later section, replacement of state funds with federal funds for specific activities was often accompanied by an increase in state support for the broadest array of programs addressing the goals of the TANF program.

These fiscal actions took place within a framework of state budget negotiations, which normally requires some trade-offs among competing priorities. Moreover, the decisions were made at a time when caseloads had fallen dramatically and many states had significant levels of unspent TANF funds. In allocating federal and state funds, states had to balance a number of competing pressures. Among these were tensions between the need to draw down TANF balances, save for future needs, and a concern about building potentially new permanent state commitments that might outlast the federal funds themselves. From this perspective, a supplantation strategy allowed states to draw down their TANF balances to spend on current needs or save for future contingencies without building permanent new state commitments.

The programmatic and fiscal flexibility afforded states through the block grant increases the opportunity to use federal funds to replace state funding in welfare-related programs. The shift from a matching grant to a block grant was in part intended to provide states with more flexibility. Given the complex and evolving relationship between the federal and state governments and their shared responsibilities for most domestic programs, it is understandable that observers will have different views of

[11] California has not yet enacted a budget that contains apparent supplantation of federal TANF funds. However, the Governor's budget proposal for California's state fiscal year 2001-2002 proposed using $154 million in federal TANF funds to replace state funds California already spent on its TANF program in 1997. This retroactive claiming of federal funds was made possible because the state recently certified that it had met its work participation rate in federal fiscal year 1997. In so doing, California's MOE requirement was reduced in that year from $2.9 billion to $2.7 billion and the governor is proposing to use unspent federal TANF funds to reimburse the state for those "unnecessary" state expenditures.

supplantation. For example, advocates for low-income families lament the failure to increase resources available to their constituents as a result of supplantation. They note that when state resources are withdrawn and replaced with federal funds fewer total funds are available for low-income families than would be the case if federal funds were added. State officials note that the flexibility to use federal funds instead of state funds in some programs gives them opportunities to use freed-up state funds as leverage to enact new or expanded programs that also benefit the low-income population. In this debate, it is interesting to note that some states prohibit their counties from supplanting at the local level. In Colorado and New York, for example, counties are prohibited from using any of their TANF funds passed through from the state to replace their county-generated spending on social services.

Supplantation Varies Widely Among States

Budgets are the tool that state policymakers use in deciding how to distribute limited resources among different policy choices. Once a state develops its priorities, decides which programs it needs, and develops estimates of how many people will be served by the programs, it can begin to develop program budgets. In general, the extent to which states can use federal funds to finance policy priorities is an important part of the budget debate—maximizing the use of federal funds means that state revenues go farther. There are certain limitations, however, on how states can utilize federal funds. For example, states must spend federal grant money on purposes specified by the federal law authorizing the grant. Furthermore, grants may also require a form of cost sharing—either a maintenance-of-effort or a state match—in order to use federal funds. These features can help ensure that states maintain their fiscal commitment to programs for which they receive federal funds.

Although states are free under the law to replace state funds with TANF, in fact two conditions facilitated supplanting: the state must have surplus TANF funds available—in addition to those it needs to maintain program levels—and it must have programs in place that are traditionally funded with state dollars over and above the level necessary to meet its MOE requirement. Without the former, it could run short of the funds it needs to meet program demands and therefore have to find state general funds to pay for those costs; without the latter, a state would run the risk of fiscal penalties for not meeting its MOE requirement.

During recent budget deliberations, 9 of the 10 states we reviewed used federal TANF funds to replace state funds in existing programs that met the broad purposes of the act. In so doing, all of these states reduced their own contributions to these programs. Since money is fungible, we cannot know conclusively how they used these particular freed-up funds. As will be discussed below, in some states budget documents clearly revealed that supplanting enabled states to save their own funds for other programs; in other states supplanting was viewed as a strategy to shift state funds from traditional cash assistance to other low-income programs in keeping with the flexibility in TANF.

The extent to which states supplanted funds varied significantly. In the most recent year for which data is available, five of the states in our study—Connecticut, Maryland, Oregon, Texas, and Wisconsin—used between 15 percent and 25 percent of their annual block grants to finance state programs that had traditionally been financed with state dollars. Four states—Colorado, Louisiana, Michigan, and New York—used 10 percent or less of their TANF grants to replace state funding. In the remaining state, California, no evidence of supplantation exists in its enacted budgets to date, but this could change with its 2001-2002 budget. (See footnote 11.)

Interestingly, the role of local governments has also apparently affected some states' ability to supplant. California, Colorado, and New York depend on their counties to define welfare spending priorities. This financing arrangement has limited the amount of TANF resources these states can use for other spending priorities because any supplantation done at the state level would reduce the amount of TANF funds available to the counties. Intergovernmental dynamics within each state were often powerful enough to dissuade these states from enacting budgets that reduced TANF funding for their counties. In both New York and Colorado, the states prohibit the counties from engaging in supplantation at the county level. That is, counties are prohibited from using any of their TANF funds to replace their own spending on social services.

Some States Supplanted to Address Fiscal Pressures

Budget officials cited many reasons for shifting program financing, and most of the states were able to achieve significant savings of state general fund dollars. For example, in Connecticut, when spending in many TANF-funded programs came in under budget, resulting in significant levels of unspent TANF funds, state officials found other accounts serving needy families that had traditionally been funded with state funds and used TANF funds instead. State budget officials estimated they used about $40 million in each of state fiscal years 1999 and 2000 to replace state funds with federal funds. They explained that because the state funds were never drawn from the state's general fund accounts, the effect of using the TANF funds in this manner was to enlarge their end-of-year general funds surplus.

Other states were also unwilling to accumulate large balances of unspent TANF funds. State officials told us they were concerned that leaving a portion of their block grant in reserve might send the signal that the funds were not needed and risk their rescission by Congress. In state fiscal year 2001, Michigan used about $27 million in TANF funds to pay for a low-income housing tax credit that had been paid for with state funds since 1973. Michigan state officials said their decisions to eliminate TANF reserves were in part due to mounting pressure to get the funds "off the table" before they could be taken back by Congress. Likewise, a Maryland state budget official said that Maryland was motivated to supplant chiefly by the perceived need to draw down its federal funds quickly or risk their rescission. They were also concerned that if they left these funds unspent it might affect future funding levels. In state fiscal year 2001, Maryland identified several program accounts with annual expenditures of state funds totaling about $30 million that, under the broad and flexible rules governing TANF expenditures, could be funded with federal funds. In developing the budget, the state replaced these state funds with federal funds. Instead of using the freed-up state funds for nonwelfare activities, however, the state used them to establish a dedicated reserve for its welfare program.

Some States Supplanted in Order to Increase Flexibility to Address Needs of Low-Income Families

In addition to realizing savings, supplantation in some states was part of a broader strategy to shift the source of funds supporting state programs for the working poor. Freeing-up state funds from basic welfare programs in some cases gave states greater latitude towards meeting their MOE requirements. For example, in 1997 when Texas first deliberated how it would use the new TANF funds in its welfare program, state officials believed that cash assistance and training would be a good place to direct state resources to count toward the state's MOE requirement. However, as caseloads dropped more quickly and to a greater extent than anticipated, it became clear that state funds were not being expended at levels sufficient to meet the MOE requirement. Subsequently, Texas decided to substitute federal for state dollars for job training activities and to direct state funds to other priorities that would spend out faster but that would still count toward the MOE. Child welfare programs were seen as a priority because of growing foster care caseloads and a state court ruling that called for heightened investigation and prevention of child abuse and neglect. Because spending on these programs was growing, these expenditures were viewed as a better source of MOE financing than spending on basic welfare services. The legislature increased appropriations for an expanded child welfare program and directed the state agency to count the state's share of the increase towards it MOE. This was not the end of the matter, however. After reviewing final TANF regulations, state agency officials found that certain foster care expenditures included in the child welfare expansion could not be counted toward the MOE requirement, which left them short again. In the end, state officials identified as MOE a portion of state aid used to support preschool programs. Since the state aid is allocated based on the number of needy children in the district, a portion of it qualifies as a MOE expenditure. The state spent nearly $320 million on this effort in 2000.

States With Significant Prior Commitments Supplanted for Fiscal Relief

Some states argue that supplantation, in effect, enabled them to gain federal funding for state initiatives that began prior to the implementation of federal reforms. From this perspective, supplantation allowed states to avoid becoming locked into spending even when federal funds come available, and also allowed for some federal recognition of their innovation and progressiveness. Furthermore, since the MOE has prevented states from reducing their spending as much as they otherwise would have been able to given recent caseload declines, it is not surprising that states such as Oregon argue that they deserve some fiscal relief.

Oregon began its welfare reform program in 1992 and, recognizing the importance of employment and training and employment-related child care programs, invested heavily in those programs even though the federal match was capped. By the time the federal reforms were enacted, Oregon's cash assistance caseload had already fallen by nearly 40 percent. Oregon officials subsequently decided that they had "over-invested" in the federal JOBS program, and since 1997, the state has withdrawn some of its own investment in these programs and replaced state funds with federal funds. Oregon argues that preventing supplantation would penalize it for being progressive and "out in front" in terms of welfare reform.

MOE Provision of TANF Limits Extent of Supplantation

As we have previously reported,[12] some supplantation is to be expected in any grant. We have previously reported that because of supplantation, on average, every additional federal grant dollar results in about 60 cents of supplantation. However, we also noted that certain grant design features such as a strong MOE provision can limit states' ability to supplant.[13] Consistent with this, in our study of 10 states, we found that while most have enacted budgets that authorized some supplantation of welfare funds, the level did not exceed 25 cents of a state's block grant dollar. For example, program and state budget officials in Louisiana said that one of the reasons for so little supplantation in Louisiana is the paucity of state funds in social service programs not already earmarked to meet other federal program requirements. The TANF MOE did more than limit the leakage of funds from these programs—it also stimulated state spending above and beyond what states would otherwise have spent. The following examples in New York and Wisconsin clearly highlight the significant impact that TANF's MOE can have on state spending, particularly at a time when caseloads were falling so much.

In New York, the level of fiscal relief possible largely depends on within-state cost sharing arrangements that were in place under the AFDC program and continue under TANF. Under AFDC, the federal government paid 50 percent of AFDC costs and the state and local governments shared the remaining costs equally. Because caseloads dropped and new programs and services were slow to start for a variety of reasons, spending rates under TANF were slower than expected. As a result, total expenditures fell. The state feared it would not meet its MOE requirement if the expenditure trends continued at the current rate and if the state continued to reimburse counties with federal and state funds. Since the state operates on a cost-reimbursement basis with its localities, if the state temporarily had suspended the federal reimbursements, the effect would have been to pay for all costs with state and local funds—making it easier to reach the state's MOE. To resolve the potential MOE shortfall, the state halted any reimbursement to the localities for expenditures they had made in the last quarter of the fiscal year. The state then counted all of the local expenditures toward the state's MOE, effectively spending more state and

[12] *Federal Grants: Design Improvements Could Help Federal Resources Go Further* (GAO/AIMD-97-7, December 18, 1996).

[13] See also *Block Grants: Issues in Designing Accountability Provisions* (GAO/AIMD-95-226, September 1, 1995).

local funds on these programs than otherwise would have been the case. The state now closely monitors total expenditures and adjusts the federal share of the reimbursement to ensure that the state will meet its MOE each year.

In Wisconsin, MOE also forced the state to spend more state funds than it otherwise may have. According to legislative members and staff we interviewed, pre-TANF, Wisconsin was spending less than the new MOE required it to spend because it had already instituted substantial reforms which helped lower caseloads, and in turn, expenditures. Because the TANF MOE was pegged to a period when state spending levels were at an historic high, Wisconsin had to raise its spending in order to meet its 75 percent MOE level. During the 1999-2001 budget deliberations, state budget analysts projected that the state would fall short of its MOE requirement by about $40 million because the number of W-2 families receiving cash assistance had fallen so dramatically. At the same time, final TANF regulations were issued and allowed use of TANF funds to establish or expand state earned income tax credit programs (EITC). This permitted Wisconsin to substitute federal funds for about $52 million a year in state funds that it was already spending on its state's EITC. But because Wisconsin was short on MOE funds to begin with, further reducing its MOE-eligible expenditures only served to worsen the looming shortfall. Members of the state's Joint Finance Committee—a bicameral legislative committee—however, realized that part of the freed-up state general revenues could be used for a property tax cut, and the rest to expand certain programs for the state's low-income population. The funds used on these expanded programs serving the low-income population could then be used to meet the state's MOE requirement so there would be no shortfall.

The compromise resulted in increased investment of state funds in a variety of programs, even though some funds were diverted to a tax cut. The package presented during the negotiations afforded the opportunity to raise TANF spending on new programs even further, thereby increasing the state's investment on low-income families. Leadership stressed that these new programs could not have been funded during the 1999-2001 biennium in the absence of the compromise arising from the freed-up state general funds.

"New Spending Test" Augmented the Effect of TANF's MOE

States' dissatisfaction with the MOE generally arises because, in order to avoid strict financial penalties, they are forced to spend more on these programs than they otherwise may have spent. Moreover, the MOE's stimulative effect on new state spending is further enhanced by what is sometimes referred to as the "new spending test." The new spending test allows state spending on eligible programs to be counted toward the TANF MOE only to the extent that this "new" spending is on behalf of eligible families and it exceeds total spending in 1995 on those same programs. Therefore, a state that had a particular MOE-eligible program in effect pre-PRWORA may only count *new* expenditures on that program toward its MOE requirement, but a state that implemented a similar program after PRWORA may count the *entire* amount spent on the program towards its MOE.

The new spending test was particularly problematic for Michigan. The state had financed a low-income homestead tax with its own funds since 1973. However, because of the new spending test, only a portion of the credit counted towards its MOE requirement. As a result, state budget officials argue that the state is penalized, when compared to other states, for having a low income tax credit before TANF was enacted; a state with no tax credit could enact a new tax credit using only TANF funds.

Not only do some states find the new spending test overly restrictive, but some states are also concerned that the provision could become difficult to enforce. Compliance with federal financial requirements is generally certified annually through the Single State Audit.[14] We spoke to many auditors who were in the midst of developing audit plans to address compliance with the new spending test. Several told us that developing these plans was relatively straightforward; the auditor should simply be able to establish a baseline for all the MOE expenditures the state was claiming and then trace those programs back to 1995 and certify that spending claimed for MOE was indeed new spending. However, these plans could become more complex if states frequently changed the

[14]Rather than being a detailed review of individual grants or programs, a single audit is an organizationwide financial and compliance audit that focuses on accounting and administrative controls. A single audit is designed to advise federal oversight officials and program managers on whether an organization's financial statements are fairly presented and to provide reasonable assurance that federal financial assistance programs are managed in accordance with applicable laws and regulations. GAO supports the single audit concept for auditing federal assistance programs and believes it is the fundamental mechanism for testing compliance with expenditure provisions in TANF.

expenditures they were counting from one year to the next (i.e., changed the programs for which they needed baselines.) For example, auditors in California said that they would expect the lead TANF agency to certify the baseline for the new spending test and they would audit the certification. Because all expenditure data is archived after 5 years, auditing the annual certification would be especially difficult and time consuming if the state changes the programs it uses to meet its MOE requirement from year to year. Officials in Colorado and New York, states that expressly prohibit their counties from supplanting, also confirmed that enforcement of their own state prohibitions is weak and that compliance is very difficult to test. Furthermore, acquiring enough knowledge about every county's social services budget in order to establish a reliable baseline would be extremely costly and might outweigh the benefits.

Net Fiscal Effects of Funding Shifts Varied Among States

Once state funds are supplanted with federal funds they are "freed-up" and become part of the larger pool of general revenues. While budgets are a good blueprint to measure policy decisions, looking only at a specific change authorized in a budget may be misleading. For example, if a state supplanted federal funds for state funds, then shifted its own funds into other programs that serve the working poor, the net impact of these shifts would be the same as if they used federal funds directly to fund these other programs. Accordingly, the impact of the funding shifts must be viewed in a broader context consistent with the new objectives and goals of TANF. In fact, under our broadest definition of TANF-related social services, eight states maintained or increased their net investments in constant dollars for programs that serve low-income families and individuals as they move from welfare to work or strive to stay off public assistance rolls; only New York and Wisconsin decreased their net investment in these programs.

To provide a broader context for considering the effects of funding shifts, we reviewed state expenditures of both federal and state funds on a wide array of social service programs that target assistance to low-income individuals and families in order to help them avoid dependency on public assistance. We surveyed[15] states for their total expenditures on these programs in 1995 (to establish a prewelfare reform baseline) and for 2000 (to measure any change in total spending). We asked states to break down their total expenditures by funding source—state funds or federal funds. Under AFDC, the fiscal partnership between the federal government and the states was defined by the federal match rate each state received to help finance its welfare programs.[16] Under TANF, the block grant is fixed—states decide how much of the federal grant to spend and how much to save. First, a state decides how much to spend in total on a set of programs. Second, a state decides the right mix of federal and state funds (subject to the MOE limitation) to use to finance these programs. This "mix" is the new fiscal balance and representative of the share of funding from each partner—the states and the federal government. Essentially the state controls both the state and federal share. In our analysis, therefore, federal spending is not defined by the level of the TANF grant allocated to each state but rather by how much of the grant the state chose to spend.

Further complicating our analysis is the fact that the populations served by the AFDC program and the TANF program are dramatically different. Under AFDC, caseload was defined principally by the number of families receiving a cash assistance payment. Under TANF, however, there is no single definition of a "case." Because states are free to use TANF funds to finance programs with a variety of different eligibility requirements, caseload can vary by state, and even by program within a state. This means that while a family might be eligible for TANF-funded child care subsidies, the same family might not be eligible for—or request—monthly cash assistance benefits., Because cash assistance caseloads have fallen in recent years, a decline in welfare expenditures might be expected. It might be unreasonable, for example, to expect a state to maintain a higher level of expenditures on cash assistance while fewer people sought assistance.

[15]We adapted a survey developed by Deborah A. Ellwood and Donald J. Boyd of The Nelson A. Rockefeller Institute of Government for their report "Changes in State Spending on Social Services Since the Implementation of Welfare Reform: A Preliminary Report (for more information on our survey see appendix I of our report).

[16]Each state defined eligibility within federal guidelines and set benefit levels. The federal government paid from 50 percent to 79 percent of the costs.

However, because TANF is intended to serve a broader purpose than did AFDC, it is reasonable to expect that states might have used some TANF funds to invest in programs that serve the goals of TANF rather than use them to expand programs targeted only to the original AFDC population. Thus, it is appropriate to consider cumulative categories of welfare expenditures in order to understand how states financed the transition of low-income families from dependence to productive employment.

To this end, we grouped individual program spending into four cumulative categories:

- Basic welfare services: cash assistance grants, training programs, and diversion payments.
- Support for the working poor: category 1 programs plus programs that many states use to provide transitional assistance to working poor families, including child care subsidies, transportation subsidies, a state EITC, or low-income housing assistance.
- Health care: category 2 programs plus health care expenditures for low-income families and individuals.
- Other TANF-related social services: category 3 programs plus other TANF-related social service programs such as child welfare, transitional services for the developmentally disabled, substance abuse treatment, and mental health services.

In the body of this report, we discuss two key aspects of fiscal trends in 1995 and 2000: (1) state spending in each category in constant 1995 dollars and (2) the percent change in the state-financed and federal-financed portions of total expenditures. To observe a net change in spending within a category the impact of both measures must be assessed. For example, if a state increases state funding on a set of programs and federal spending increases by a larger amount (or the state draws down even more federal funds), the state-financed share of total expenditures would decrease even though the state's investment in dollar terms increased. Conversely, if a state reduced state spending for a particular set of programs on which the decrease in federal spending was larger, the state-financed share of total expenditures would have increased even though the state's investment in dollar terms decreased. So, in order to observe a net divestiture of state funds in our analysis, for example, two conditions must be met: (1) a state must have reduced its own spending in dollar terms from 1995 levels[17] and (2) the state-financed portion of total spending must have also declined from 1995.

Category 1: Basic Welfare Services

Under the most narrow definition of welfare (Category 1)—one in which the definition of a case is similar to that under AFDC prewelfare reform—total spending (federal and state combined) generally declined, but somewhat less than the dramatic decline in the number of cash assistance families. The correlation between spending and caseload is not perfect even in this most narrow definition of welfare spending. In large part this is because the orientation of most states' welfare programs towards jobs skills and job readiness programs required increased investments in work-related activities; as cash assistance budgets were declining, more recipients were required to participate in work or work-related training programs. Significantly, while spending dropped in this traditional category under TANF, a comparable caseload decline under the old open-ended matching design would have triggered a more substantial cut in spending because of the way in which AFDC was financed.

In eight states, total expenditures on these programs declined more than 35 percent in real terms although caseloads declined by more than

[17] We conducted our analysis in both nominal dollars and constant (real) 1995 dollars. While either basis leads to similar results, for clarity's sake, we discuss our findings in terms of real dollars throughout this report. A discussion in nominal dollars may be found in state appendixes II-XI.

45 percent over the same period. (See table 1.) The other two states—Texas and Louisiana—present a different picture. Spending in these two states with historically low benefit levels did not correlate with the states' caseload declines. Although caseloads declined by more than 50 percent in both states, total spending remained constant in Texas and declined by about 20 percent in Louisiana. As a result, spending per family more than doubled in both states. These two states also increased their monthly cash assistance grants—in 1999 Texas raised its monthly benefits for the first time in 15 years while Louisiana increased its benefits in 2000 for the first time since 1981. Although notable, this probably had little effect on overall spending trends in this category. A more likely influential factor was the rapid increase in new spending on employment and training.

Table 1: Changes in Basic Welfare Services

State	Percent change in total (federal and state) expenditures (State fiscal years 1995 - 2000)	Percent change in families receiving cash assistance (January 1995 to June 2000)
Colorado	-64	-72
California	-47	-47
Wisconsin	-46	-78
Oregon	-45	-58
Maryland	-44	-64
Michigan	-42	-66
Connecticut	-42	-55
New York	-37	-46
Louisiana	-21	-69
Texas	0	-54

Note: Percent change in total expenditures calculated using 1995 dollars.

Source: GAO survey and analysis of state expenditure data.

While all 10 states reduced their own spending on Category 1 programs, we observe more varied trends in terms of the fiscal partnership. (See table 2.) In 6 of the 10 states (see bolded text in table 2) the state-financed share of total expenditures declined relative to 1995 levels. Of the remaining four states, one maintained its share of spending, and three spent more of their own funds on these activities than the federal government relative to the 1995 ratios.

As noted above, a state's ability to alter the mix of federal and state funds used to finance its welfare program depends on whether or not it has enough expenditures in other programs—outside the narrow definition of basic welfare services—to meet its MOE requirement. Although the three states—New York, California, and Wisconsin—that increased their share of total expenditures on these activities in 2000 also reduced their own spending on these programs, they found that the MOE limited their ability to further divest funds.

Table 2: Category 1—State Expenditures on Basic Welfare Services (State Fiscal Years 1995 and 2000)

State	Percent change in state funds	Percent change in state-financed portion of total expenditures
Oregon	**-82**	**-22**
Colorado	**-76**	**-14**
Maryland	**-56**	**-9**
Connecticut	**-49**	**-6**
California	-44	+3
Michigan	-42	0
New York	-34	+4
Louisiana	**-28**	**-2**
Texas	**-22**	**-8**
Wisconsin	-4	+32

Note: Percent change in state funds calculated using 1995 dollars.

Source: GAO survey and analysis of state expenditure data.

Category 2: Support for the Working Poor

While six states reduced the level of state resources devoted to basic welfare programs (Category 1) in both constant dollar terms and as a share of total expenditures, many state officials suggested that states have used these "freed-up" resources to invest in new (or expand existing) programs using a broader definition of assistance to low-income families, such as child care programs; work-supports, such as a state-EITC; and other postemployment transitional services—essentially, support for the working poor (Category 2). When considering states' cumulative funding for this broader category, five states still divested some of their resources from these programs in terms of both constant dollars and percentage-share of total expenditures; Texas was the only state that did not reduce its own spending in dollar terms from 1995 levels —instead, it actually increased spending in dollar terms on Category 2 programs. (See table 3.) It is worth noting, however, that the states' share of total spending in these five states declined less than those observed in Category 1. Moreover, states' shares for this category are cumulative and reflect both their shares in Category 1 and Category 2. When looking at the spending for Category 2 alone, some states with large reductions in Category 1 programs significantly increased funds for programs that were added to the analysis in Category 2—i.e., programs that more broadly support the working poor. For example, in Colorado, state spending declined by 76 percent in Category 1 compared to only a 7-percent decline in Category 2. Because state spending tripled on child care and other work support programs—programs appearing in our analysis for the first time in Category 2—the declines observed in Category 1 were largely offset.

Table 3: Category 2—Expenditures on Programs Supporting the Working Poor (State Fiscal Years 1995 and 2000)

State	Percent change in total funds	Percent change in state funds	Percent change in state-financed portion of total expenditures
New York	-25	-20	+5
Connecticut	**-19**	**-21**	**-2**
California	-15	-12	+2
Oregon	**-12**	**-32**	**-7**
Wisconsin	-11	-11	0
Maryland	**-9**	**-17**	**-4**
Michigan	-4	-4	0
Colorado	**+2**	**-7**	**-3**
Louisiana	**+2**	**-7**	**-2**
Texas	+28	+11	-6

Note: Percent change in total and state funds calculated using 1995 dollars.

Source: GAO survey and analysis of state expenditure data.

Category 3: Support for the Working Poor and Related Health Care Costs

State officials cite many other budget priorities that have demanded their attention in recent years. Many of these priorities also benefit low-income families but are not included in Categories 1 and 2 of our analysis of spending under welfare reforms. For example, some states expanded health care services for low-income families and their children. During the time frame of our study, the federal/state partnership to provide health insurance to low-income children (The State Children's Health Insurance Program—SCHIP) was enacted. In addition, Wisconsin and Oregon began enhanced Medicaid programs for low-income individuals not eligible for Medicaid. In Oregon, total health care spending for the low-income working poor tripled since 1995 while the state-funded share of these costs more than doubled.

Although TANF funds cannot be used directly to expand access to Medicaid and there are limitations on the states' ability to use their MOE funds to expand access to Medicaid, we asked states to report on certain health care expenditures given the importance of this key benefit in helping people move into the workforce. Specifically, we asked states to provide expenditure data on their health care-related costs for low-income individuals but asked them to exclude any costs associated with their elderly population, including long-term and institutional care. State funding for low-income health programs is generally driven by the federal matching requirements of programs such as Medicaid and SCHIP rather than the TANF program. Accordingly, from this point forward in this report, any observable shifts in the federal/state fiscal balance cannot be solely attributed to changes brought about through the flexibility of the TANF block grant or its MOE requirement. Nevertheless, our study still reflects the use of freed-up funds from welfare programs to finance new or expanded programs in health care for the same population.

Total spending on the cumulative costs of basic welfare services plus other programs supporting the working poor, including their health care costs (Category 3), continues to vary considerably among the states. Nevertheless, as we broaden the scope of our analysis, states appear more likely to have maintained or increased their investments in these programs. (See table 4.) Accordingly, only three states (see bolded text in table 4)—as compared to six states in Categories 1 and 2—appear to have reduced their investments in both constant dollar terms and as a percentage share of total funds. Three states have increased their investment in these programs, two (Michigan and California) have maintained the fiscal balance, and while the remaining two states (Maryland and Texas) shifted the fiscal balance slightly in their favor, they nevertheless increased their own investment in these programs in dollar terms.

Table 4: Category 3—Expenditures on Programs Supporting the Working Poor and Related Health Care Costs (State Fiscal Years 1995 and 2000)

State	Percent change in total funds	Percent change in state funds	Percent change in state-financed share of total expenditures
Connecticut	**-10**	**-11**	**-1**
California	-6	-7	0
New York	**-2**	**-9**	**-5**
Michigan	-1	-1	0
Wisconsin	**+2**	**-3**	**-2**
Louisiana	+2	+8	+1
Texas	+12	+11	-1
Maryland	+16	+12	-1
Colorado	+46	+56	+3
Oregon	+72	+81	+2

Note: Percent change in total and state funds calculated using 1995 dollars.

Source: GAO survey and analysis of state expenditure data.

Because money is fungible, this analysis cannot determine with any certainty whether the particular state funds freed up by TANF funds were used to finance expansions in health care for low-income individuals or families. However, it does show that in five states state funding increased in dollar terms for these programs over the study period. In fact, in Oregon and Colorado, total expenditures on health care increased dramatically and the state share of total expenditures slightly increased relative to the federal share. Only three states (see bolded text in table 4) reduced their investments in these programs in constant dollar terms as well as in terms of the state-financed share of total expenditures.

Category 4: TANF-Related Social Services

We further expanded the definition of assistance to test whether states may have used their freed-up funds to expand other social service programs for low-income families by asking states to report their expenditures in 1995 constant dollars on a wide range of services, including child welfare, mental health services, substance abuse programs, and programs designed to help the developmentally disabled become more self sufficient (Category 4—Other TANF-related Social Services). Again, we asked states to exclude any costs that were not transitional in nature, such as costs associated with long-term institutional care.

As expected, states continue to be more likely to have maintained or increased their fiscal commitments to Category 4 programs—the most macro level of our analysis. (See table 5.) Only two states (see bolded text in table 5)—compared to three states in Category 3—appear to have reduced the amount of funds invested in these programs in terms of constant dollars and percentage share of total funds. Eight states increased their investment in this broad program area. In terms of the overall fiscal balance between the federal government and these eight states, most maintained or increased the state-financed share of total expenditures relative to 1995 levels.

In some states the analysis provides a dramatically different picture as we consider broader definitions of spending categories. For example, in Category 1 programs, of the 10 states in our study, Oregon and Colorado displayed the most severe spending reductions in both constant dollar terms as well as percentage share of total expenditures: -82 percent (dollars) and -22 percent (share); and -76 percent (dollars) and -14 percent (share), respectively. In Category 4, however, these same states show the most dramatic increases in investments in these programs: 42 percent (dollars) and 52 percent (share) in Colorado; and 61 percent (dollars) and 65 percent (share) in Oregon.

Table 5: Category 4—Expenditures on TANF-Related Social Services for Low-Income Families and the Working Poor (State Fiscal Years 1995 and 2000)

State	Percent change in total funds	Percent change in state funds	Percent change in state share
New York	**-4**	**-11**	**-5**
Connecticut	-1	+2	+2
Louisiana	+5	+13	+2
California	+5	+5	0
Wisconsin	**+7**	**-1**	**-4**
Michigan	+13	+15	+1
Maryland	+17	+11	-3
Texas	+19	+17	-1
Colorado	+42	+52	+3
Oregon	+61	+65	0

Note: Percent change in total and state funds calculated using 1995 dollars.

Source: GAO survey and analysis of state expenditure data.

States' Contingency Plans Are Undeveloped

Paradoxically, while much attention has been placed on whether states have replaced their own spending with federal funds, states have also been under considerable scrutiny for not spending their TANF funds more quickly. Finding the right balance between saving for future needs and investing resources today in programs to help people make the transition from welfare to work continues to be one of the main challenges states face as they develop strategies to address the needs of low-income families. If states wish to set aside reserves for future welfare costs, they have two options: they can save federal TANF funds or they can save their own funds. If they elect to save federal TANF funds, they must keep these funds in the U.S. Treasury until the funds are needed.

As of September 30, 2000, states reported leaving $8.6 billion in unspent TANF funds at the U.S. Treasury; this amounts to 13.5 percent of the total TANF funds awarded since 1997. HHS reporting requirements do not ask states to signal their intentions for these funds. As a result, congressional decisionmakers lack reliable information on whether states are saving adequately for a "rainy day." However, the disparity in the reported balances among the states suggests that some states may not be well prepared to address any increased demand in their welfare programs while others may have saved substantially more than they might need. Although 5 of the 10 states in our study consider a portion of their unspent funds to be "rainy day funds," it does not appear that the amounts designated as reserved were calculated based on any sort of contingency planning or analysis.

Impact of External Factors on TANF Caseloads Is Uncertain

As we previously reported, it is unclear what impact a major economic downturn or recession will have on welfare participation given the significant reforms in national welfare policy.[18] While research literature generally suggests that caseloads will rise in an economic downturn, there is substantial uncertainty regarding the extent of the increase. However, any increase in caseload will almost certainly mean higher costs.

During a fiscal crisis, state policy makers face difficult choices regarding whom to serve, for how long, and with what services. Each of these "hard choices" must be financed in the context of fiscal limitations—including legislative restrictions, constitutional balanced budget mandates, or

[18] *Welfare Reform: Challenges in Saving for a "Rainy Day"* (GAO-01-674T, April 26, 2001).

conditions imposed by the bond market—on a state's ability to increase spending, especially in times of fiscal stress. For example, revenues may come in lower than expected during an economic downturn and a state's enacted budget can fall into deficit. State balanced budget requirements often motivate states to both reallocate resources within their budgets and cut program spending or increase taxes during recessions. This can exacerbate budgetary stress caused by caseload volatility.

For these reasons prudent fiscal planning, especially contingency budgeting for a fiscal rainy day, becomes particularly important. In general, during any sort of fiscal crisis, a state's need to cut spending or increase revenues can be alleviated if it has accumulated surplus balances in rainy day funds—these surpluses may be used to cover a given year's deficit.[19] However, unless there are reserves specifically earmarked for low-income families, welfare programs will have to compete with other state priorities for any of the rainy day funds. Since the fiscal risks of welfare programs have now largely shifted to the states, it is reasonable for Congress to inquire as to whether states are prepared for these risks.

Data on State Reserves Have Significant Limitations

Although many might view the unspent balances left at the U.S. Treasury as a "de facto rainy day fund" for future welfare costs, states do not report unspent balances in a consistent manner. This makes it difficult to ascertain how much of these balances are truly uncommitted and therefore available for future contingencies. As a result, federal policymakers lack complete, reliable information to help assess states' plans for economic contingencies, including whether the levels of available funds are adequate, and whether all states have access to these funds.

Current Reporting Requirements Do Not Clarify the Nature of State Reserves

Reporting requirements should enable collection of data that will assist policymakers in their oversight responsibilities. However, largely because welfare administrative structures differ dramatically across states, information on unspent TANF balances is not compiled in the same way in all states. This makes it difficult to ascertain how much of these balances are truly uncommitted and therefore available for future contingencies. As a result, the information on unspent balances is not comparable, and provides little useful information on the nature and adequacy of states' resources for future fiscal risks.

[19]For additional information, see *Budgeting for Emergencies: State Practices and Federal Implications* (GAO/AIMD-99-250, September 30, 1999).

HHS regulations regarding *unobligated* and *unliquidated* balances also contribute to a lack of clarity.[20] Under HHS regulations, if a state has allocated a portion of its TANF grant to a rainy day fund, the state must report these balances as *unobligated*. However, *unobligated* balances include more than these rainy day fund allocations. These balances can also include funds for which the state has made no spending plans or funds the state has reserved for activities in future years. As a result, it is impossible to tell from the *unobligated* balances alone whether a state has contingency plans. For example, in developing a budget for a new child care program, officials in Wisconsin assumed that once the program was fully subscribed it would require all available resources—including any *unobligated* TANF funds from previous fiscal years. State officials said that even though at the end of federal fiscal year 2000 the state reported $40 million TANF funds as *unobligated*, the state has programmed these funds to pay child care subsidies to low-income families in future reporting periods.

Unspent TANF funds may also be reported as *unliquidated obligations*. These are funds for which, to varying degrees, an underlying commitment exists for the funds—either through a contract for services for eligible clients or to a county for expenses it will incur in operating a county-administered welfare program. However, it is unclear how much of these unspent balances are actually committed for future needs. For example, both California and Colorado have county-administered welfare systems. These states pass most of their annual block grants directly to the counties. As caseloads have continued to decline in both states, the budgets over-estimated actual expenditures leaving considerable balances. Although these funds remain in the U.S. Treasury until the county needs to spend them, they remain as *unliquidated obligations* committed to the counties. California reports that it has over $1.6 billion in unliquidated TANF obligations but only about $2.5 million in *unobligated balances*, implying that nearly all these funds are earmarked. Recently, California amended its state statute to allow the state to re-obligate some of these funds, if necessary, among counties. Colorado, which reported about $95 million in *unliquidated obligations* as of September 30, 2000, and passes virtually all TANF resources to the counties, did likewise. As of June 30, 2000 the state

[20]Under HHS regulations the states use two categories to report on the status of their unspent TANF funds: (1) *unobligated balances* represent funds not yet committed for a specific expenditure by a state and (2) *unliquidated obligations* represent funds states have committed but not yet spent.

estimated that counties hold about $67 million in reserves, or about 70 percent of the total *unliquidated obligations*, for future contingencies.

As the above examples illustrate, the difference between *unobligated balances* and *unliquidated obligations* is often unclear, and varies by state. A significant portion of California's and Colorado's *unspent funds* are not yet actually committed for a specific expenditure but these facts cannot be determined based on the aggregate data—in part because of the way HHS requires states to report funds. Reporting a significant share of their unspent balances as *unliquidated obligations* implies that there is an underlying commitment on these funds when, in fact, these funds are no more committed than the funds Wisconsin must report in its *unobligated balances* but which are budgeted for expected outlays in Wisconsin's child care subsidy program.

California Holds Reserves in Counties

In addition, we found that in California, the confusion regarding the proper reporting of certain expenditures further blurs the aggregate levels of unspent TANF balances. California has transferred more than $1 billion of the state's TANF dollars to its counties in the form of incentive payments—yet these funds remain unspent and are on deposit in county bank accounts. As noted previously, California relies on its counties to define welfare priorities at the local level, and California transfers most of its federal funds to the counties to finance programs that help make the transition from welfare to work. For most services the counties receive federal funds as they need them and until that time the funds remain in the federal Treasury. However, one state program pays counties incentive payments that are designed, in part, to motivate the counties to help the state meet certain TANF performance goals. Specifically, the state makes awards to its counties based on the number of welfare cases that have left the rolls for employment and the number of cases the counties have diverted from the rolls and are employed. To date the counties have received awards totaling more than $1 billion. These funds are federal TANF funds that have been drawn from the U.S. Treasury and deposited into county bank accounts.

According to state law, counties must spend these funds on TANF-related purposes. The state has also issued guidance to the counties that any interest earned while these funds are on deposit must be reinvested into the TANF program. Apart from the aforementioned guidance, state statute defers to the counties regarding how best to use the funds. While state officials have said that these incentive payments were not intended for counties to use for contingency budgeting, counties are not prohibited from using these funds to cover unexpected costs if needed.

In February 2001, state officials reported that counties have spent only $46 million—about 4 percent—of these funds. This means counties in California have about $1 billion in unspent TANF funds on account that are not included in the "unobligated balances" totals reported to HHS. HHS believes that California could be in violation of CMIA which seeks to limit the interest costs to both federal and state governments by coordinating the timing of a states' draw down from the Treasury with the timing of the state's expenditure needs. This coordination ensures that the timing of a state's draws do not favor either party and neither partner incurs unnecessary interest costs. California maintains that these payments are valid expenditures to service providers—their counties—under a performance-based agreement to administer welfare services.

Improved Reporting Requirements Could Improve Federal Oversight and Provide States With Incentives to Save

The lack of transparency regarding states' plans for their unspent TANF funds prompted us in 1998 to recommend that HHS and the states work together to explore options for enhancing the information available regarding these balances.[21] Although HHS, the National Governor's Association (NGA), and the National Conference of State Legislatures (NCSL) all agreed with us that more information regarding unspent TANF balances would be useful, little progress has been made in implementing this recommendation, and HHS' final regulations, issued on April 12, 1999, did not address the issue. States were already concerned that the TANF reporting requirements would pose a substantial burden on state program administration and argued that adding another reporting requirement to allow states to signal their intentions for their unspent balances would only add to those burdens. However, the lack of useful information on these balances continues to weaken the effectiveness of congressional oversight over TANF funding issues, including how well prepared states may be to address a fiscal downturn.

[21] *Welfare Reform: Early Fiscal Effects of the TANF Block Grant* (GAO/AIMD-98-137, August 18, 1998).

Our 1998 recommendation proposed a strategy that state and federal officials had tried before and found to be successful. In 1981, a number of categorical grants were block granted to states to provide maximum flexibility in developing and managing programs, along the same lines that TANF was designed in 1996. However, due to variations in the way states reported information to the federal government on activities funded by some of these block grants, Congress had no national picture of the grants' impact. States and some national organizations recognized that these aggregate data were important and developed their own strategies to collect the data.[22] We found that a cooperative data collection approach was easier to implement when (1) there was federal funding to support data collection activities, (2) national-level staff worked with state officials, and (3) state officials helped in systems design. We continue to believe that better information on the status of these unspent balances is crucial to effective oversight and could even enhance states' incentives to save some of their TANF funds. Absent credible information on balances, there may be a greater risk that Congress could take action to recoup TANF funds—a prospect that has prompted some states to draw down and spend their TANF funds rather than leave them in the Treasury.

Contingency Planning Receives Little Attention as States Cite Few Incentives to Save

As we have previously mentioned, states can save for a rainy day in two ways: they can save federal TANF funds and/or they can save their own funds. However, states have noted significant disincentives with both options. As previously noted, state officials voiced concern that accumulating unspent federal TANF balances might signal that these funds are not needed and that they have been under considerable pressure to spend their TANF grants more quickly. Similarly, although some states have accumulated a portion of their own funds in general purpose state rainy day funds, these funds are not a guaranteed safety net—welfare would have to compete with other programs for these dollars in the event funds are needed. Moreover, dedicated state-funded welfare reserves are expensive because these funds cannot count towards a state's MOE.

Although some states consider portions of their *unobligated* TANF balances to be rainy day funds, it does not appear that the amounts reserved were based on any kind of contingency planning or analysis by the

[22] *Block Grants: Federal-State Cooperation in Developing National Data Collection Strategies* (GAO/HRD-89-2, November 29, 1989) and *Block Grants: Federal Data Collection Provisions* (GAO/HRD-87-59FS, February 24, 1987).

state. According to NGA, few states have engaged in a systematic fiscal planning process to project their needs under a variety of economic scenarios. Our review of 10 states supports NGA's findings. Five of the 10 states we studied told us that they consider a portion of the funds left at the U.S. Treasury to be rainy day funds for unanticipated program needs. But the levels of the reserves established in those five states do not appear to have been determined through a fiscal planning process that reflects budgetary assumptions about projected future needs. Instead, these states merely designate residual TANF funds not already appropriated by the state legislature for other purposes as constituting the state's welfare rainy day fund.

Although many states have healthy general-purpose rainy day funds for which all programs would compete for funds during times of fiscal stress, only one of the states in our review, Maryland, has earmarked state funds in a reserve specifically for contingencies in its welfare program. Reserving funds specifically for welfare requires state decisionmakers to make trade-offs among competing needs. Any funds a state sets aside for future welfare contingencies cannot count toward a states' maintenance of effort in the year they are reserved—in order to qualify as MOE, the funds must be spent. As a result, it is a very expensive proposition indeed for a state to budget both for a welfare reserve and to meet its MOE.

In state fiscal year 2001, Maryland identified nine program accounts with annual expenditures of state funds totaling about $30 million that, under the broad and flexible rules governing TANF expenditures, could be funded with federal funds. In developing the budget, the state replaced these state funds with federal funds. Instead of using the "freed-up" state funds for nonwelfare activities the state used them to establish a dedicated reserve for its welfare program. In effect, Maryland was able to draw down federal funds and save them for future needs rather than use those funds to expand existing or create new programs.

Design of Federal Contingency Mechanisms Is Complex and Restrictive

While the ability to carry forward TANF balances is likely viewed as the principle mechanism by which states can prepare for a rainy day, PRWORA also created two safety-net mechanisms for states to access additional federal resources in the event of a recession or other emergency—the $2 billion Contingency Fund for State Welfare Programs (Contingency Fund) and the $1.7 billion Federal Loan Fund for State Welfare Programs (Loan Fund).

The Contingency Fund is authorized through 2001, at which time it expires. The President's FY 2002 budget proposal did not include a request to reauthorize the Contingency Fund. Because of a provision in the Adoption and Safe Families Act of 1997 that reduced the TANF Contingency Fund by $40 million, the current balance in the Contingency Fund is $1.96 billion.[23] States are deemed "needy" and eligible to receive funds from the Contingency Fund if they trigger one of two criteria: (1) the state's unemployment rate exceeds 6.5 percent for 3 months and is equal to at least 110 percent of its rate in the same period of the previous year or (2) its average monthly food stamp caseload for the most recent 3-month period is equal to at least 110 percent of the average monthly caseload from the same 3-month period in fiscal year 1994 or 1995. Once eligible, a state must certify that it has increased its own current spending to prewelfare reform levels before it can gain access to the fund.

Requiring states to increase their own financial stake in their welfare programs before giving them additional federal funds is, in principle, a reasonable approach that seeks to balance both the federal government's interest in ensuring that states in trouble have access to additional funds and its interest in ensuring that states have done everything possible to address the shortfalls before turning to the federal treasury. However, this could prove to be too demanding. Not only does the statute require states to bring their spending up to the prewelfare reform levels at a time when states are experiencing fiscal stress, but PRWORA establishes a different and more challenging base for the Contingency Fund's MOE. While a state's MOE requirement under the basic TANF program can include state funds expended under certain state programs (known as "separate state programs") and child care expenditures, the MOE requirement for the Contingency Fund does not include these items. Because states spend a significant share of their MOE funds on activities that do not qualify as Contingency Fund MOE expenditures, state budget officials told us that, rather than shifting their spending priorities to meet the Contingency Fund MOE, they would find other ways to manage deficits in their TANF budgets before they would consider turning to the Contingency Fund.

[23]The Adoption and Safe Families Act of 1997 reduced the contingency fund for state welfare programs by $40 million over four years (P.L. No. 105-89, §404, 111 Stat. 2134).

In 1997 seven states[24] and the District of Columbia qualified for contingency funds. However, only two states requested and were awarded contingency funds—North Carolina and New Mexico. In the end, only New Mexico complied with the Fund's requirements and accepted $2 million. No state has used the Fund since 1997.

Equally important as the requirement that states raise their own financial commitment in order to gain access to additional federal funds is a requirement that states share in all additional program costs—even beyond the MOE requirements. Requiring a match encourages states to be more cost-conscious than if the costs of an expanding caseload were covered only with federal dollars. While the Contingency Fund requires states to match all federal dollars at the states' FMAP rate,[25] the statute goes a step further. The statute limits the monthly draws to one-twelfth of 20 percent of a state's annual block grant. This limitation requires a complex annual reconciliation process to certify that the state meets its matching requirement but also that it did not receive more than its monthly proportional share of contingency funds. (See figure 3.)[26] Prorating a state's draws from the Contingency Fund—especially if the state qualifies for a period that spans 2 federal fiscal years—reduces the share of federal funds to which it is entitled. This effectively increases the matching requirement (even higher than required under AFDC), thus raising the state's costs for gaining access to the funds.

[24]These states are Alaska, California, Hawaii, New Mexico, New York, North Carolina, and Washington.

[25]Under AFDC, state spending was matched at a rate based on each state's per capita income. This rate, FMAP, is also used for other federal-state matching programs such as Medicaid. It ranges from 50 percent for wealthy states to 83 percent of poorer states.

[26]For more information see *Welfare Reform: Early Fiscal Effects of the TANF Block Grant.*

Figure 3: The Contingency Fund's Annual Reconciliation Process

As currently structured, the reconciliation process favors states that are "needy" within a single federal fiscal year compared with those that are "needy" in months that overlap consecutive federal fiscal years. A state that is needy for all 12 months during a federal fiscal year would have to match all funds drawn at its applicable fiscal year FMAP rate with no adjustments for the number of months it was eligible because it was needy throughout the year. However, a state that is "needy" for 12 consecutive months that span 2 federal fiscal years (e.g., 6 months in each year) with an identical FMAP rate will see its federal match rate reduced by half because of the adjustment made for the number of months the state was needy in each year.

To illustrate, the state that was needy for an entire federal fiscal year and was eligible for and had drawn $20 million of contingency funds would be able to retain these funds, provided the state had spent the necessary matching funds. In contrast, the state that qualified as needy for the same number of months and was eligible for the same amount from the contingency fund but overlapping 2 fiscal years would initially obtain $10 million in each year, reflecting its 6 months of eligibility in each year, but then the state would have to remit half of these funds after each year's reconciliation. This latter reduction is the result of prorating the state's grant by the number of months it was eligible for contingency funds, even though the state's initial claim for each year was already based on the number of months of eligibility. As a result, the second state would be allowed to retain a total of $5 million of federal funds in that fiscal year, $5 million of federal funds in the next fiscal year—a total of $10 million even though its eligibility over these 2 years was the same as the state receiving $20 million. In addition, the second state would have to meet the contingency fund MOE in both years.

Unlike the Contingency Fund, the Loan Fund does not have triggers. Instead, states that have not incurred penalties for improper use of TANF funds are eligible for loans from the Loan Fund. Such loans are to have a maturity of no more than 3 years at an interest rate comparable to the current average market yield on outstanding marketable obligations of the U.S. Treasury with comparable maturities. Some state officials told us that they are eligible for better financing terms in the tax-exempt municipal bond market. More important, officials in some states indicated that borrowing specifically for social welfare programs in times of fiscal stress would not receive popular support.

In summary, neither the Contingency Fund—as currently designed—nor the Loan Fund is likely to be used by states in a fiscal crisis to obtain more resources for their welfare programs. The Loan Fund is most likely the wrong mechanism to provide assistance to states in a fiscal crisis. However, if the Contingency Fund is reauthorized, Congress could also contemplate improvements to enhance its usefulness in addressing budgetary shortfalls in states' welfare programs that, at the same time, could provide stronger incentives for states to save for a rainy day.

Concluding Observations

While addressing the needs of low-income families remains a joint federal-state responsibility, TANF changed the nature of the fiscal relationship between federal and state governments in this area. As we have reported in the past, block grants prompt trade-offs between federal and state control over program finances, accountability, and administration. The challenge is to strike a balance between providing states with the reasonable flexibility and discretion needed both to achieve efficiencies and to adapt federal programs to differing local needs while at the same time retaining accountability for achieving certain broad national goals. While policy-makers should use data on state spending and performance when designing any grant program, the design of block grant programs ultimately involves philosophical judgments about the proper roles and relationships among levels of government in our system.

Within this context, Congress will consider trade-offs in the fiscal design of the TANF program as it moves to reauthorize the program. The design of the grant—its fiscal requirements, allocation provisions, funding flexibility, and accountability provisions—has an important bearing on the federal-state fiscal balance. By shifting from an open-ended matching to a closed-ended block grant program, TANF shifted greater fiscal responsibilities to the states for allocating both federal and state resources across activities and for bearing the fiscal risks associated with the impacts of an economic downturn on program needs. The design of the TANF grant enabled the states to reduce their spending to a moderate extent as caseloads declined, with a floor established by the MOE requirement. The grant level was also high enough to permit states to plan ahead and perhaps create reserves for use should case levels increase in less robust economic periods. The higher grant levels arguably should inspire states to create reserves for the future in order to avoid fiscal stress during less robust economic times.

Reflecting on the states' fiscal activities in the past 5 years, our study can help provide insights on key fiscal design questions for the reauthorization debate:

- How has the fiscal design of the program affected the balance of fiscal responsibilities between federal and state governments in terms of addressing the goals of the program; what effects might proposed changes have on this balance?
- Does the program enable or promote the saving of reserves at both federal and state levels to address a future "rainy day"?

Federal/State Fiscal Balance

In a previous study on the design of federal grant programs, we noted that federal grants do not necessarily have the effect of augmenting spending in aided areas on a dollar-for-dollar basis, since a portion of the federal funds are often used by states to replace some of their own funds. We observed that several factors influenced the potential for fiscal substitution including (1) the breadth of activities for which the grant can be used, (2) the presence and design of MOE and/or nonsupplant provisions, and (3) the extent of states' prior investment on the aided activities. Under TANF, each of these factors has, in fact, played an important role in defining the new fiscal balance between federal and state governments.[27]

Our study suggests that states did reduce their support for basic welfare services in the face of declining caseloads, with the federal government picking up a greater share of the costs for this narrow category of activity. Replacing state funds with TANF funds was a common budgetary practice in all 10 of the states, and entirely legal under the federal program. At the same time, when looking at the broadest level of TANF-related social services, it is apparent that most states have maintained or even increased their own investment over time to address the overall needs of low-income families.

The design of the grant influenced these results. The increased flexibility in TANF increased the potential for states to use federal funds in areas of traditional and long-standing state support. However, that same flexibility also enabled states to focus their efforts on TANF's broader goals of supporting work and self-sufficiency for low-income families.

The absence of a nonsupplant provision for TANF funds—similar to the "new spending test" on state MOE funds—permitted direct substitution of federal for state funds. However, even with this substitution, the range of activities eligible for TANF funding was broad enough to enable states to identify enough state-funded activities to meet their MOE. Unlike a nonsupplant provision, the MOE was not designed to stop reallocation of state funds within TANF-eligible services. Instead, it was intended to limit the extent to which states could use federal funds for fiscal relief. Indeed, it appeared to play a strong role in limiting the degree to which states could reduce their spending to fully reflect the sharp drop in cash assistance caseloads.

[27] *Federal Grants: Design Improvements Could Help Federal Resources Go Further* (GAO/AIMD-97-7, December 18, 1996).

If states used TANF funds to replace state funds counted for MOE, they had to increase their own spending on other low-income programs to satisfy the MOE requirement. Moreover, even though MOE permitted states to reduce their spending by 20-25 percent from the base year, it can be argued that the requirement caused some states to spend more than they otherwise would have spent in light of the more than 50 percent drop in caseloads. Given the impact that MOE appears to have had on state spending to date, any changes in the level and design of this requirement could have major consequences for the federal-state fiscal balance for this program.

That different observers and actors will have different views of supplantation is to be expected. Some would argue that allowing supplantation of any kind increases the likelihood that states could weaken their commitment to the core services (e.g., cash assistance) on which low-income families depend most and shift more of the financing for these services to the federal government under the guise of program flexibility. Potentially, supplantation permits states to convert federal TANF funds into a kind of general revenue sharing program with very little incremental impact on poverty. Although most states did supplant within the narrowest category of spending in our analysis, given the stated purposes of PROWRA, this is too narrow a perspective. Since TANF is intended to serve the broader purpose of helping low income families achieve greater levels of self sufficiency, the focus should be not only on how specific grant funds were spent but rather on how states allocated federal and state funds more broadly to address this outcome. Accordingly, focusing on the act of supplantation alone in the narrowest category of spending provides a misleading perspective of the fiscal impact of the program. A more complete analysis would address the impact of the states' broader fiscal actions on the goals of TANF.

These differing perspectives inform the debate over whether or not to add a nonsupplant provision to the TANF program during reauthorization. Some argue that creating a nonsupplant provision similar to that found in other federal grant programs would help ensure that all federal funds supplement existing state spending. While the program's MOE provision places a floor under state spending for the broad area of assistance to low-income families, a nonsupplant provision would be aimed at preventing states from using federal funds to replace state funds for specific activities. Some have argued that the absence of a nonsupplant provision undermines the goal of the "new spending test" because this test applies to activities states count toward MOE but not to activities on which federal TANF funds are spent.

However, any consideration of a nonsupplant provision should recognize that such a provision could have significant adverse effects as well. Such a provision would penalize states that took the initiative to start programs before the federal TANF program became available. The states that began programs using state funds before the federal grant would be locked in to maintaining their own spending commitments to these activities while other states without such prior commitments could fund such activities entirely with federal dollars. Thus, a nonsupplant provision not only would appear to reward states for inaction but also could serve to induce states to defer program innovation until federal funds become available. In this context it is worth noting that in our study, supplanting tended to be concentrated in states with prior investments in programs supporting the working poor; states with relatively low levels of state effort did not have the kind of investment that prompted supplanting in the first place. Given this perspective, supplantation could be seen as rewarding these states for their past fiscal initiative without further reducing benefits in low-effort states.

Once accountability shifts to the broader goals supported by the block grant program, many would argue that states should have the flexibility to shift funds across activities within the broader umbrella of social services for lower income families to best meet the broad goals of the program. Indeed, states in our study took advantage of this flexibility by using TANF funds to free up state funds to fund broader activities supporting low-income families. Just as the absence of a nonsupplant provision creates the potential for the grant to become a general fiscal relief program, the presence of such a provision might limit the intended breadth of the block grant by locking states into pre-established funding priorities. From this perspective, a broad-based maintenance-of-effort provision—such as the TANF MOE requirement—calling for states to maintain spending across a wide range of relevant programs might both limit substitution while providing greater state discretion than a traditional nonsupplant requirement.

Whether or not Congress imposes a nonsupplant provision regarding TANF funds, given the intent of the block grant, federal oversight should focus on the broader fiscal balance, i.e., the way states use multiple federal and state funding streams to support the overall goals of the program. As we have said, focusing on more narrow categories of spending can be misleading for broad purpose grants;[28] federal funds for any one specific program tend to lose their fiscal identity and become integrated with funds from related federal and state programs. Furthermore, in the case of TANF, the performance outcomes call for states to bring to bear a wide range of related federal, state, and local funding streams to make a difference for low-income families. Accordingly, periodic reporting for the entire federal-state fiscal effort is important. As we have said, we found that states generally maintained or increased their support for the broadest category of assistance for low-income families. However, it will be important for the Department of Health and Human Services periodically to gather information on these broader measurements of the federal-state fiscal balance so that Congress can monitor this important indicator in the future, particularly as the economy changes and potential caseload demands for programs and services increase.

HHS should undertake this effort in concert with states to ensure that the reports accurately reflect a broader fiscal picture. Although such reporting may constitute an additional burden to the states, following a select sample of states over a period of years and relying on independent researchers to gather the data across consistent categories every few years could mitigate such burdens. Further, states have an interest in maintaining congressional confidence in the quality of this information. The past history of block grants at the federal level suggests that nationally consistent information is often necessary to maintain support within Congress for continued funding and flexibility. In the absence of uniform information, policymakers can lose confidence in state implementation and are often pressed to intervene in block grant programs based on examples that may not be representative of states' overall track record.

Planning for Future Contingencies

Both the states and the federal government have a significant interest in preparing TANF to meet challenges in times of fiscal distress. While the shift from the open-ended match of AFDC to the fixed-dollar TANF block

[28]For more information, see *Grant Programs: Design Features Shape Flexibility, Accountability, and Performance Information* (GAO/GGD-98-137, June 22, 1998)

grant under PRWORA provided states with increased program flexibility, and sometimes, fiscal relief, it also increased the states' exposure to fiscal risks in the event of an economic downturn or increased program costs. Clearly, this gives states an interest in planning for future needs. Similarly, the fact that the federal government recognized its continued federal role in assisting low-income families, coupled with the fact that those states that fail to engage in contingency planning could, when faced with fiscal pressures, turn to the federal government for help creates a federal interest in the viability of TANF in times of economic stress.

In testimony this past April we offered for congressional consideration several options that might improve the federal contingency mechanism as well as strengthen states' incentives to "save for a rainy day."[29]

Options to Improve the Federal Contingency Mechanism

The Contingency Fund, as currently designed, has not proven to be an inviting option to the states that have actually experienced fiscal stress to date. Should Congress decide to reauthorize the Contingency Fund, consideration could be given to approaches that could both improve the usefulness of the fund for hard pressed states as well as ensure that states contribute their fair share to future welfare costs. Such approaches could include (1) eliminating the more restrictive the Contingency Fund-MOE and substituting the more flexible basic TANF-MOE and (2) eliminating the Monthly Payment Limitation (MPL) on the amount of contingency funds to which each state has access. These actions could help strengthen the role of the Contingency Fund in state contingency budgeting.

Realigning the MOE and eliminating the MPL would make the Fund more accessible and, therefore, more responsive. If states had better access to federal contingency funds, they might be more likely to use the money when needed. However, greater accessibility must be balanced by fiscal responsibility. It is important to be mindful of this balance so as not to make it too easy for states to access federal contingency funds because they might be less likely to save for a rainy day on their own, which could pose risks to the federal Treasury. The changes discussed above would still require states to increase their own spending to pre-TANF levels (i.e., meet a 100-percent MOE) to gain access to the Contingency Fund—a higher level than they must maintain for the regular TANF program—as well as provide a matching share for the additional federal funds. By broadening the fiscal base that states can draw upon to meet this higher MOE, these changes

[29] *Welfare Reform: Challenges in Saving for a "Rainy Day"* (GAO-01-674T, April 26, 2001).

might not only make the fund more accessible in times of need but prompt states to save their own funds in anticipation of accessing the federal funds.

Options to Increase States' Incentives to Save

There are other options that could strengthen states' incentives to save. For example, Congress could (1) allow states to count rainy day funds towards a portion of their MOE and (2) allow states to draw down their entire TANF grants and save these funds in their own treasuries. There are pluses and minuses to each—and the exact design and implementation will be important in determining the actual impact of any change.

Allowing states to count rainy day funds towards part of their MOE would give them a greater incentive to create such funds. However, "maintenance of effort" implies an actual expenditure and has played a critical role in limiting supplantation. If states save their own funds instead of spending them, they might be more likely to draw down all of their TANF dollars now to replace the state dollars—thus resulting in no net increase in spending in this area. This effect could be mitigated by limiting the amount of rainy day funds that could count towards a state's MOE. In addition, as we suggested in our April testimony, states could be required both to certify that state rainy day funds were auditable and to establish criteria for the size of the fund and the release of funds from it.

Some state officials have said that requiring states to keep unspent TANF funds in the U.S. Treasury provides a disincentive to save these funds. As noted earlier, they believe that these balances could be attractive targets for rescission by Congress. If states could keep unspent TANF funds in state accounts instead, these officials suggest, states would have more of an incentive to save for contingencies. Such a provision would mean outlays would be recognized at the time of the grant award rather than when the money is spent for a program need.

There are significant issues associated with this proposal. First, regardless of where these federal funds are "stored," states are accountable for the use of these funds in accordance with the law. Congress would still need consistent, reliable, and auditable information on the funds. Second, such a proposal would affect the measured federal surplus. Since outlays would be recognized when the states received their grants, more outlays would be recorded sooner. If states draw down all unspent balances in a single year, the outlays recorded for the TANF program would shift and the budget surplus drop by that amount in the near term.

In addition, the federal government would incur interest costs while states could earn interest on grant money drawn down from the U.S. Treasury but not yet spent by the states. This would violate CMIA, which prohibits states from drawing down funds until those funds are needed and so helps ensure that neither the states nor the federal government incur unnecessary interest costs (or forgoes interest income) in the course of federal grant disbursement. CMIA also promotes transparency since states' unspent balances remain visible in the federal Treasury rather than spread through the various state treasuries—although given the measurement problems discussed earlier, this may overstate the quality of current information.

To provide TANF an exemption from a governmentwide grant policy that settled years of intergovernmental conflicts between federal and state administrators would require justification. The permanent nature of the appropriation to each state and the significant devolution of responsibilities and fiscal risk to states may argue for an exemption from CMIA. If Congress wished to provide this exemption without abandoning fiscal neutrality between the federal and state governments, it could require states to reimburse the U.S. Treasury for any interest the states earn on TANF drawdowns. Under such a provision the states would hold the funds, but the earnings on the funds would remain as if the funds were in the U.S. Treasury. Similarly, requiring better reporting on states' expenditures and reserves could mitigate the damage to transparency.

Recommendations for Executive Action

Given the breadth of the goals for the TANF program, understanding the overall federal-state fiscal balance covering the broad range of TANF-related social services is important for national oversight of the program. However, little information is currently gathered systematically on expenditures on the broad array of social services we surveyed for this report. In order to inform decisionmakers on the status of the federal-state fiscal balance, the Secretary of Health and Human Services should consult with the states to explore cost-effective ways to periodically gather data revealing the federal-state fiscal balance relevant to achieving the broader programmatic goals of the TANF program. The categories used in this report could constitute a basis for these periodic reports.

We also reiterate our prior recommendation that the Secretary work with the states to provide for more transparent reporting by the states of their plans for the unspent TANF balances. Such plans can enhance congressional oversight and provide the states with an opportunity to better demonstrate their plans and needs for federal funding.

Agency Comments

We received comments from HHS, which are reprinted in appendix XIII. In addition, each of appendixes II through XI was reviewed by officials in the relevant states and their comments were incorporated as appropriate. We also provided copies of the draft report to the National Governor's Association (NGA) and the National Conference of State Legislatures (NCSL). NCSL provided official comments. NGA did not provide official comments, but senior analysts provided us with substantive informal comments on the draft. We incorporated these comments, NCSL's comments, and technical comments from HHS as appropriate. NGA staff and NCSL both commented that the report was balanced. NCSL noted that the report "clearly puts TANF spending in context of how states make policy and budget decisions and will enhance the upcoming debate over welfare reform reauthorization." At the same time both NGA staff and NCSL expressed concern that some readers could use the data in this report to criticize states' decisions to shift state funds from Category 1 to broader TANF-related purposes. Our report acknowledges that these shifts were prompted by a number of factors including the declining caseloads and the breadth of TANF's goals. These funding shifts are a result of policy choices made by the states—we do not impose a value judgement on the appropriateness of these choices. Moreover, we point out that these shifts are not only legal, but are encouraged by TANF law. We continue to believe analysis across the full range of categories is important to providing a more complete picture of state choices.

With regard to our recommendation to explore ways periodically to gather data revealing the federal-state fiscal balance covering the broad range of TANF-related services, HHS agreed that "comprehensive, timely data from the states will be essential during TANF reauthorization," but suggested that unspecified legislative restrictions and cost constraints could hamper its ability to collect this essential information. We believe that all data collection should be cost-effective. We note that the Department agrees that this information is essential for TANF reauthorization; at this stage we suggest that the necessary data might be obtained through incremental adjustments to and leveraging of the current reporting requirements and existing research. In addition, as part of the reauthorization debate all data collection requirements might be examined with an eye to focusing reporting requirements on the data that Congress, the states, and the Department consider most useful in assessing progress towards meeting the goals of welfare reform. As part of that re-examination, the Department could note any legislative changes necessary to facilitate this process.

As agreed with your offices, we are sending copies of this report to the Secretary of Health and Human Services, appropriate congressional committees, and other interested parties. We will also make copies available to others upon request.

If you or your staff have any questions about this report, please contact me on (202) 512-9573 or Thomas M. James on (202) 512-2996. Individuals making key contributions to this report included Bill J. Keller, Patricia L. Elston, Jacqueline M. Nowicki, Raymond G. Hendren, and Marcus G. Melton.

Paul L. Posner

Paul L. Posner
Managing Director
Federal Budget Issues and Intergovernmental Relations

Scope and Methodology

Scope

To meet our objectives, we studied TANF-related budget decisions and collected data on social service expenditures in 10 states—California, Colorado, Connecticut, Louisiana, Maryland, Michigan, New York, Oregon, Texas, and Wisconsin. These 10 states—the same states we studied in 1998—were chosen because they represent a diverse array of socioeconomic characteristics, geographic locations, experiences with state welfare initiatives, and state fiscal and budget issues.[1] Although differences in the way states present their social services budgets and the way they finance their programs make any generalizations difficult, our case study analysis of these 10 states, with their diverse approaches to financing welfare reforms, provides opportunities to highlight critical financing issues states face implementing their welfare reforms.

Methodology

To provide background information and context to our discussion on how states are using federal and state funds to finance programs to help the poor, we reviewed and summarized state welfare plans, program documents, and other supporting documentation. We discussed state welfare programs with state program and budget officials, legislative analysts, and local welfare advocacy groups. We reported on features of state welfare programs in place by state fiscal year 2001.

[1] *Welfare Reform: Early Fiscal Effects of the TANF Block Grant* (GAO/AIMD-98-137, August 18, 1998).

Supplantation in the State Budget

A discussion of whether a state uses federal TANF funds to supplant state funds depends in large part on the definition of *supplantation.* Much of the controversy over whether states have used federal funds to replace their own spending, and the extent to which they have done so, hinges on this definition of supplantation. In this analysis we used a rather limiting definition of supplantation, one used by the former Chair of the Human Resources Subcommittee, Committee on Ways & Means, House of Representatives in a letter to Governors dated March 15, 2000, which defines supplantation as the act of "replacing state dollars with TANF dollars on activities that are legal uses of TANF funding." A limiting definition is justified because all funds are interchangeable. The effect of any state decision to use federal funds to supplant its own funds is first to enlarge the pool of state general fund resources available to finance any state program, how the state then establishes priorities for funding new and existing programs—essentially, how it will use its freed-up funds—must be viewed apart from its decision to supplant.[2]

In order to gauge the extent to which a state used TANF funds to free up state funds, we analyzed state budgets and supporting budget documentation. We identified instances where the state changed how it financed certain programs by replacing state funds from its current-services baseline[3] budget with federal TANF funds through state fiscal year 2001. We also gathered information on the general fiscal environment that existed in each state as these budget choices were made, other spending priorities that competed for state funds, any fiscal crises in the states, and interactions with other federal programs.

While it is difficult to tell with certainty how a state uses its freed-up funds, the decision to supplant is often made through the state's appropriation or

[2]Most academic studies that seek to assess the extent to which states use federal funds to supplant their own define supplantation as a decrease in state spending from what the state would have spent if more federal funds had not been made available. These studies gather historical data on state spending, control for certain demographic variables such as caseload changes, identify trends in state spending, and then extrapolate those trends. The studies compare the trends with actual expenditure data and explain any variance from the trends as supplantation.

[3]A current-services baseline budget assumes the continuation of current policies and reflects anticipated costs of ongoing programs and activities without policy changes. It generally includes allowances for inflation and changes in caseload. Proposed policy changes that would affect the costs of programs are compared to the current-services baseline to estimate the budgetary impact.

budget process, which is often accompanied by analyses of different policy options for the use of any freed-up funds and can influence policymakers' decisions to approve the switch in financing. In reviewing these analyses it is possible to understand the choices facing decisionmakers as they decide among the different ways to use federal and state funds, to finance programs that benefit low-income families and other needy individuals. To describe the motivation for states to use federal TANF funds to free up state funds, we interviewed key staff from the state welfare agencies, state budget offices, legislative fiscal analysts offices, as well as some state legislators with oversight responsibilities for welfare reform.

Spending Trends From 1995-2000

While budgets are a good blueprint to measure policy choices, looking only at a specific change authorized in a budget may be misleading. For example, if a state supplanted federal funds for state funds, then shifted its own funds into other programs that serve the working poor, the net impact of these shifts would be the same as if it used federal funds directly to fund these other programs. Accordingly, the impact of the funding shifts must be viewed in a broader context consistent with new objectives and goals of TANF; which are to

- provide assistance to needy families so that children may be cared for in their homes or in the homes of relatives,
- end the dependence of needy parents on government benefits by promoting job preparation, work, and marriage,
- prevent and reduce the incidence of out-of-wedlock pregnancies, and
- encourage the formation and maintenance of two-parent families.

To provide this broader context for considering the effects of funding shifts, we reviewed state expenditures of both federal and state funds on a wide array of social service programs that meet these objectives. In this analysis, a federal expenditure is not defined by the level of the TANF grant allocated to each state but rather by how much of the grant the state chose to spend. Essentially, the states control both the state and federal share and thus control the "fiscal balance." Under AFDC, the fiscal partnership between the federal government and the states was defined by the federal match rate each state received to help finance its welfare programs. Under TANF, the block grant is fixed—states decide how much of the federal grant to spend and how much to save.

This "fiscal balance" is key to understanding how the partnership between the federal government and the state in financing welfare services may have changed. In order to measure post-PRWORA changes in the mix of federal and state funding across TANF-related social services, we asked the 10 states to provide expenditure data on programs that provide social services to the needy. To facilitate gathering this information, we adapted a fiscal survey developed by the Nelson A. Rockefeller Institute of Government.[4] Specifically, we asked for state and federal expenditures on a variety of programs that targeted assistance to low-income families and individuals in state fiscal years 1994-1995 and 1999-2000, and we verified the data they reported to us against their own accounting records. To improve the alignment of our survey data with TANF's goals, we excluded social services expenditures targeted to the elderly and those services that were not transitional in nature.

We used the survey as a tool to encourage states to view these programs broadly, and not to limit their survey responses just to those programs that received TANF funding. The survey allowed us take a comprehensive look at state social service program budgets. Generally, we asked the State Budget offices to help us coordinate the survey responses. In their oversight role of the entire state budget, these offices had a broader view of state funding priorities than the State Social Services departments, or any one specific department, which focus primarily on their own budgets. We asked state budget and program officials to identify programs that met our survey criteria, whether or not these programs were funded with TANF or MOE dollars (see appendix XII for our survey criteria instructions), and to provide us with expenditures on these programs for their state fiscal years 1995 and 2000. Our focus on the state fiscal year as opposed to the federal fiscal year allowed states to provide us with data directly from their accounting records without having to make adjustments to the federal fiscal year. [5] Since our objective was to examine changes in the way states have used federal and state funds to finance programs that help the poor, this focus on the state fiscal year is adequate. Moreover, since state decisions to supplant federal funds for their own were made in the context

[4]"Changes in State Spending on Social Services Since Implementation of Welfare Reform: A Preliminary Report." Ellwood and Boyd, February 2000.

[5]Seven of the 10 states in our review begin their fiscal year on July 1 and end on June 30. The other three states are all different; in New York it begins on April 1 and ends on March 31, in Texas it begins on September 1 and ends on August 31, and in Michigan it begins on October 1 and ends on September 30.

of their budget deliberations, the survey's focus on the state fiscal year complemented our analysis of state budget decisions.

Once the state program and budget officials identified the programs to include in the survey, we verified through program documentation and discussions with these state officials that the program descriptions, targeted beneficiaries, and program goals met the survey criteria. We worked closely with state officials to complete the survey instrument (see appendix XII) with data from state accounting records.[6] We verified with officials from the State Auditor's offices that state expenditure system controls had been tested and verified. As noted previously, a federal expenditure, for the purposes of this analysis, is not defined by the federal allocation to the state, rather by how much the state chooses—or in some cases is required—to spend on the aided activity. For this reason, we did not consider a number of 100-percent federally funded programs that do not flow through the state budget. For example, the Food Stamps program is administrated by the state and the shared administrative costs are included in the survey but the value of the food stamp coupons disbursed in the fiscal year, borne 100 percent by the federal government, is not.

In our analysis we aggregated state expenditure data by program category, allowing us to group programs into four categories—Basic Welfare Services (Category 1), Support for the Working Poor (Category 2), Health Care (Category 3), and Other TANF-related Social Services (Category 4). The analysis is cumulative; that is, all expenditures in Category 1 are included in Category 2, and so on. See figure 1 for a description of the types of programs that are included in our spending categories. We aggregated program spending in order to make comparisons among states in how they design and fund their strategies to address TANF's goals. State budget structures are very different; some states place all their needs-based employment and training programs within their social services budgets; other states place these programs in their economic development agencies. These differences make comparisons of state budgets and expenditures difficult. In asking states to report spending on individual programs, regardless of which state agency oversaw these programs, and then aggregating the programs into the same categories for each state, we were able to compare state expenditure trends across all states. Given the

[6] In some cases state accounting records were not closed out when we completed our survey instruments. In those cases, working with state program and budget analysts, we estimated state fiscal year 2000 expenditures based on actuals to date or historical spending patterns.

differing views of supplantation, our categories were designed to provide decisionmakers with information on shifts in spending on the widely different—and increasingly broad—strategies employed by the states to achieve the goals of the TANF program.

Our first category includes programs that are linked closely with the goals and objectives of the former welfare programs, namely cash assistance payments and some job training programs. Our second category adds programs that many view as supplements to those basic welfare services. The additions include programs that help families make the transition from welfare to work or avoid welfare altogether. For example, child care subsidies and rental assistance payments can help parents remain working even if they are working in low-wage jobs; family formation and pregnancy prevention programs are also included in this category as they address specific TANF goals. Our third category adds health care costs to the types of programs already discussed. The inability of many low-income families to gain access to health insurance once they leave the welfare rolls has been recognized as a major barrier hindering their ability to attain self-sufficiency. PRWORA delinked the AFDC program from the Medicaid program, but in an effort to safeguard access to health insurance for eligible low-income families, the act required states to implement a separate Medicaid eligibility category which ensured that eligible low-income families could qualify for Medicaid even if they were no longer receiving cash assistance. Improving access to health insurance, especially for low-income individuals, has been in the forefront of this country's domestic policy debate for the last few years. During this time frame, states were encouraged to participate in a new federal health insurance program for low-income children—the States' Children's Health Insurance Program (SCHIP)—who were not eligible for Medicaid. Moreover, some states expanded access to health insurance to other low-income individuals not eligible for Medicaid. Adding states' health care expenditures to our analysis recognizes the costs of these programs and states' investments in strategies to help families make the transition from welfare to work. Finally, our last category recognizes the full breadth of programs that some states use to develop strategies to achieve TANF's goals. These program include child welfare programs, substance abuse programs, mental health programs, and programs that help the developmentally disabled attain a level of self-sufficiency. While many of these state programs do not have income standards to determine eligibility, many states are able to certify that some of the participants in these programs meet the eligibility requirements set forth in their TANF plans and can claim TANF funds for these expenditures. As such, states are able to supplement, or supplant from, these existing programs—or create new programs—as part of their strategy to achieve their TANF goals.

State Contingency Plans

To describe the measures states are taking to “save for a rainy day” and to analyze the impact these actions have on TANF reserve balances at the U.S. Treasury, we analyzed the ten states’ budgets as well as the quarterly financial reports they are required to file with HHS on the status of TANF funds they have been awarded to date. In addition, we interviewed program and budget officials to determine the states’ plans for their unspent federal TANF funds. In particular, we asked states that have set aside some of their federal funds for contingencies for information on how the size of these reserved funds were determined. We also interviewed officials in all 10 states to determine how they might mitigate the impact of an economic downturn on their program budgets if changes in the economy caused welfare rolls to swell and costs to rise. To obtain information on the levels of unspent TANF funds in all 50 states we reviewed financial data reported by the states to HHS.

We requested comments on a draft of this report from HHS, NGA and NCSL. These comments are discussed in the letter and HHS’ comments are reprinted in appendix XIII. In addition, we provided drafts of each state appendix to the appropriate state officials for technical review and have incorporated their comments where appropriate.

California

Background

State fiscal year:	July 1-June 30
Budget cycle:	Annual
TANF grant:[a]	$3.734 billion
75% MOE:	$2.727 billion
Cash assistance caseload:[b]	926,000 families in 1995 489,000 families in 2000 47 percent decline

[a]California received an additional $45 million in federal TANF funds in 2000 and $36 million in 2001 as bonuses for successful outcomes.

[b]Caseloads as reported to HHS for January 1995 and June 2000 and rounded to the nearest thousand. Caseload data for 2000 do not include 63,000 families receiving assistance through a separate state program.

California implemented its welfare reform program called California Work Opportunity and Responsibility to Kids (CalWORKS) in January 1998. The program provides cash aid and services to eligible needy California families, with the goal of ensuring that individuals who work are better off financially than if they do not work.

To be eligible for cash aid, generally adults in families must engage in work-related activities or lose their eligibility. Most are assigned immediately to job search activities, and if unsuccessful after 4 weeks, may be assigned to other work-related activities such as job training, education, counseling, or substance abuse treatment. Cash assistance includes the monthly assistance payment, and diversion payments made in lieu of monthly assistance, where appropriate and in accord with county policies. The maximum monthly assistance payment was increased in 2000 and ranges from $626 for a family of three in high-cost counties to $596 in low-cost counties. In addition to cash assistance, single parents may receive the first $50 of the current month's child support collected on the families' behalf.[1] Families are eligible for cash assistance if their adjusted incomes are less than the payment level, and they remain eligible for up to 5 years as long as their adjusted incomes do not exceed the payment level. After that time, the children may continue to receive assistance.

[1]The state and federal governments may retain collections as reimbursement for cash assistance payments made to these families. California has chosen instead to give its full share to CalWORKS families.

While they are participating in program activities, CalWORKS families may receive help with child care, transportation, and related expenses. Depending on the policy of the county in which they reside, families who leave assistance for employment may continue to receive case-management and supportive services for 1 year. Transitional medical assistance is available for 1 year and to the extent funding is available, subsidized child care can be authorized for up to 2 years or longer if the families' incomes remain below 75 percent of the state median income.[2] Two-parent families and recent legal immigrants not eligible under TANF are in separate programs that are funded entirely with state funds and used to count towards the state's MOE.

California administers its welfare program through its 58 counties. The counties pay cash assistance directly to welfare families and have considerable policy and programmatic discretion in managing cases and providing services. The state allocates its federal TANF and state MOE funds to the counties in the form of block grants and, in turn, requires that counties invest a portion of their own funds toward the MOE. About $141 million in county funds was counted toward the MOE in 1999. Counties have received additional federal TANF funds from the states as performance incentive payments for successful program outcomes and are permitted to use these funds for any TANF purpose.

Supplantation in the State Budget

In California, since passage of TANF, it appears that the Governor and legislature have enacted budgets that fully support the state MOE and have managed to balance competing priorities with no evidence of supplantation. For the most part, we found little evidence that the state had engaged in major shifts in the methods of financing its welfare programs. The state has devolved the funding for program development and implementation to the counties, leaving few opportunities for the state to shift federal funds into budget accounts that had previously been funded with state funds. Further, when asked about possible supplantation by the counties, state officials responded that their monitoring has not yielded any indication that counties have used federal TANF or state MOE funds to free up their own county funds. State officials also considered county-level supplantation unlikely, because few counties operate programs with their

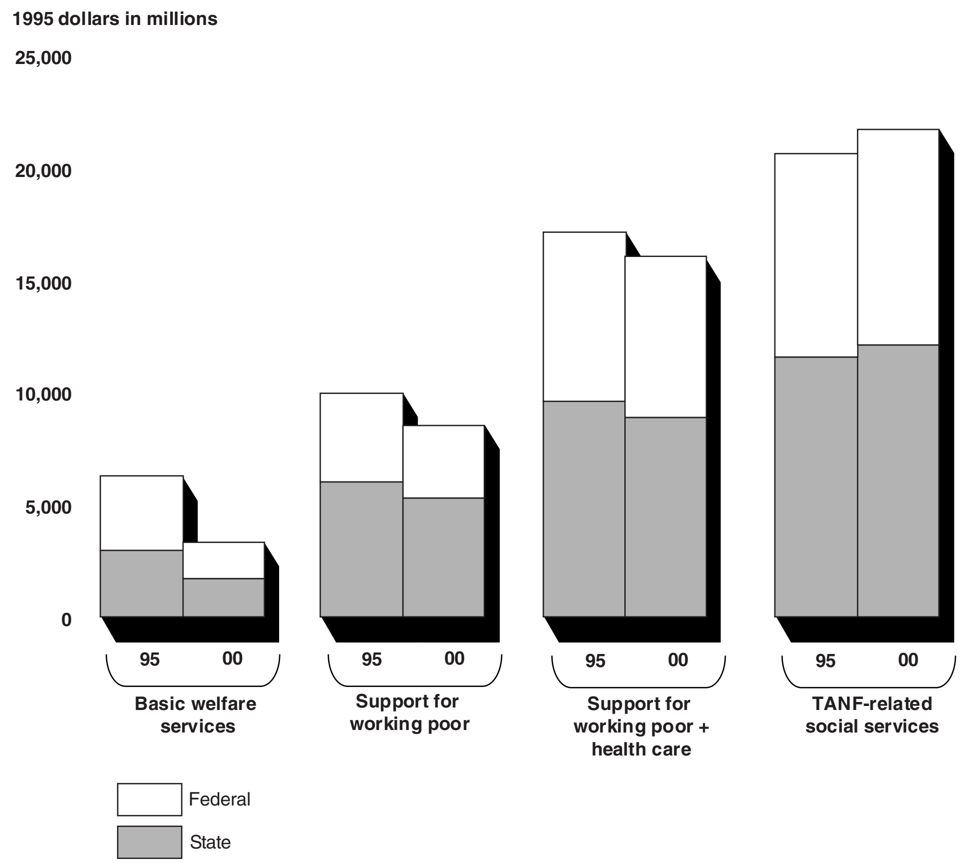
[2]According to state officials families, who actually receive child care subsidies are at much lower income levels, usually between 35 and 50 percent of SMI.

own funds that could be considered allowable candidates for TANF funds, leaving few opportunities for supplantation.

At several points in their budget deliberations, California's Governor and legislature considered the opportunities afforded by lower caseloads and fixed federal funding to free up state general funds. For example, the state recently learned that it met 1997 work participation rates, which qualified the state for a 75 percent, rather than 80 percent, MOE. As a result, the state can retroactively claim some of its unspent TANF balances in lieu of the state funds that it spent in 1997. In his budget proposal for state fiscal year 2001-2002, the Governor recommended using some of the state's unspent federal TANF balances to reimburse the state for $154 million it spent in 1997 to meet its $2.9 billion MOE requirement. In another example, California assumed financial responsibility after 1995 for providing nonemergency health care, primarily preventive in nature, to recent legal immigrants who are not eligible for TANF. Legislative analysts have suggested that the state count its investment in this program as MOE, reduce the state's investment in CalWORKS by an equivalent amount, and use TANF funds to make up the difference. CalWORKS would remain intact and fully funded. One analyst explained that the proposal would help reduce reserves of unspent TANF balances, yield state savings, and, at the same time, effectively restore federal funds that were previously available for this service.

Spending Trends From 1995 to 2000

Figure 4: California's TANF-Related Expenditures for State Fiscal Years 1995 and 2000



To assess how state budget decisions might have affected spending, we collected data on California's use of state and federal funds. The results are grouped into four categories, as shown in figure 4 and described further in appendix I. Each category is identified on the graph by two bars—one for spending that occurred in state fiscal year 1995 and one for spending that occurred in state fiscal year 2000. From left to right, the categories are cumulative. Expenditures for basic welfare services, such as cash assistance and job training, are included in expenditures for support of the working poor. These expenditures in turn are included in expenditures for support of the working poor plus health care. Finally, all expenditures are included in social services expenditures.

It is clear from figure 4 that total spending in California has declined in real terms for the first three categories, but has increased in the last category which includes all social services. The majority of California's MOE requirement is met through its cash assistance payments. As caseloads have fallen in California, total spending on basic welfare services declined from $6.3 billion to $3.6 billion in nominal dollars from state fiscal years 1995 through 2000. (See table 6.) In real terms, this represents a drop of 47 percent. Although total cash assistance payments have declined, the state still must meet a fixed MOE requirement. Given the state's strategy in meeting its MOE, the state's contributions to these programs has increased from 48 to 51 percent of the total. As a result, California now finances a greater share of the total program costs for basic welfare services than it did prior to welfare reform.

Table 6: California's TANF-Related Expenditures

Dollars in millions

	Nominal		Real (expressed in 1995 dollars)	
	1995	2000	1995	2000
Basic welfare services				
Total funds	$6,252	$3,618	$6,252	$3,301
State funds	$2,998	$1,829	$2,998	$1,669
Support for the working poor				
Total funds	$9,962	$9,283	$9,962	$8,470
State funds	$6,037	$5,843	$6,037	$5,331

Source: GAO survey and analysis of state expenditure data.

Combined spending on support for the working poor which includes basic welfare services as well as other benefits, employment services, and child care for both welfare recipients and the working poor, has declined slightly from $10 billion to $9.3 billion in nominal dollars from state fiscal years 1995 to 2000; this represents a real decline of about 15 percent. Although less is being spent, the state share of program spending rose from 61 percent in 1995 to 63 percent in 2000.

When health care expenditures are added to the totals described above, combined spending increased slightly in nominal dollars, from $17.1 billion to $17.6 billion from state fiscal years 1995 through 2000, but not enough to keep up with inflation (see table 7). Instead, in real terms, total spending declined by 6 percent. During this time, the state's share has remained constant at 56 percent of total expenditures, with federal funds making up the remaining 44 percent.

Table 7: California's TANF-Related Expenditures

Dollars in millions

	Nominal		Real (expressed in 1995 dollars)	
	1995	2000	1995	2000
Support for the working poor plus health care				
Total funds	$17,146	$17,586	$17,146	$16,046
State funds	$9,579	$9,756	$9,579	$8,902
TANF-related social services				
Total funds	$20,634	$23,809	$20,634	$21,724
State funds	$11,525	$13,289	$11,525	$12,125

Source: GAO survey and analysis of state expenditure data.

However, when expenditures for child welfare and other social services, such as substance abuse and mental health treatment are included, total expenditures increased in both nominal and real terms from state fiscal years 1995 through 2000. Countering the decline in spending on basic welfare services, total child welfare expenditures increased by two-thirds and other social services expenditures doubled. In this area, the state maintained its investment at 56 percent of total expenditures from 1995 through 2000.

Additional federal safety-net programs provide food assistance and supplemental security income for needy families and children in California. For example, the federal government provided about $2.5 billion in food stamp benefits to low-income individuals in California in 1995 and $1.8 billion in 2000. In addition, from 1995 through 2000, federal supplemental security income payments increased from $3.4 billion to $4 billion, with about 65 percent of these benefits going to individuals under 65 years of age.

Rainy Day Funds

California budgets nearly all of its annual block grant, reserving very little for future contingencies. It had no TANF reserve set aside until state fiscal year 2000-01 when it appropriated about $50 million in federal TANF funds to a reserve account.[3] Even though the state does not have significant reserves for contingency purposes, the state does have substantial reserves of unspent funds. According to the financial reports filed by the state with HHS as of September 30, 2000, the state reports $1.6 billion in total unspent TANF funds, almost half of its TANF grant for any given year. (See table 8.)

Table 8: Unspent TANF Funds in California as of September 30, 2000

Dollars in millions

Unobligated TANF Funds	Unliquidated obligations of TANF funds	Total unspent funds	Unspent funds as a percent of annual TANF grant
$3	$1,637[a]	$1,640	44%

[a]Subsequent amended reports submitted by California reduced unliquidated obligations for this period to $612 million.

Source: HHS' Administration for Children and Families.

Most of the state's unliquidated funds have been obligated to counties in their annual single allocation. In its second year under TANF, California kept tight control of funds, issuing separate allocations to counties for each expenditure category. Because this process limited counties' flexibility and made it difficult for the counties to reform their welfare programs in a timely fashion, the state changed its strategy in its second year under TANF. Now the state allocates the majority of program funds to counties in broad-purpose single allocations that are viewed as block grants. These allocations represent the maximum amount of reimbursement that the counties can expect from the state for their basic CalWORKS expenditures. When the state accounts for its TANF block grants on its quarterly financial reports to HHS, the state reports its allocations to counties as obligations in accordance with federal regulations. The allocations are typically made in July after the state has enacted its budget. Therefore, California's TANF obligations typically spike in the last quarter of the federal fiscal year as a result of its allocation process.

[3]TANF funds held in reserve must be left in the U.S. Treasury until expended.

Counties operate on a cash accounting basis, submitting claims for reimbursement of expenditures that they have made for CalWORKS from their block grant allocations. When the state receives county claims for reimbursement, the state reports these as expenditures on federal forms. Unliquidated obligations represent the difference between what the state has allocated to the counties and what the counties have spent on actual cases. Because spending on the TANF programs has declined proportionally with the decline in caseloads, the state continues to report high levels of unliquidated obligations. However, state officials maintain that as the counties make progress implementing welfare reforms they are liquidating their TANF obligations more quickly so that each year the level of reported unliquidated obligations has decreased. Based on current expenditure projections, these officials do not expect high levels of unliquidated obligations to continue.

Recently, the state amended its statute so that these funds can be re-allocated from counties where they may not be needed to counties that are running short. Because the state has the discretion to reobligate these unspent funds from counties with ample reserves to counties with greater unmet needs, these unspent funds—currently reported as "unliquidated obligations"—are a potential source of funds that state can use as long as some counties continue to carry-forward large unspent balances.

California also has another significant source of unspent TANF funds that can be used by the counties to finance increased costs in the event of economic contingencies. California has transferred more than $1 billion of the state's TANF dollars to its counties in the form of incentive payments—yet most of these funds remain unspent and are on deposit in county bank accounts. This state program pays counties incentive payments that are designed, in part, to motivate the counties to help the state meet certain TANF performance goals. Specifically, the state makes awards to its counties based on the number of welfare cases that have left the rolls for employment and the number of cases the counties have diverted from the rolls and are employed. To date the counties have received awards totaling about $1.1 billion. These funds are federal TANF funds that have been drawn from the U.S. Treasury and deposited into county bank accounts.

According to state law, counties must spend these funds on TANF-related purposes. The state has also issued guidance to the counties that any interest earned while these funds are on deposit must be reinvested into the TANF program. Apart from the aforementioned guidance, state statute defers to the counties regarding how best to use the funds. The program was authorized in 1997 as part of the legislation that established CalWORKS and the first awards were paid in 1999. While state officials have said that these incentive payments were not intended for counties to use for contingency budgeting, counties are not prohibited from using these funds to cover unexpected costs if needed. In fact, some counties regard the incentives as their reserve funds, according to one state official.

In February 2001, state officials reported that counties have spent only $46 million—about 4 percent—of these funds. This means counties in California have about $1 billion in unspent TANF funds on account that are not included in the "unobligated balances" totals reported to HHS. HHS believes that California is in violation of CMIA, which seeks to limit the interest costs to both federal and state governments by coordinating the timing of a states' draw downs from the Treasury with the timing of the states' expenditure needs. This coordination ensures that the timing of a state's draws do not favor either party and neither partner incurs unnecessary interest costs. California maintains that these payments are valid expenditures to service providers—their counties—under a performance-based agreement to administer welfare services.

Colorado

Background

State fiscal year:	July 1-June 30
Budget cycle:	Annual
TANF grant:[a]	$136 million
75% MOE:	$83 million[b]
Cash assistance caseload:[c]	39,000 families in 1995 11,000 families in 2000 72 percent decline

[a]Colorado receives between $3 million and $10 million in annual supplements because the state's pre-TANF population growth exceeded 10 percent.

[b]HHS found that in 1999 not enough of Colorado's two-parent caseload was engaged in work activities to meet the higher participation rates required for that group and approved the state's Corrective Action Plan on April 27, 2001. Because the state did not meet the requirement, it will be held to an 80-percent MOE of about $88 million.

[c]Caseloads as reported to HHS for January 1995 and June 2000 and rounded to the nearest thousand.

Colorado implemented its welfare reform program called Colorado Works in July 1997 with the goal of promoting personal responsibility and enabling needy families to become self-sufficient. To achieve this goal, the state has given each county social services agency the flexibility to select an approach to program design and service delivery that the county agency considers likely to yield success. Under the program, cash assistance caseloads have declined steadily through mid-2000.

Colorado contracts with its 63 counties for the operation of Colorado Works through a memorandum of understanding and allocates most of its federal TANF and state MOE funds—about $140 million in state fiscal year 2000—in the form of block grants. The counties are required to invest a portion of their own funds to help make up the required state MOE, equivalent to 20 percent of the county's 1995 expenditures on these programs.

To receive cash assistance, applicants must sign individual responsibility contracts or treatment plans immediately and participate in work related activities within 24 months, or earlier in accordance with county requirements. Counties determine the type of work activities that are available and whether other activities, such as mental health and substance abuse treatment, can be considered work-related. The state has set the minimum standard benefit amount at $357 per month for a family of three, virtually unchanged since before TANF, but individual counties may set higher levels. Needy families with children whose adjusted incomes do not exceed the state's cash assistance levels are eligible for the program. Those who participate may also receive other benefits, such as transportation, clothing, or education payments. Families may receive cash assistance for no more than 5 years, in accordance with TANF law. In lieu of ongoing cash assistance, eligible families and, at county option, other needy families may receive single, lump-sum diversion payments. Recent immigrants not eligible for TANF are served in a separately funded program.

Families who succeed in finding jobs may achieve earnings that make them ineligible for Colorado Works. For example, a single parent--with two children--earning the minimum wage for a 40 hour work week would no longer qualify for cash assistance. However, the family would qualify for 12 months of additional medical assistance. When they exhaust those benefits, the families may continue to receive health care for their children, because the state has streamlined the application and enrollment process and replaced the Children's Health Insurance Program (CHIP) monthly premiums with nominal enrollment fees to cover families with incomes between 151 and 185 percent of poverty. Also families with incomes that do not exceed $75,000 may be eligible for services and benefits such as emergency aid and family preservation services as described in individual county plans.

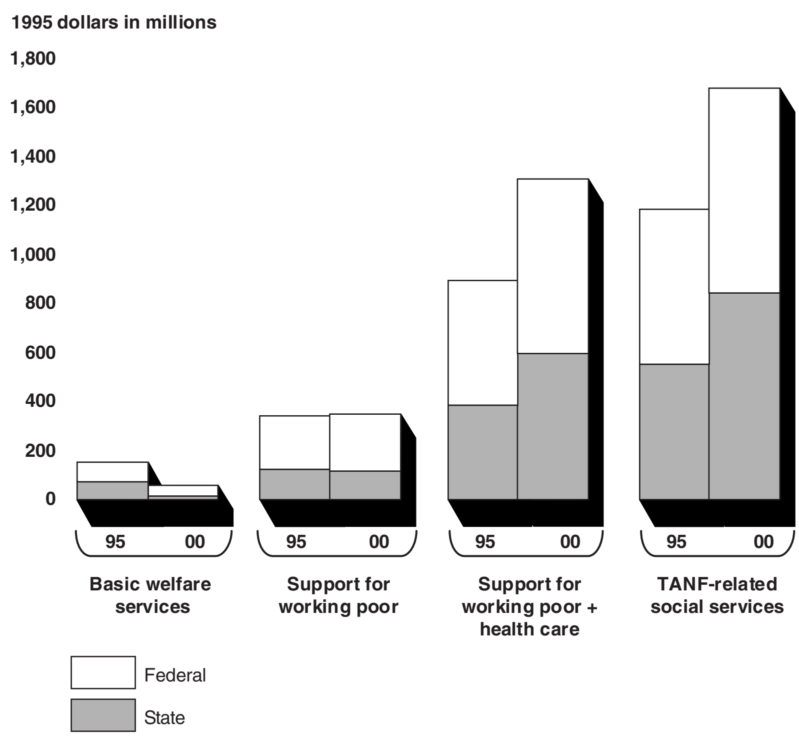
Supplantation in the State Budget

We found little evidence in Colorado of the state's use of federal funds to replace state funds. State officials contend that supplantation is less likely in Colorado than might be the case in other states for two reasons. First, counties wield a great deal of political power in Colorado. Since most of the TANF funds the state receives are immediately allocated to the counties, the state retains very little budgetary control over TANF funds. Most state and county officials we spoke with agreed that politically it would be very difficult if the state were to use TANF funds to replace state funding in other programs, because it would mean that there would be fewer TANF funds to appropriate to the counties. Second, the counties are less likely to supplant funds because, according to a state official, most have not had significant budgetary resources allocated to TANF-related program areas from which they could supplant. In addition, in its state welfare reform legislation, the state imposed an explicit prohibition against counties using their block grants to supplant county general funds.

Although most of the state's block grant is passed through to the counties, the state has kept two modest reserves of TANF funds for use at the state's discretion. (See "Rainy Day Funds" section of this appendix for more information.) In state fiscal year 2000, the state reassessed the way these two reserve funds were financed as they had accumulated significant balances and had never been drawn upon. The counties were amassing significant reserves as well since actual expenditure rates were lower than their annual allocations. In reassessing the financing mechanism for the state reserves, the state had about $20 million that it could use for other purposes. Of this total amount, the state used about $7 million to refinance a number of state-funded programs which freed-up a like amount of state funds. These "freed-up" state funds were used to finance a new reading initiative for elementary school children.

Spending Trends From 1995 to 2000

Figure 5: Colorado's TANF-Related Expenditures for State Fiscal Years 1995 and 2000



To assess how state budget decisions might have affected spending we collected data on Colorado's use of state and federal funds. The results are grouped into four categories, as shown in figure 5 and described further in appendix I. Each category is identified on the graph by two bars--one for spending that occurred in state fiscal year 1995 and one for spending that occurred in state fiscal year 2000. From left to right, the categories are cumulative. Expenditures for basic welfare services such as cash assistance and job training are included in expenditures for support of the working poor. These expenditures in turn are included in expenditures for support of the working poor plus health care. Finally, all expenditures are included in social services expenditures.

States prepare, authorize, and execute their budgets differently and, as a result, it is very difficult to compare state budgets as they are presented by each state. One of the challenges in our methodology was to ensure, to the extent possible, that comparable program expenditures were presented similarly for each state. For the most part, expenditures for social services are made out of states' general funds and federal funds—as opposed to states' capital funds which finance large scale construction and infrastructure budgets. In Colorado, constitutional and statutory restrictions limit expenditure growth and the size of the state's rainy day fund. Thus, in any given year if state revenues exceed expenditures, the state rebates the surplus to taxpayers. A number of the rebates the state offered in state fiscal year 2000 were targeted to low-income taxpayers, but these rebates were authorized on a onetime basis only and contingent on certification by the State Revenue Department that a state general fund surplus occurred. Because these expenditures were never factored into the states' baseline budget we did not consider them in our analysis of state spending trends. Essentially we believe that these rebates did not present decisionmakers with the same choices presented decisionmakers in other states and should not be considered in our analysis of whether states used TANF funds to supplant their state funds.

Nevertheless, these targeted rebates were considerable. In state fiscal year 2000, the state temporarily expanded its EITC from 8.5 percent of the federal credit to 10 percent at a cost of about $32 million. It also temporarily increased the child care tax credit to targeted to families with incomes less than $64,000 at a cost of about $61 million. If we had included the rebates in our analysis, these expenditures would have appeared first in our Category 2—Support for the Working Poor and cumulatively throughout Categories 3 and 4.

In line with the caseload declines, total spending on basic welfare services declined dramatically between 1995 and 2000—from $155 million to about $61 million. (See table 9.) This represents a drop of about 64 percent in real terms, but state spending declined even further—by 76 percent in real terms—from $70 million to about $17 million. Accordingly, the share of the programs now financed with state funds declined from about 45 percent of the total in 1995 to about 31 percent in 2000.

Table 9: Colorado's TANF-Related Expenditures

Dollars in millions

	Nominal		Real (expressed in 1995 dollars)	
	1995	**2000**	**1995**	**2000**
Basic welfare services				
Total funds	$155	$61	$155	$55
State funds	$70	$19	$70	$17
Support for the working poor				
Total funds	$340	$380	$340	$347
State funds	$127	$129	$127	$118

Source: GAO survey and analysis of state expenditure data.

However, for expenditures on a broader array of programs that support the working poor, total expenditures increased 2 percent in real terms. This trend was driven by increased spending of federal funds in child care and child development programs. Despite the increase in total spending on this category, the share of the expenditures financed with state funds declined by about 7 percent in real terms. (See table 9.) However, as noted previously, the state targeted $93 million in rebates of the state's surplus in 2000 to low-income families.

Table 10: Colorado's TANF-Related Expenditures

Dollars in millions

	Nominal		Real (expressed in 1995 dollars)	
	1995	2000	1995	2000
Support for the working poor plus health care				
Total funds	$894	$1,436	$894	$1,309
State funds	$385	$657	$385	$600
TANF-related social services				
Total funds	$1,188	$1,842	$1,188	$1,681
State funds	$555	$924	$555	$843

Source: GAO survey and analysis of state expenditure data.

By expanding our expenditure analysis to include the costs of health care for the working poor, we find that the state has increased both the total level of spending as well as the share of the total it finances from state funds. Total spending on programs supporting the working poor and their related health care costs rose by about 46 percent in real terms from 1995 to 2000. The share of those expenditures the state financed out of state funds rose even further, however, by about 56 percent. Accordingly, the share financed by the state increased since 1995 when it financed about 43 percent of total costs; in 2000, the state's share was 46 percent.

Under the broadest definition of TANF-related social services including child welfare programs, transitional services for the developmentally disabled, mental health services, and substance abuse programs—cumulative expenditures on those programs as well as those previously discussed in this analysis rose by 42 percent in inflation adjusted terms. The state's share of the total rose even more, however, and as a result the state now finances a larger share of the total costs. In 1995, the state financed 47 percent of the total and, in 2000, it financed 50 percent of the total.

Additional federal safety-net programs provide food assistance and supplemental security income for needy families with children in Colorado, but are not shown in figure 5. The federal government provided $213 million in food stamp benefits to low-income individuals in the state in 1995, and $130 million in 2000. In addition, from 1995 to 2000, federal supplemental security income payments increased from $216 million to about $239 million in nominal dollars—about 82 percent of these benefits went to individuals under 65 years of age.

Rainy Day Funds

Colorado has established reserves of TANF funds; a short-term emergency fund for the state Department of Human Services to use to address contingencies, a long-term reserve that could be used in the event of an economic downturn, and a county reserve fund. Since Colorado allocates most of its TANF block grant to counties, some counties have been able to amass significant reserves. While these reserves remain in the U.S Treasury until the counties need them, these funds remain under county control. The fundamental purpose of the county reserves is to provide for the maximum amount of flexibility to counties to implement the provisions of welfare reform to meet local needs. However, many county officials view these reserves as the first line of defense for the counties to turn to in the event of a recession.

Because TANF funds are allocated to the counties under the memorandum of understanding, the state records all TANF funds including the county reserves as an obligation by the state even though the county might not have made specific decisions regarding their plans for these funds. As of June 30, 2000, the end of the state's fiscal year, the state estimated that the counties held about $67 million in reserves. The state's TANF financial reports for the end of the federal fiscal year 2000—September 30, 2000—however, record no unobligated balances but $94 million in unliquidated obligations. (See table 11).

Table 11: Unspent TANF Funds in Colorado as of September 30, 2000

Dollars in millions

Unobligated balance	Unliquidated obligations	Total unspent funds	Unspent funds as a percent of annual TANF grant
0	$94.2	$94.2	69%

Source: HHS' Administration for Children and Families.

In addition to the county reserves, the state maintains both its short-term and long-term reserves. The "Short-term Emergency Works Fund" receives an annual appropriation of $3 million of federal TANF funds. These funds are provided to the state Department of Human Services to use in response to counties for emergencies. Depending on the circumstances, the counties are required to deplete their allocation and their reserve before gaining access to these emergency funds. At the end of the state fiscal year, the balance in the fund is reduced to zero and any funds not expended are transferred to the "Long-term Works Reserve Fund."

The long-term reserve was designed to provide the state and the counties with enough funds to continue the state's welfare program in the event of an economic downturn. The state's Department of Human Services (DHS) developed a model to forecast how the state's welfare costs might respond under a variety of economic scenarios. Although DHS presented the results of the model to the legislature as a basis for determining the appropriate size for the Long-term Works Reserve Fund, a legislative analyst told us the model was flawed. While the model forecasts changes in caseloads, it multiples the higher caseloads by a factor that is less than the minimum monthly assistance grant for a family of three. The model does not factor in other costs for employment and training programs, child care subsidies, or any other transitional service.

The state funds the long-term reserve a number of ways. First, at the end of the state fiscal year, it assesses each county's expenditures against its allocation. Counties retain the first 20 percent of their unspent balance and fifty percent of the remaining unspent balance. The remainder reverts to the state's Long-term Reserve Fund. In addition, each year the balance from the state's short-term reserve reverts to the long-term reserve, as well as any federal TANF funds made available to the state—e.g., through the high performance bonus—that have not otherwise been appropriated or spent. While the funds in the long-term reserve are federal TANF funds and can only be used for the Colorado Works program, there is no statutory prohibition against the legislature making appropriations from these funds for a number of TANF-related purposes, in addition to an economic contingency.

Connecticut

Background

State fiscal year:	July 1-June 30
Budget cycle	Biennial
TANF grant:[a]	$267 million
75% MOE: $183 million	$183 million
Cash assistance caseload:[b]	61,000 families in 1995 27,000 families in 2000 55 percent decline

[a]Connecticut received $2.5 million in 2000 and $2.6 million in 2001 in federal TANF funds as bonuses for successful program outcomes.

[b]Caseload as reported to HHS for January 1995 and June 2000 and rounded to the nearest thousand.

Connecticut launched its statewide welfare program, Jobs First, in January 1996, based on earlier demonstration programs operated under federal waivers that began in 1995 and continue through September 2001. The purpose of Jobs First is to encourage able-bodied individuals to actively seek, obtain, and retain employment.

To receive cash assistance, job-ready adults in families must look for work immediately, in accordance with the program's work-first philosophy. As an incentive, families may continue to receive their full monthly cash assistance payments while they are working as long as their earnings are below the federal poverty level and they have not exceeded the program's time limits on cash receipt. Families in Jobs First may also retain up to $100 in child support collected on their behalf by the state agency without any reduction in their cash assistance, and they are eligible for medical assistance. They may also receive help with transportation and child care, if necessary to facilitate their employment or job search.

The maximum cash assistance payment is $543 a month for a family of three, an amount unchanged since the enactment of TANF. However, eligibility for assistance has eased, as permitted under TANF, making families eligible with incomes at or below 75 percent of the state's median income, which approximates 335 percent of the federal poverty rate. Alternatively, eligible applicants may choose diversion payments equivalent to 3 months of cash assistance and forgo assistance under the Jobs First program. Receipt of cash assistance under Jobs First is limited by state law to 21 months for those considered job ready but may be extended in increments of 6 months for families with incomes below the monthly cash assistance payment level.

Families who lose assistance due to time limits and who do not have income at or above the cash assistance payment standard are referred to the state-funded safety net program called Worksteps for counseling, food, clothing, and up to 12 months of vouchers for rental assistance. Working families who leave Jobs First may receive transitional medical assistance for 2 years after they leave the program. Subsidized health care is also available to children of the working poor whose incomes are at or below 185 percent of the poverty level. Working families may receive subsidized childcare if their incomes are below 75 percent of the state median income.

Needy two-parent families who meet eligibility guidelines are served under a separate, state program with policies similar to Jobs First. Recent legal immigrants who are not eligible for TANF may receive cash and medical assistance under a separate program supported with state funds. Both these programs count towards state MOE.

The state operates Jobs First directly through its social service offices located in five regions that determine eligibility and arrange for electronic payments of cash assistance. Since 1998, job training and employment services are provided through the state's Department of Labor and its regional workforce boards and subcontractors. In addition to Jobs First and related programs, TANF funds are used to support child welfare and substance abuse services as well as teenage pregnancy prevention pilots in eight urban and one rural area.

Supplantation in the State Budget

Connecticut's policy is to draw down its entire TANF grant, leaving nothing in reserve. Historically, most of Connecticut's TANF grant has been expended through traditional welfare programs within the control of the state social services agency. As caseloads have fallen, it has become increasingly difficult for the agency to spend the entire grant and at the end of federal fiscal year 1999, the state reported nearly $40.7 million of unspent TANF funds. Budget officials said they asked the agency to pursue options that would allow the state to use TANF funds instead of state funds in programs operated outside the agency. Using TANF funds, the agency hired a contractor to help identify such program expenditures, and in June 2000, retroactively drew down $40 million of its TANF balances for expenditures the state made in 1999. In addition to these direct-TANF claims, by maximizing the amount of TANF funds it transfers to the Social

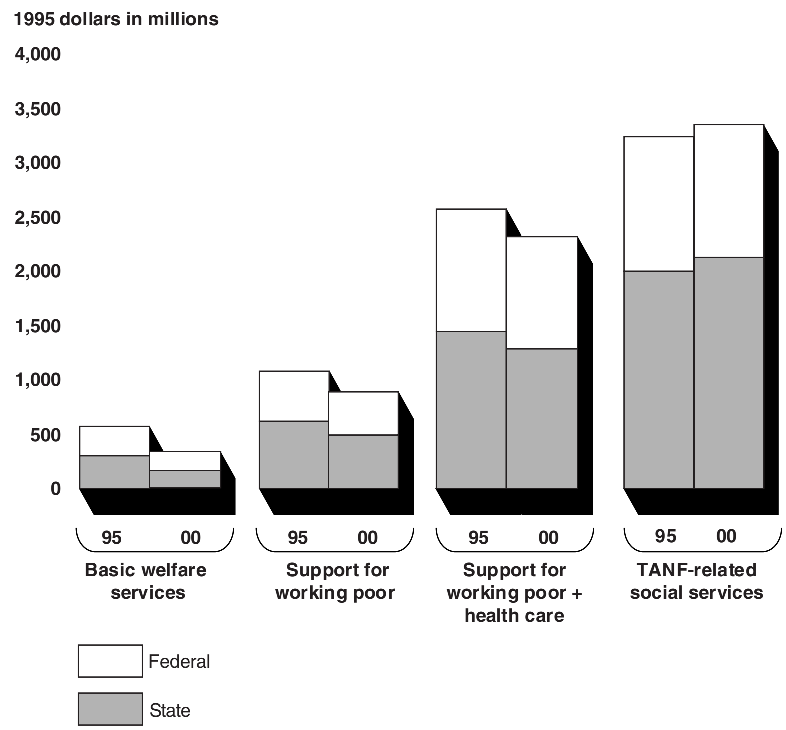
Services Block Grant, the state also frees up its funds from the budgets of a variety of other state-funded programs. The state has reported saving about $24 million a year in state funds through this transfer mechanism.

The state initiated expansions in child welfare programs and early childhood development programs with state funds between 1995 and 2000; once significant TANF-savings were achieved as a result of the large decreases in cash assistance caseloads, state budget officials contend that these savings were then reinvested into those child welfare and early childhood development programs. State officials said that the expenditures the contractor helped them identify were—in large measure—from these child welfare and early childhood development programs.

Given current caseload levels, state budget officials said that in limiting the use of TANF funds to only those programs operated by the state social services agency it would continue to be difficult to spend the state's entire TANF grant. As a result, the state will most likely continue to claim the full TANF grant each year in order to cover expenditures in other departments which had previously been paid for with state funds State budget officials said that program expansion is difficult in Connecticut because of a spending cap that applies to both federal funds and state funds and therefore limits the growth of new programs and new spending regardless of the source of financing.

State Spending Trends From 1995 to 2000

Figure 6: Connecticut's TANF-Related Expenditures for State Fiscal Years 1995 and 2000



To assess how state budget decisions might have affected spending, we collected data on how Connecticut uses both state and federal funds in its TANF-related social services programs. The results are grouped into four categories, as shown in figure 6 and described further in appendix I. Each category is identified on the graph by two bars--one for spending that occurred in state fiscal year 1995 and one for spending that occurred in state fiscal year 2000. From left to right, the categories are cumulative. Expenditures for cash assistance and employment training are included in expenditures for support of the working poor. These expenditures in turn are included in expenditures for support of the working poor plus health care. Finally, all expenditures are included in social services expenditures.

Spending on cash assistance payments in Connecticut has gone down by about $250 million in nominal dollars from state fiscal year 1995 through

2000, as caseloads have declined and the monthly assistance level has remained constant. (See table 12.) At the same time, spending on job training has increased by about $40 million so that it nearly equals the amount spent on cash assistance. Adjusted for inflation, overall spending on cash assistance and job training has declined 42 percent. The state's share of cash assistance and job training costs has fallen relative to the federal share. Where the state paid about 52 percent of these costs in 1995, it paid only 46 percent in 2000.

Table 12: Connecticut's TANF-Related Expenditures

Dollars in millions

	Nominal		Real (expressed in 1995 dollars)	
	1995	2000	1995	2000
Basic welfare services				
Total funds	$574	$365	$574	$333
State funds	$300	$168	$300	$153
Support for the working poor				
Total funds	$1,087	$967	$1,087	$883
State funds	$618	$534	$618	$488

Source: GAO survey and analysis of state expenditure data.

Looking at the broader picture of expenditures for welfare recipients and the working poor in Connecticut that includes the totals above and child care shows less steep declines. (See table 12.) Combined expenditures fell by $120 million from 1995 through 2000 in nominal dollars, a drop of 19 percent in real terms. The decline is moderated because the aforementioned reductions in cash assistance are offset to some extent by increases elsewhere. Spending on child care accounts for the largest increase, more than doubling to $181 million in 2000. Budget officials note that some of the additional funds targeted for child care remain unspent; it is unclear whether this is because demand has leveled off or available child care is difficult to access. The state paid 57 percent of all these costs in 1995; by 2000 its share had dropped by 2 percent relative to the federal share.

Total spending on health care costs for low-income individuals and families increased by nearly $100 million, but the increase was not enough to offset the reductions in programs to support the working poor and basic welfare services. (See table 13.) When healthcare expenditures are added to the totals described above, combined spending shows a slight decline of $24 million in nominal dollars from state fiscal years 1995 through 2000, representing a decline of 10 percent in real dollars. However, the state's share of funding has remained stable—about 56 percent—since 1995.

Table 13: Connecticut's TANF-Related Expenditures

Dollars in millions

	Nominal		Real (expressed in 1995 dollars)	
	1995	2000	1995	2000
Support for the working poor plus health care				
Total funds	$2,567	$ 2,543	$2,567	$2,320
State funds	$1,452	$1,417	$1,452	$1,293
TANF-related social services				
Total Funds	$3,371	$3,664	$3,371	$3,343
State Funds	$2,060	$2,229	$2,060	$2,097

Source: GAO survey and analysis of state expenditure data.

In contrast, a different trend appears when costs of child welfare and other social services such as services for those with developmental disabilities, substance abuse problems, and mental health needs are included in the totals above. Expenditures for all social services declined slightly in real terms from 1995 through 2000 (see table 13), but state spending shows a small increase. Costs of these services have been borne primarily by the state, but some shifts occurred between 1995 and 2000, such that the federal share of child welfare increased modestly—as evidenced by the state's use of TANF funds in place of state funds in these programs—while the state share of other services increased modestly. Overall for TANF-related expenditures on social services that include basic welfare services, support for the working poor, child care and health care, the state's investment has increased relative to the federal investment; the state share rose from 61 percent in 1995 to about 63 percent in 2000.

Additional federal safety-net programs provide food assistance and supplemental security income for needy families and children in Connecticut. For example, the federal government provided $204 million in food stamp benefits to low income individuals in Connecticut in 1995 and $197 million in 2000. In addition, from 1995 to 2000, federal supplemental security income payments increased from $176 billion to $223 billion with about 82 percent of these benefits going to individuals under 65 years of age.

Rainy Day Funds

According to budget officials, Connecticut employs a unique system of budgeting they term “gross budgeting.” An agency receives an appropriation deemed sufficient to cover its priorities for the budget year without regard to the source of funding. The agency is expected to allocate its expenditures to the appropriate federal or state funding source and document all claims to federal funds. This claiming process is revisited at year-end to ensure that the agency maximizes the use of federal funds available.

As noted previously, Connecticut’s budgetary policy is to spend its entire TANF grant, leaving no balances at the U.S. Treasury. State officials said their budget strategy is to provide the agency with the financing it needs to accomplish its objectives and to require the agency to find a way to claim all available federal funding. In addition, state budget officials explained that there was concern that any balances left might be rescinded by the Congress.

In line with its policy, Connecticut reports no unspent TANF funds through September 30, 2000. (See table 14.)

Table 14: Unspent TANF Funds in Connecticut as of September 30, 2000

Unobligated TANF funds	Unliquidated obligations of TANF funds	Total unspent funds	Unspent funds as a percent of TANF annual grant
0	0	0	0%

Source: HHS’ Administration for Children and Families.

Accordingly, Connecticut does not have a TANF rainy day fund. The state does not have a formal mechanism or fund to prepare for shortfalls in funding for its future social service needs. Budget officials said that the state has always placed a priority on serving the needy and historically has found a way to finance these programs.

Louisiana

Background

State fiscal year:	July 1-June 30
Budget cycle:	Annual
TANF grant:[a]	$164 million
75% MOE:	$55 million
Case assistance caseload:[b]	82,000 families in 1995 26,000 families in 2000 69 percent decline

[a]Louisiana receives from $4 million to $13 million in annual TANF supplements because the state's pre-TANF expenditures per poor person were less than 35 percent of the national average. In addition, Louisiana received a bonus of $3.7 million in 2000 for positive program outcomes.

[b]Caseload as reported to HHS for January 1995 and June 2000 and rounded to nearest thousand.

The welfare reform that took effect in Louisiana in January 1997 consists of two components: (1) a cash assistance component called the Family Independence Temporary Assistance Program (FITAP) and (2) an employment and training component called FIND Work. The overall goal is to decrease long-term dependency on cash assistance through the promotion of job preparation and work.

Although work is the goal, the program is not based on a strict work-first approach. Instead, families may receive cash assistance for up to 2 years, the limit set in TANF law, before they are required to participate in work activities or lose their eligibility for continued assistance. Those who are completing education or training programs, actively seeking work, employed a short time with limited earnings, or otherwise exempt may continue to receive cash payments beyond the 2 years. Those who are not exempt and who have received cash assistance for 2 years must wait another 3 years before they are eligible for cash assistance again. After the equivalent of 5 years of cash receipt, they are ineligible, in accordance with TANF.

The maximum cash payment for a family of three is $240 a month, an increase from the $190 a month that was in effect from 1981 through 2000. Needy families with children whose adjusted incomes are below the payment level are eligible for cash assistance. State policy requires that applicants be screened for drug abuse and, where appropriate, assessed, tested, and treated. To facilitate their participation in activities under the FIND Work component, families may receive transportation subsidies up to $60 a month, child care, and case management. Subsidized jobs may be provided where unemployment is high in order to help meet work participation requirements. To provide a financial incentive to work, families who obtain unsubsidized jobs may continue to receive their full cash assistance payments for 6 months, if their earnings are within certain limits. When their earnings make them ineligible for monthly cash assistance, they may receive 12 months of transitional medical and child care assistance.

For needy children who are not in the care of their parents, Louisiana instituted a kinship care program in March 2000. Under this program, needy children are eligible for a monthly cash payment if they are legally in the care of relatives other than their parents, and if the relatives' income is less than 150 percent of the federal poverty level. In July 2000, the state expanded its teen pregnancy prevention efforts, in line with the new TANF goals.

A single state agency in Louisiana administers both FITAP and FIND Work. State staffs working out of offices in the local parishes[1] throughout the state process applications and determine eligibility for cash assistance payments that are made electronically. Work-related activities and other services are provided under contracts with the state agency.

Supplantation in the State Budget

We found little evidence of supplantation in Louisiana's budget since TANF was enacted. A state-funded teenage pregnancy prevention program was moved to the state social services agency in state fiscal year 2000, expanded statewide, and funded with $3.5 million in TANF funds instead of state funds. The freed-up state funds were used on other state priorities.

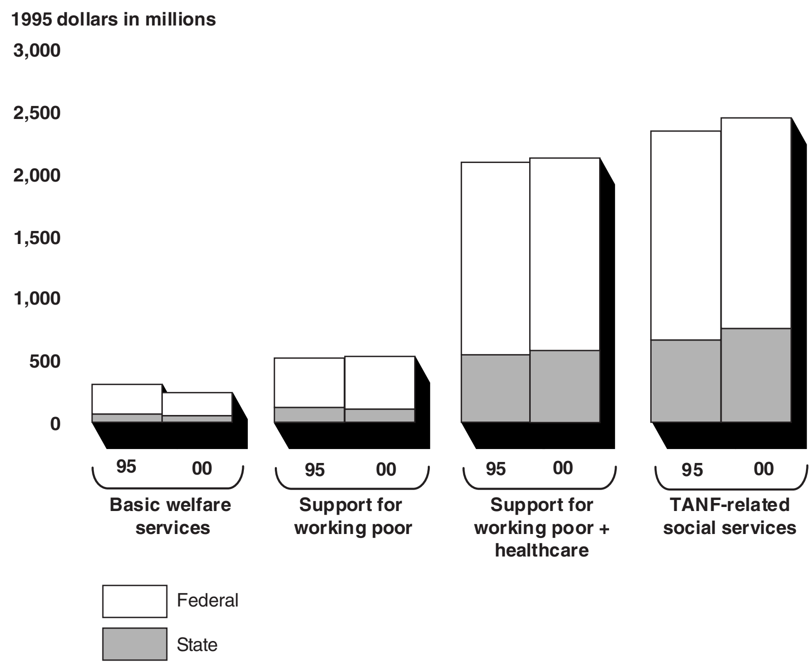
According to senior budget officials, the lead TANF agency in the state—the Department of Social Services (DSS)—controls the use of the federal TANF funds in the budget process. Senior DSS officials said that they have been very concerned about the perception federal oversight authorities might get of Louisiana if the stateLouisiana used the TANF funds to replace state funds—even if the rules allowed it. The executive budget office and the legislature have largely deferred to the agency when budgeting for TANF.

[1]Parishes are similar to counties in that they are a subunit of government.

State budget officials said that state general funds for social services are relatively scarce, and there are very few programs financed with state funds that are not already being used to match federal funds in other programs or to meet the TANF maintenance-of-effort requirement. Given the span of control of DSS, there is little incentive for the agency to look outside its own budget for programs that could be financed with TANF funds. Thus, the cautious approach to replacing state funds with TANF funds is due, in part, to the limited role played by the state budget office and the legislature in directing the use of the TANF funds to other areas within the state budget.

Spending Trends From 1995 to 2000

Figure 7: Louisiana's TANF-Related Expenditures for State Fiscal Years 1995 and 2000



To assess how state budget decisions might have affected spending, we collected data on how Louisiana uses state and federal funds to finance its TANF-related social services expenditures. The results are grouped into four categories, as shown in figure 7 and described further in appendix I.

Each category is identified on the graph by two bars—one for spending that occurred in state fiscal year 1995 and one for spending that occurred in state fiscal year 2000. From left to right, the categories are cumulative. Expenditures for cash assistance and employment training are included in expenditures for support of the working poor. These expenditures in turn are included in expenditures for support of the working poor plus health care. Finally, all expenditures are included in social services expenditures.

Spending of combined state and federal funds for cash assistance and job training in Louisiana has declined by 21 percent in real terms from 1995 through 2000 as the number of families receiving cash assistance has fallen. The state's investment has declined from $69 million to $55 million—a real drop of 28 percent. The state's share of total expenditures slipped declined from 23 percent in state fiscal year 1995 to 21 percent in 2000. Federal funds make up the difference and continue to support most of the costs of cash assistance and job training in Louisiana, as is evident in table 15.

Table 15: Louisiana's TANF-Related Expenditures

Dollars in millions

	Nominal		Real (expressed in 1995 dollars)	
	1995	**2000**	**1995**	**2000**
Basic welfare services				
Total funds	$305	$263	$305	$240
State funds	$69	$55	$69	$50
Support for the working poor				
Total funds	$522	$581	$522	$530
State funds	$117	$120	$117	$109

Source: GAO survey and analysis of state expenditure data.

Real gains are shown in total spending on programs that support the working poor by helping low-income families transition—or stay—off public assistance. In addition to FITAP, these services include child care, transportation subsidies, and employment services. Total spending rose by nearly $60 million—a real gain of about 2 percent. Driving this trend is increased spending on child care, which more than tripled from 1995 through 2000. However, the state used federal funds to finance most of this increase. While state spending remained virtually unchanged in nominal terms, it declined by about 7 percent in real terms. Again, the state's share of total expenditures has slipped declined from 23 percent in state fiscal year 1995 to 21 percent in 2000.

Total spending on traditional welfare programs, supportive services for the working poor, and their related health care costs grew by about 2 percent in real terms from 1995 through 2000. In nominal dollars total expenditures increased from $2.1 billion to $2.3 billion, as shown in table 16. State spending rose by nearly $100 million—or 8 percent in real terms. Federal spending stayed relatively constant in real terms. The relative shares of the costs of these programs changed as a result. The state now finances about 28 percent of these programs, but in 1995 it financed about 26 percent.

Table 16: Louisiana's TANF-Related Expenditures

Dollars in Millions

	Nominal		Real (expressed in 1995 dollars)	
	1995	**2000**	**1995**	**2000**
Support for the working poor plus health care				
Total funds	$2,083	$2,339	$2,083	$2,134
State funds	$543	$643	$543	$587
TANF-related social services				
Total funds	$2,338	$2,681	$2,338	$2,446
State funds	$663	$821	$663	$749

Source: GAO survey and analysis of state expenditure data.

An upward trend is also evident when costs of child welfare and other social services such as those for substance abuse, mental health, and developmental disabilities, are included in the totals above. Total expenditures for all social services increased from $2.3 billion to $2.7 billion in nominal dollars from state fiscal years 1995 through 2000—an increase of 5 percent in real terms. State spending increased by about 13 percent in real terms. The state share of all these programs costs rose from about 28 percent in 1995 to about 31 percent in 2000.

Additional federal safety-net programs provide food assistance and supplemental security income for needy families and children in Louisiana. The federal government provided $634 million in food stamp benefits to low-income individuals in Louisiana in 1995 and $452 million in 2000. In addition, from 1995 to 2000, federal supplemental security income payments increased from $715 million to $745 million, about 85 percent of which went to individuals under the age of 65.

Rainy Day Funds

Louisiana has left a large share of its TANF funds unspent. As of September 30, 2000 Louisiana reported about $169 million in unspent TANF balances, more than the state's annual block grant award and about 26 percent of the cumulative TANF funds awarded to the state since 1996. (See table 17.) While these funds must remain in the U.S. Treasury until they are needed, state program officials said that they consider these balances to be a contingency fund. They added that they would use the funds to cover unexpected program costs in the event the appropriations estimates were too low. Budget officials told us that no study had been conducted on how much the state would need to maintain in a reserve in order to be able to finance its welfare program during an economic downturn. DSS budget officials said they were concerned about the impact a recession might have on the program's budget and sought to set aside a significant TANF reserve to ensure that the state had access to additional program funds. While DSS did not establish a specific balance for its reserve, budget officials believe that now that it has reached the level of the state's annual block grant they might have a better chance of making their case in the legislature for using more of the future grants to create new programs or expand existing programs.

Table 17: Unspent TANF Funds in Louisiana as of September 30, 2000

Dollars in millions

Unobligated TANF funds	Unliquidated obligations of TANF funds	Total unspent funds	Unspent funds as a percent of annual TANF grant
$169	0	$169	103.1%

Source: HHS' Administration for Children and Families.

State program and budget officials acknowledge that the budget climate in the state makes it very difficult to raise spending for social services even if the state can use federal funds to finance the programs. Once new programs are enacted they create new constituencies that will continue to demand services. These officials expressed concerns that if federal funding were ever reduced or some restrictions placed on the block grant that affected the state's flexibility, the state would have to find a way to finance the program with its own funds.

State program officials said that they have known for some time that in order to spend more of the TANF funds that were available on a declining caseload, they would have to expand programs or create new programs and services to help FITAP families transition into the workforce. They also said that it is very difficult to get the legislature to act on these requests. For example, they said it took 3 years to negotiate an increase in the monthly cash grant for a family of three from $190 to $240. This increase, which took place in state fiscal year 2000 was the first increase in grant levels since 1981. Based on current caseload projections this increase in the cash grant was expected to cost an additional $18.6 million per year and was funded entirely with federal TANF funds. During the same fiscal year the state expanded access to its subsidized child care program—at a cost of $24 million, financed entirely with TANF funds—that was expected to serve an additional 8,000 eligible children.

Although legislative analysts disagreed with the department's assessment that the legislature has opposed expanding the use of TANF funds, they acknowledged that there is a conservative political environment in the state. They added, however, that they plan to begin pressing DSS to explore more options for spending the state's TANF resources and for slowing the growth in unspent balances.

Maryland

Background

State fiscal year:	July 1-June 30
Budget cycle	Annual
TANF grant:	$229 million
75% MOE:	$177 million
Cash assistance caseload:[a]	81,000 families in 1995 29,000 families in 2000 64 percent decline

[a]Caseloads as reported to HHS for January 1995 and June 2000 and rounded to the nearest thousand.

Maryland's welfare reform effort, known as the Family Investment Program (FIP), was initiated in October 1996. The program represents a major shift from an income maintenance focus to one that seeks to promote family independence through work, personal and family responsibility, and community involvement.

To receive cash assistance under FIP, adults in eligible families must be willing to seek work immediately. The maximum cash assistance level for a family of three is $439 a month, an amount that has increased since passage of TANF to keep pace with inflation. Medical assistance coverage is automatic for families receiving cash aid. Needy families with children whose adjusted incomes are below the monthly cash assistance levels are eligible for FIP.

Support services available to FIP families vary by county and may include transportation, child care, referral to family planning, and substance abuse treatment in addition to assessment, job search, and employment services. In place of monthly cash assistance, diversion payments are available to eligible families, according to policies established by each county. After 3 months of cash receipt, a working family may receive child care and medical assistance for up to 12 additional months.

Working low-income families may be eligible for the state's earned income tax credit. Separate, state-funded programs are offered for needy two-parent families, legal immigrants not otherwise eligible for TANF, children in the care of relatives who are not their parents, and certain other groups. These programs, and the state's earned income tax credit (EITC), are used toward the state's MOE.

A single Maryland state agency supervises FIP, which is administered at the local level by county social service agencies and by contract with nonprofits and other organizations. In addition to FIP, TANF funds are used to support a broad array of other programs. These include programs that provide work opportunities for youth, summer activities designed to lower school drop-out rates, home visits with expectant parents who are at risk of welfare dependency, family support centers, independent living skills for teen parents, family preservation, and other child welfare services.

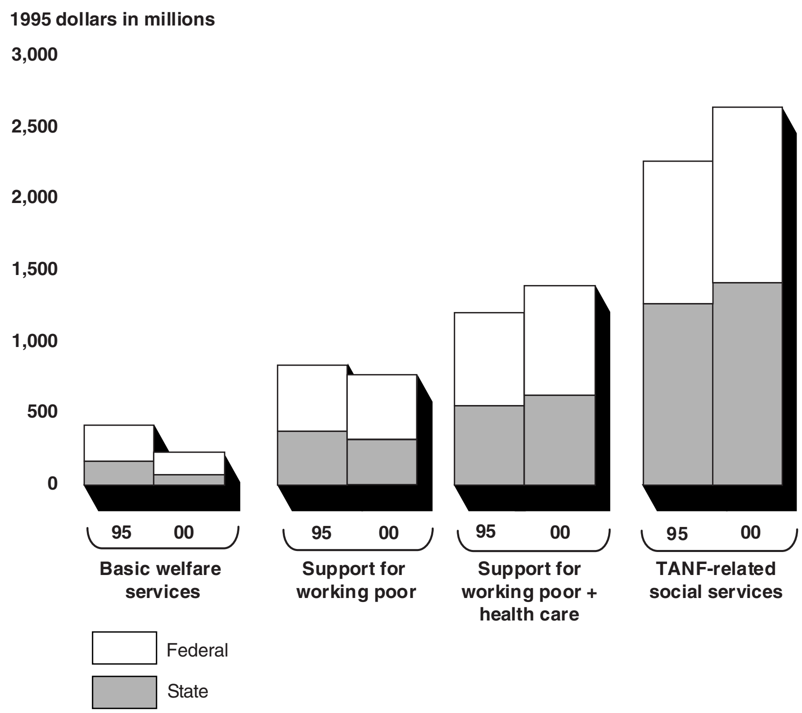
Supplantation in the State Budget

In preparing the FIP budget for state fiscal year 2001, the state sought to replace state funding in a variety of program accounts with federal TANF funds. However, instead of using the freed-up state funds for other spending priorities Maryland set them aside in the Dedicated Purpose Account—essentially a rainy day fund that can only be spent on programs for low-income families. State budget officials suggested that substituting state funds with TANF funds in this way was a more fiscally prudent approach for using their unspent TANF balances than spending all savings on expanding programs and services. They said that their decision was rooted in concerns that Congress would recategorize the block grant and restrict state flexibility, or rescind TANF funds left unspent by the states. There was also concern that the TANF block grant might be reduced in reauthorization, and if this occurred, the state could be left with high expectations and demands for services previously funded with federal dollars that would have to be continued with state dollars. These concerns, coupled with the desire to prepare for economic contingencies, motivated the state to consider using unspent TANF funds to replace state funds which were then set aside in the Dedicated Purpose Account.

Maryland's fiscal year 2001 budget used $30 million in federal TANF dollars to continue several programs formerly supported with state funds. A state budget official said that if the FIP caseload and expenditures remain stable, then there will be sufficient TANF funds available over the next 2 years to continue to finance these programs and to allow the state to deposit its freed-up funds in the Dedicated Purpose Account. The state also retroactively adjusted its state fiscal year 2000 appropriations and authorized a shift of $22.3 million in state funds out of several child welfare and pregnancy prevention programs.

Spending Trends From 1995 to 2000

Figure 8: Maryland's TANF-Related Expenditures for State Fiscal Years 1995 and 2000



To assess how state budget decisions might have affected spending, we collected data on how Maryland uses both state and federal funds in its TANF-related social services programs. The results are grouped into four categories, as shown in figure 8 and described further in appendix I. Each category is identified on the graph by two bars—one for spending that occurred in state fiscal year 1995 and one for spending that occurred in state fiscal year 2000. From left to right, the categories are cumulative. Expenditures for basic welfare services like cash assistance and employment training are included in expenditures for support of the working poor. These expenditures in turn are included in expenditures for support of the working poor plus health care. Finally, all expenditures are included in TANF-related social services expenditures.

Spending on basic welfare services in Maryland has been cut from $417 million in state fiscal year 1995 to $257 million in 2000 as a direct result of the smaller caseload. (See table 18.) In real terms, spending has declined 44 percent, despite higher monthly cash assistance payment levels for FIP families. Before welfare reform was enacted, the state contributed about 41 percent of the expenditures in these areas. Since welfare reform was enacted, however, the state's and counties' contributions for cash assistance and job training has dropped to 32 percent.

Table 18: Maryland's TANF-Related Expenditures

Dollars in millions

	Nominal		Real (expressed in 1995 dollars)	
	1995	2000	1995	2000
Basic welfare services				
Total funds	$417	$257	$417	$ 234
State funds	$170	$ 81	$170	$74
Support for the working poor				
Total funds	$837	$835	$837	$762
State funds	$377	$345	$377	$315

Source: GAO survey and analysis of state expenditure data.

The spending decline is less steep when programs that provide support for the working poor are also considered. In this category, spending slipped from $837 million in 1995 to $835 million in 2000 in nominal dollars. Adjusted for inflation, this represents a decline of 9 percent. In line with the state's decision to make child care more affordable and accessible, child care spending has grown by $47 million so that it nearly equals spending on cash assistance. Since 1995, Maryland's share of spending on these programs has declined by about 4 percent.

When we include health care expenditures in our analysis, the trend is reversed—total spending increases from $1.2 billion to $1.5 billion over the same time period. (See table 19.) This represents an increase in real terms of about 16 percent. Combined federal-state spending on health care for the working poor as well as those in FIP has nearly doubled to $695 million. Since 1995, Maryland's share of all spending on basic welfare services, support for the working poor, and health care has declined only slightly—by about 1 percent.

Table 19: Maryland's TANF-Related Expenditures

Dollars in millions

	Nominal		Real (expressed in 1995 dollars)	
	1995	2000	1995	2000
Support for the working poor plus health care				
Total funds	$1,208	$1,530	$1,208	$1,396
State funds	$560	$689	$560	$628
TANF-related social services				
Total funds	$2,261	$2,897	$2,261	$2,644
State funds	$1,273	$1,552	$1,273	$1,416

Source: GAO survey and analysis of state fiscal survey.

An upward trend in total spending is also evident when costs of child welfare, juvenile justice, and other social services such as services for the developmentally disabled, substance abuse treatment, and mental health services are included in the totals above. Expenditures for all TANF-related social services increased from $2.3 billion to $2.9 billion in nominal dollars from state fiscal year 1995 to state fiscal year 2000. In real terms, this represents an increase of 17 percent. On average for all services included in our survey, Maryland funds about 54 percent of costs, down about 3 percent since welfare reform was enacted.

Additional federal safety-net programs provide food assistance and supplemental security income for needy families with children in Maryland, but they are not shown in figure 8. The federal government provided $366 million in food stamp benefits to low-income individuals in Maryland in 1995, and $204 million in 2000. In addition, from 1995 to 2000, federal supplemental security income payments increased from $333 million to $411 million in nominal dollars—about 80 percent of these benefits went to individuals under 65 years of age.

Rainy Day Funds

Maryland is the only state in our study to set aside state funds rather than federal funds for economic contingencies. As early as 1997, Maryland placed $15.7 million of its state general funds in the Dedicated Purpose Account for welfare programs, and in 2001, the state deposited an additional $52 million in state funds into this account. But as previously noted, Maryland found a way to transfer the costs of saving state funds to the federal government.

As with states that set aside a portion of their federal TANF block grant funds for a rainy day, the levels of Maryland's reserves do not appear to be based on any sort of contingency planning or analysis. While an economic model which forecasted how caseloads—and related costs—might respond under a variety of economic scenarios was presented to the legislature, a senior budget official acknowledged that the amount deposited in the Dedicated Purpose Account was based on the amount of state funding that could be replaced with federal TANF funds.

In Maryland there are several safeguards in place to help ensure that these funds remain in reserve until they are needed to finance budget shortfalls in welfare programs. The executive branch must get legislative approval for any appropriation from the fund, and under state statute, funds deposited to a dedicated purpose reserve must be spent on purposes for which the fund was established. If, after 4 years, the funds are not spent, they revert to the state's general purpose rainy day fund. However, the state can reauthorize the dedicated reserve fund for an additional four years, as it did with the original $15.7 million deposited to the fund in 1997. Senior budget officials said that they expect the state legislature to continue to appropriate these funds for their designated purpose—the state's welfare program.

Although Maryland has shifted TANF funds into various state programs outside of FIP, the state has accumulated significant reserves of unspent TANF funds, representing 45 percent of its annual grant. See table 20 for the TANF funds that the state reported as unspent through September 20, 2000.

Table 20: Unspent TANF Funds in Maryland as of September 30, 2000

Dollars in millions

Unobligated TANF funds	Unliquidated obligations of TANF funds	Total unspent funds	Unspent funds as a percent of TANF annual grant
$49.5	$54.2	$103.7	45.3%

Source: HHS' Administration for Children and Families.

Amounts reported as unobligated are due in large part to delays in getting the new program up and running and to the larger than expected drop in the number of families the program is serving, according to a senior budget official. Funds reported as unliquidated are due primarily to the structure of the state's operation and its reliance on county social service agencies and other contractors for the provision of services.

Unlike other states with county-administered welfare programs, Maryland records obligations of TANF funds only when the counties enter into contracts for specific services or have been billed for services already provided. Many local social service offices were not ready for the significant changes required by welfare reform, and they were slow to start spending the federal and state funds that were available. Even after these programs were established, the program management inexperience of many local social service personnel contributed to delays in disbursing funds.

In developing the state's 2001 budget, Maryland included about $160 million in unspent TANF funds in addition to its annual block grant. The state dramatically increased spending on child care by raising the income eligibility requirements and thereby allowing more families access to the subsidies. State officials said that these budget actions, once fully implemented, should succeed in drawing down the unspent TANF balances. In fact, according to budget estimates, the state's basic TANF grant is not sufficient to sustain this level of funding in future years. If budget forecasts prove accurate, some analysts predict the state will have to cut back some funding from these new programs or increase the levels of general funds it contributes to maintain the programs' funding levels.

Michigan

Background

State fiscal year:	October 1-September 30
Budget cycle:	Annual
TANF grant:[a]	$775 million
75% MOE:	$469 million
Cash assistance caseload:[b]	207,000 families in 1995 71,000 families in 2000 66 percent decline

[a]Michigan received an additional $3 million in federal TANF funds in 2000 as a bonus for work-related program outcomes and $20 million in both 1999 and 2000 for reductions in out-of-wedlock births.

[b]Caseloads as reported to HHS for January 1995 and June 2000 and rounded to the nearest thousand.

Under a series of waivers of federal rules, Michigan initiated its welfare reform program from 1992 through1996 through incremental policy changes applied to a research and demonstration project. The statewide program that resulted in October 1996 from these early experiments consists of two components: a cash assistance component called the Michigan Family Independence Program (FIP) and an employment and training component called Work First. As the name implies, the program is guided by work-first principles, and seeks to help families achieve the maximum possible self-support and independence.

To receive cash assistance, the adult in the family must participate in work or related activities within 2 months of enrollment unless he or she meets established criteria for deferrals from work requirements. The maximum amount of cash assistance paid has not changed since passage of TANF and is $459 per month for a family of three living in Wayne County, the state's most populous county. Needy families with children whose adjusted incomes are below the monthly cash assistance levels are eligible for the program. Once they become eligible, there is no time limit on families' receipt of cash assistance, because families in need of assistance will be supported with state funds when federal TANF funds can no longer be used. In addition to cash assistance, families may receive up to $50 in child support collected by the state agency on their behalf.[1]

[1]The remainder is retained by the state and federal governments as reimbursement for cash assistance payments made to these families.

After attending orientation and signing a personal responsibility plan and family contract, program participants are assigned to job search, subsidized work, or other activities. To make it possible for participants to work or attend other required activities, they may receive case management services, emergency assistance, transportation, subsidized child care, rental subsidies for up to 2 years, and individual development accounts for future education or home ownership. These services and benefits are supported with TANF funds and are also available to families with incomes below 200 percent of the federal poverty level who are not enrolled in the program. When program participants find work and no longer need cash assistance, they remain eligible for transitional childcare and medical assistance.

Outside of the program, TANF funds are used for several activities that are designed to help prevent poverty, promote child welfare by allowing children to remain in their own homes, and encourage family formation. These include state's supplemental security income payments, family preservation and support services, and family planning and teen pregnancy prevention efforts. They also include subsidies to families with incomes up to $60,000 to allow them to care for their disabled children in their homes and subsidies to families with incomes under 500 percent of the federal poverty level who adopt special needs children. In addition, Michigan helps families with incomes below 80 percent of median income levels obtain affordable housing by subsidizing down payments and repairs.

Michigan's program is operated by two state agencies. One agency provides cash assistance directly to welfare recipients and the other develops agreements with local providers, called Michigan Works! Agencies, for employment and training services.

Supplantation in the State Budget

Since 1998, Michigan has used TANF funds to replace about $126 million of state funds in a variety of state programs. For example, according to a legislative fiscal analysis, in 1998 the state shifted about $34 million in general funds out of about 10 program accounts and replaced these funds with federal TANF funds, and in state fiscal year 1999 the state found about $46 million in seven additional programs. In the single largest example of supplantation, the state began using $27 million in TANF funds in state fiscal year 2000 to finance a low-income homestead tax credit that had been financed with state funds since 1973, and the state funds were used to finance other priorities.

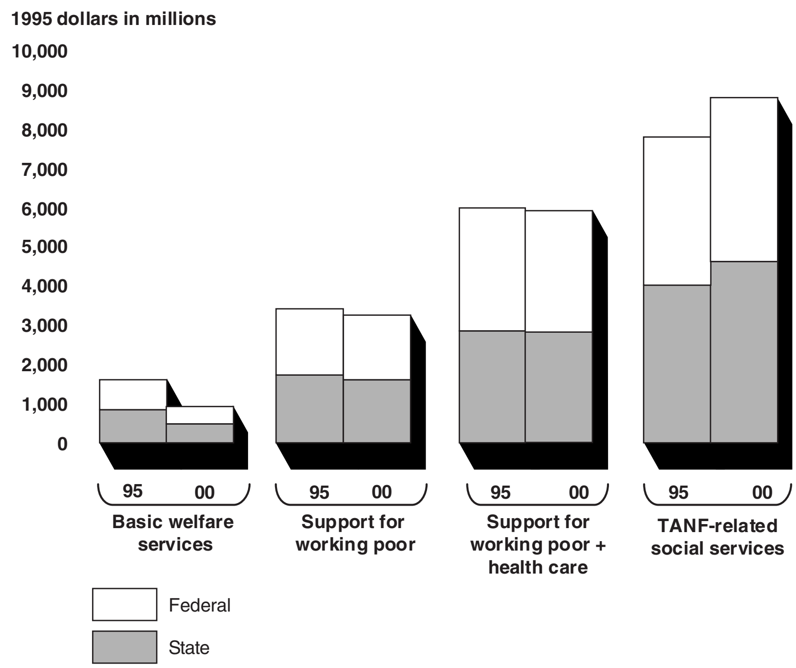
State budget officials said that even though the state has enjoyed healthy finances, it has been very difficult for the state agency administering FIP to get state funds beyond what is needed to cover the MOE requirement. As a result, a number of new welfare-related initiatives are funded with federal dollars. They added that the state's policy is to maximize the use of federal funds whenever possible. Given this budget environment, when Michigan has to come up with additional state funds for the state agency, a senior budget official said they have to find ways to come up with general funds savings in order to offset the need for additional state resources.

In state fiscal year 2000, Michigan had to finance a $160.7 million supplemental appropriations bill for the state agency administering FIP. About $80.6 million of this total were state funds which were needed to pay federal fines relating to its child support enforcement program, to increase food stamp compliance, and to cover certain child welfare activities funded in the prior fiscal year with TANF funds but not allowed under the final TANF rules. State officials said that there was little political appetite in Michigan to begin new programs that would require outlays of state funds.

The supplemental bill requiring additional state funds helped set the stage for the state fiscal year 2001 budget debate. Since a provision in TANF law limits what a state can count toward their MOE requirement, Michigan claimed only a portion of the homestead credit to count towards its MOE requirement. This provision, called the "new spending test," stipulates that when states use expenditures on programs that were not part of the old AFDC programs to count towards its MOE requirements, they can only use those expenditures that represent an increase over what the state spent on the programs in the base year of 1995. State budget officials argue that this penalizes Michigan compared to other states for having a low-income tax credit before TANF was enacted; a state with no tax credit in existence could enact one using only TANF funds. As a result, these officials maintained that it was reasonable to expect Michigan to refinance its tax credit with TANF funds, putting the state on par with other—less generous—states.

Spending Trends From 1995 to 2000

Figure 9: Michigan's TANF-Related Expenditures for State Fiscal Years 1995 and 2000



To assess how state budget decisions might have affected spending, we collected data on how Michigan used their federal and state funds to finance TANF-related social service expenditures. The results are grouped into four categories, as shown in figure 9 and described further in appendix I. Each category is identified on the graph by two bars—one for spending that occurred in state fiscal year 1995 and one for spending that occurred in state fiscal year 2000. From left to right, the categories are cumulative. Expenditures for cash assistance and employment training are included in expenditures for support of the working poor. These expenditures in turn are included in expenditures for support of the working poor plus health care. Finally, all expenditures are included in social services expenditures.

For cash assistance and job training, total spending has fallen from $1.6 billion to $1.0 billion. (See table 21.) Adjusted for inflation, this represents a decline of 42 percent. State spending[2] also declined from $835 million to $527 million in nominal dollars, for a drop of 42 percent in real terms. As a result, the state share of spending has remained relatively constant at about 51 percent since state fiscal year 1995.

Table 21: Michigan's TANF-Related Expenditures

Dollars in millions

	Nominal		Real (expressed in 1995 dollars)	
	1995	2000	1995	2000
Basic welfare services				
Total funds	$1,621	$1,031	$1,621	$941
State funds	$835	$527	$835	$481
Support for the working poor				
Total funds	$3,401	$3,562	$3,401	$3,250
State funds	$1,711	$1,778	$1,711	$1,622

Source: GAO survey and analysis of state expenditure data.

When spending on a broader array of programs that provide support for low-income families and the working poor is examined, the decline in total spending is less pronounced. In this broader area, combined federal-state spending remained relatively stable. (See table 21.) In real terms, this represents a decrease of 4 percent, but considering that cash assistance caseloads have fallen by nearly 66 percent, it suggests a strong commitment of resources to these programs. Notably, total expenditures increased by nearly $500 million in child care, $131 million in employment support and job training programs, and $67 million in housing assistance. Michigan's share remained stable as well, with the state continuing to contribute about 50 percent of the costs of these activities.

Spending on health care programs for this population, combined with support for the working poor, shows little change in either total spending

[2]In referring to state spending in this section, we include county generated funds that are used to count towards state match and MOE requirement.

or in the composition of spending—state funds vs. federal funds (see table 22). The state continues to finance about 48 percent of these programs.

Table 22: Michigan's TANF-Related Expenditures

Dollars in millions

	Nominal		Real	
	1995	**2000**	**1995**	**2000**
Support for the working poor plus health care				
Total funds	$5,973	$6,480	$5,973	$5,912
State funds	$2,853	$3,095	$2,853	$2,824
TANF-related social services				
Total funds	$7,783	$9,633	$7,783	$8,790
State funds	$4,006	$5,066	$4,006	$4,623

Source: GAO survey and analysis of state expenditure data.

Our survey also captured spending on a number of other social service programs that are geared towards meeting the needs of Michigan's low-income families and the working poor. These programs include child welfare, mental health, and substance abuse programs—all programs that can benefit from TANF funding. Real spending increases are evident when these costs are included in the totals above. Total spending increased from $7.8 billion to $9.6 billion in nominal dollars—an increase of 13 percent in real terms from state fiscal years 1995 to 2000. Total spending on social services such as developmental disabilities, mental health, and substance abuse alone has increased by over $1 billion, whereas child welfare and juvenile justice increased by over $200 million. For all social services combined, state spending outpaced the federal spending. As a result, the state now pays a slightly higher share of the costs of these programs—about 53 percent in 2000 compared with 52 percent in 1995.

Additional federal safety-net programs provide food assistance and supplemental security income for needy families with children in Michigan, but are not shown in figure 9. The federal government provided $807 million in food stamp benefits to low income individuals in Michigan in 1995, and $338 million in 2000. At the same time, federal supplemental security income payments increased from $878 million to $997 million in nominal dollars—about 89 percent of these benefits went to individuals under 65 years of age.

Rainy Day Funds

Michigan does not have a TANF-specific rainy day fund. However, the state does have a large general fund reserve—the Budget Stabilization Fund. As of September 30, 2000, the fund had a balance of $1.3 billion. This fund is available to finance the state's spending needs during an economic downturn when state revenues fall short of expectations, including any shortfalls in the state's TANF program. State officials said that during the recession in the early 1990s, most state departments were required to cut back spending. The Budget Stabilization Fund was used to minimize the degree to which cuts were needed. The state welfare agency's budget returned to prerecession baseline levels as soon as the fiscal crisis was over.

Officials told us the state's decision to forgo a dedicated welfare reserve was influenced largely by its wish to avoid leaving any TANF funds unspent at the U.S. Treasury. In state fiscal year 2000-01 the governor proposed leaving nearly $85 million unbudgeted—although this is not strictly a rainy day fund, it would have been a source of funds the state could have used in a fiscal crisis. During the budget process, the state House of Representatives recommended establishing a $25 million rainy day fund reserve and increased spending on other TANF-related services to use the remaining $60 million the governor had left unbudgeted. However, the state Senate did not go along with that provision. A senior analyst with the state's Senate Fiscal Agency said that concerns that unspent TANF funds might signal to the U.S. Congress that these funds were not needed prompted the state Senate to commit virtually all of the available TANF funding. The supplemental appropriations bill was also designed, in part, to reduce Michigan's TANF surplus remaining in the U.S. Treasury—again because these balances had attained a heightened visibility and raised concerns that they might be rescinded by the U.S. Congress.

Michigan administers its welfare program directly through its state offices and does not rely extensively on subgrantees or contractors to provide services. Those eligible for specific services generally deal directly with the Family Independence Agencies Offices around the state. As a result, the state does not record significant levels of TANF obligations that remain unliquidated for extensive periods. Table 23 shows the TANF funds that Michigan reported as unspent as of September 30, 2000.

Table 23: Unspent TANF Funds in Michigan as of September 30, 2000

Dollars in millions

Unobligated TANF funds	Unliquidated Obligations of TANF funds	Total unspent funds	Unspent funds as a percent of annual TANF grant
$200.0	$14.1	$214.1	28%

Source: HHS' Administration for Children and Families.

Even though Michigan reports considerable levels of unobligated balances, this does not mean either that the state has no plans to use those funds or that these funds have been set aside in a rainy day fund. In fact, in state fiscal year 2000-01, the state appropriated almost its entire block grant and all TANF funds left unspent from earlier fiscal years. The final enrolled bill left only $500,000 unbudgeted out of more than $844 million in TANF funds available. The budget contains nearly $760 million to finance ongoing expenditures in the states' welfare program and about $85 million to finance new projects such as a child care rate increase and teen parent counseling programs. Although these programs have been enacted and funded through the state's appropriation process, the majority of the funds used will remain unobligated until the programs are established and incurring expenses. This is because the state will operate these programs directly and so cannot record an obligation of funds until they are actually expended.

State budget officials said that Michigan should be able to deal with increased caseloads, even within the existing state agency budget. Many of the new programs funded from the supplemental were one time initiatives, which adds flexibility to the state budget process, because if resources become tight in other programmatic areas the funds used to finance these one time initiatives could be used elsewhere. The officials added that, even though the budgets essentially authorized the expenditure of the entire TANF grant, the state would continue to carry forward some unused TANF funds which could be canceled and re-appropriated to more pressing needs at the state agency that operates FIP.

In addition, budget analysts from both the legislative and executive branch in Michigan suggested that the state typically overestimates the resources needed for many of these new programs. It is unclear how many people will enroll in the new programs or even how much they will cost. Historically, analysts agree the state has not spent all TANF funds it has appropriated and they expected it is likely with these new programs as well so there will continue to be some level of unused TANF funds, even with the new expansions.

New York

Background

State fiscal year:	April 1-March 31
Budget cycle	Annual
TANF grant:[a]	$2.443 billion
75% MOE:	$1.719 billion
Cash assistance caseload:[b]	461,000 families in 1995 248,000 families in 2000 46 percent decline

[a]New York received an additional $8 million in federal TANF funds in 2000 as a performance bonus.

[b]Caseloads as reported to HHS for January 1995 and June 2000 and rounded to nearest thousand.

New York launched its welfare reform program in August 1997 with the passage of state legislation creating the Family Assistance (FA) program. The goal of the program is to promote self-sufficiency by providing temporary and transitional assistance for needy families, along with services designed to increase employment and job retention.

When families apply for FA, the adults are assessed to determine their job readiness. Those considered job ready are encouraged to seek work immediately. Under the state's policy, families may receive cash assistance for up to 24 months before adults must obtain employment or participate in assigned activities, but localities may establish shorter time frames for job ready adults. The amount of cash assistance families can receive varies by location and family size. For example, in one downstate county a family of three may receive a maximum of $703 while in an upstate county the maximum is $499. These payment levels have not changed since the enactment of TANF. Families whose adjusted incomes are below cash assistance levels are eligible for FA. In addition to cash assistance, a family may receive up to $50 a month in child support collected on its behalf.[1] Families who receive monthly cash assistance payments for the equivalent of 5 years are not eligible for receipt of TANF cash assistance, in accordance with the TANF law.

Under a separate safety-net program supported by state and local funds, families who reach the 5-year time limit may continue to receive assistance,

[1]The remainder is retained by the state and federal governments as reimbursement for cash assistance payments made to these families.

but the assistance is not paid in cash to the adults in these families. Instead, the assistance takes the form of payments made directly to landlords and utility companies to cover costs such as housing and heating. Recent immigrants who are ineligible for TANF cash assistance under TANF law, children living apart from adult relatives, and other needy individuals may also be eligible for the safety-net program. They may receive direct cash payments each month for up to 2 years, and subsequently, payments may be made to landlords and utility companies on their behalf, where deemed appropriate.

Provision of certain services to help families overcome barriers to self-sufficiency are mandated by the state, while other services vary in accordance with programs developed at the local level. The state requires that families be provided information on, and screening for domestic violence and that adults be screened and, if needed, treated for substance abuse. Under the state's policy, family members may look for work for more than 6 weeks and may pursue 2 years of postsecondary education, although their participation in these activities does not count toward the work participation rates that states must achieve under TANF. For working families receiving cash assistance, subsidized child care is guaranteed, and it may be provided for other families with incomes up to 200 percent of poverty, depending on availability of funds and local agency policy. Families who find work and no longer receive monthly cash payments may continue to receive 12 months of transitional medical assistance. They may also be eligible for state and federal earned income tax credits or refunds and state child care tax credits or refunds.

In addition to supporting the FA program, TANF funds are used to provide emergency, housing, and transportation assistance. They are also used for pregnancy prevention and family formation programs, in line with the new federal welfare goals, and for child welfare activities.

Although the state oversees FA, it has devolved responsibility for program design and operation to local social service agencies in the state's 57 counties and New York City. The state supplements the localities' basic FA programs with an appropriation funded entirely with TANF funds to provide other supportive services to help families avoid or ease their transition from public assistance. The localities must submit annual spending plans for social services for approval by the state agency that oversees these activities. To carry out their programs, the localities receive block grants from several state agencies to cover childcare, child welfare, employment and related services for TANF-eligible family members, and transitional services for families with incomes at or below 200 percent of poverty. Local agencies continue to be required to provide their share of funds to match state funds for basic cash assistance provided through the FA program in order to help meet the state's MOE level.

Supplantation in the State Budget

In 1997, we reported that New York used federal TANF funds to provide over $344 million in fiscal relief for the state and its counties. While it is possible for all states to replace state funds with federal funds once they meet their MOE requirement, in New York the level of fiscal relief possible depends on cost-sharing arrangements that were in place under the AFDC program and that continue under TANF. In New York, social services are provided by local government social service offices. These local offices provide services and then submit claims for reimbursement of those services to the state. Under the AFDC cost-sharing arrangements, the federal government paid 50 percent of the AFDC costs and the state and local governments shared the remaining costs equally. The state also had a general assistance program that provided support to individuals who were not eligible for the AFDC program, such as those who had no dependent children. The state and local governments also shared these costs. This arrangement continues under TANF; both the state and localities contribute equal shares towards the MOE requirement. Theoretically, once the MOE is met neither the state nor local governments need to make any further contributions and can rely on unspent TANF funds to finance the program for the rest of the year. However, caseloads have dropped, and the state has struggled to come up with enough expenditures to meet its MOE.

Senior state budget officials said that this aspect of fiscal relief has been overemphasized in the budget debate and, in many respects, did not materialize as projected. In calculating the level of fiscal relief the new financing arrangement might bring, the budgets assumed relatively stable spending levels. That is, if the counties spent the same total amount, they could be reimbursed for a higher share of the total claim. New programs and services that could be offered to the ever-dwindling caseload were slow to start for a variety of reasons, which affected the new program's outlay rates. As a result, total expenditures also fell—in line with a falling caseload—and the state found itself falling well short of the expenditures it would need to meet its MOE.

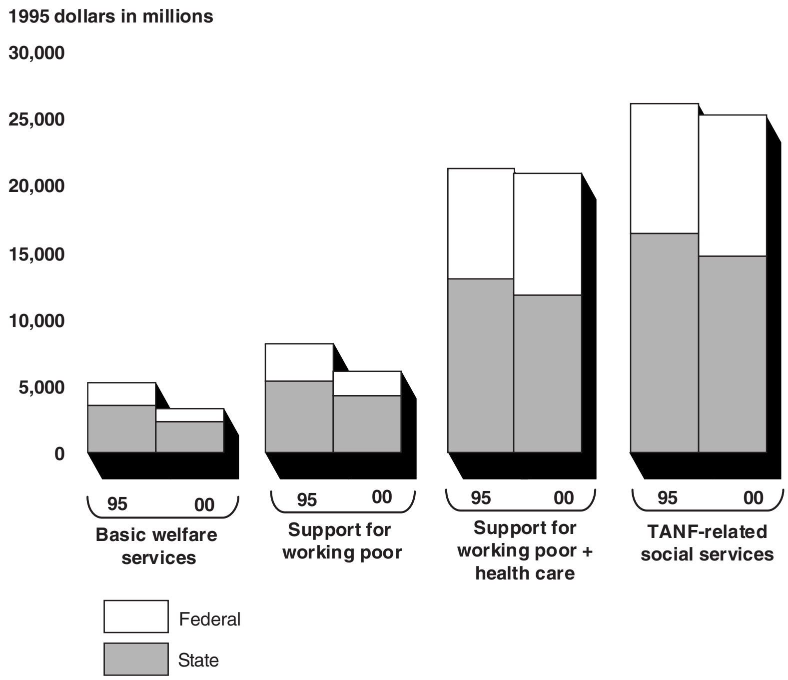
The pressing fiscal issue in New York became one of how to meet the MOE under its cost-sharing arrangement. The state realized it would not meet its MOE requirement if expenditure rates continued at the current rate and it continued to reimburse counties with federal and state funds. Since the state operates on a cost-reimbursement basis with its localities, if the state were to have temporarily suspended the federal reimbursements, the effect would have been to pay for all costs with state and local funds making it easier to reach the state's MOE. To resolve the potential MOE shortfall, the state halted any reimbursement to the localities for expenditures they made in the last quarter of the fiscal year. In so doing, the state counted all of the local expenditures toward the state's MOE, but provided little in the way of fiscal relief to the counties. The state now monitors closely total expenditures and adjusts the federal share of the reimbursement to ensure that the state will meet its MOE each year.

While fiscal relief may not have materialized as a result of these cost-sharing arrangements, the state has been able to achieve significant fiscal relief in other ways. For example, as permitted by federal law, the state transfers TANF funds to the Social Services Block Grant (SSBG). State officials explain that, in the past, most of the SSBG funds were used to augment federal, state, and local funding for child welfare. In transferring TANF funds to SSBG for use in the child welfare system, the state has reduced the nonfederal share of these program costs considerably. Federal funds represented nearly 54 percent of child welfare program expenditures in state fiscal year 2000-2001 whereas the federal funds supported 49 percent of spending on these programs in 1995. The state reports spending about $1.5 billion in total on child welfare programs in 2000. By shifting about 5 percent of those costs to the federal government, it realized savings of approximately $72 million.

More recently, however, the state has changed its approach to financing welfare programs. The state will maintain its traditional structure of reimbursing counties for basic welfare services and counting both the state and local share towards its MOE requirement. Beginning in state fiscal year 1997-1998, it created a number of new grants—funded exclusively with TANF funds—which provide resources to local social service agencies that they can use to develop new programs to serve the needs of both those still on the welfare rolls and those transitioning off the rolls. Under this new financing arrangement, the state and local share of total TANF program expenditures will decrease as the state maximizes use of federal funds. Because of fears that counties will take advantage of the flexibility of the TANF block grant and reduce their own commitment to some social service programs, the state prohibits counties from using any of the TANF funds to "supplant" their own spending on social services for needy families.

Spending Trends From 1995 to 2000

Figure 10: New York's TANF-Related Expenditures for State Fiscal Years 1995 and 2000



To assess how state budget decisions might have affected spending, we collected data on how New York used state and federal funds to finance TANF-related social services. The results are grouped into four categories, as shown in figure 10 and described further in appendix I. Each category is identified on the graph by two bars--one for spending that occurred in state fiscal year 1995 and one for spending that occurred in state fiscal year 2000. From left to right, the categories are cumulative. Expenditures for cash assistance and employment training are included in expenditures for support of the working poor. These expenditures in turn are included in expenditures for support of the working poor plus health care. Finally, all expenditures are included in social services expenditures.

Table 24: New York's TANF-Related Expenditures

Dollars in millions

	Nominal		Real (expressed in 1995 dollars)	
	1995	2000	1995	2000
Basic welfare services				
Total funds	$5,188	$3,590	$5,188	$3,276
State funds	$3,483	$2,534	$3,483	$2,312
Support for the working poor				
Total funds	$8,148	$6,659	$8,148	$6,076
State funds	$5,380	$4,696	$5,380	$4,285

Source: GAO survey and analysis of state expenditure data.

In New York, total expenditures in every category declined between state fiscal year 1995 and 2000. Spending on cash assistance, both to TANF-eligible families and to those receiving safety-net assistance and enrolled in job training programs declined from $5.2 billion to $3.6 billion in nominal dollars. (See table 24.) Adjusted for inflation, spending on cash assistance and job training has declined 37 percent—in line with the drop in TANF caseloads. Although the state now finances a greater share of total expenditures,[2] this may be largely due to the struggles the state faced in meeting its MOE requirements. State officials concede that New York was slow to begin spending on new programs and, therefore, had to spend state funds first.

There has also been a decline in both federal and state funds spent on programs supporting the working poor which include child care, employment services, and other benefits as well as the cash assistance and job training described above. In state fiscal year 1995, the amount spent was $8.1 billion; by 2000, the amount was $6.7 billion in nominal dollars. This represents a decline of 25 percent in real dollars. Although less is being spent overall, the state's share of expenditures in state fiscal year 2000 is 5 percent higher than it was in state fiscal year 1995. (See table 24.)

[2]In referring to state spending in this section, we include county-generated funds that are used to count towards state match and MOE requirements.

We also tracked health care expenditures for our target population. (See table 25.) Including health care spending in our survey data does not change the picture. Total spending dropped 2 percent when adjusted for inflation. But the federal share of the costs of these programs increased by 10 percent in real terms while state share decreased by 9 percent. As a result, the fiscal balance across this range of social services shifted significantly from 1995 to 2000. The state financed 61 percent of the costs of all these activities in 1995; in 2000 it financed 56 percent.

Table 25: New York's TANF-Related Expenditures

Dollars in millions

	Nominal		Real (expressed in 1995 dollars)	
	1995	2000	1995	2000
Support for the working poor plus health care				
Total funds	$21,285	$22,910	$21,285	$20,904
State funds	$12,955	$12,893	$12,955	$11,794
TANF-related social services				
Total funds	$26,133	$27,635	$26,133	$25,216
State funds	$16,405	$16,045	$16,405	$14,640

Source: GAO survey and analysis of state expenditure data.

The same trend holds when we broaden our survey to include other social services that are eligible for TANF funding—child welfare services, mental health programs, and substance abuse programs. Total spending declined by about 4 percent in real terms; state spending declined by about 11 percent. The state share decreased from 63 percent in 1995 to 58 percent of program costs in 2000.

Additional federal safety-net programs provide food assistance and supplemental security income for needy families with children in New York, but are not shown in figure 10. The federal government provided $2 billion in food stamp benefits to low income individuals in New York in 1995, and $1.4 billion in 2000. In addition, from 1995 to 2000, federal supplemental security income payments increased from $2.1 billion to $2.7 billion in nominal dollars—about 73 percent of these benefits went to individuals under 65 years of age.

Rainy Day Funds

For its welfare reform program, the state has a dedicated reserve account called the New York Works compliance fund. The funds in this account are federal TANF dollars that the state has not budgeted for other TANF-related purposes. These funds remain in the U.S. Treasury until the state needs them. Budget officials estimate that the balance in this fund was about $662 million as of September 30, 2000—the end of the last federal fiscal year. Under the state statute creating this fund, amounts are determined based on residual funds; it specifies that after making all authorized payments, any unspent TANF funds may be deposited to the compliance fund. Agencies that need additional funds can gain access to these funds with the approval of the state budget director. No legislative branch approval is required. The statute does not specify what criteria the state budget officer should use in deciding whether to grant an agency access to the fund.

In accordance with federal requirements, the TANF balances in the New York Works compliance fund are held in reserve at the U.S. Treasury. Federal regulations require states to report any TANF funds held for a rainy day as unobligated balances. (See table 26.) However, a significant share of what the state reports as unobligated is not part of the state's rainy day fund because even though these funds are appropriated they are not obligated until the county has submitted a claim for reimbursement. Under federal regulations, the state must also report funds it will use to reimburse the counties for basic welfare services as unobligated until the state actually reimburses the counties for these expenditures. This is significantly different from the approach used in other county-administered welfare systems. (See appendix II for information on California and appendix III for information on Colorado.) In these states, funds are obligated when the state notifies the counties of their allocations. While even in these states federal regulations require that TANF funds remain at the U.S. Treasury until the counties need them for immediate expenditure, unspent TANF funds are recorded as an unliquidated obligation rather than simply an unobligated balance.

Table 26: Unspent TANF Funds in New York as of September 30, 2000

Dollars in millions

Unobligated balance	Unliquidated obligations	Total unspent funds	Unspent funds as a percent of annual TANF grant
$761	$547	$1,308	53%

Source: HHS' Administration for Children and Families.

New York also reports a significant level of unliquidated obligations. Once the state determines the annual allocation levels for the new block grants to the counties, it can enter into an obligation for those funds. As in other states with county or contractor-administered welfare systems, this is a way in which the state reduces the level of unobligated TANF balances. State officials said that, in addition to ensuring that new program spending was predominately financed with federal funds, they were concerned that if they continued to report large unobligated balances, Congress might perceive that those funds were not needed by the state.

Oregon

Background

State fiscal year:	July 1-June 30
Budget cycle:	Biennial
TANF grant:	$168 million
75% state MOE:	$92 million
Cash assistance caseload:[a]	40,000 families in 1995 17,000 families in 2000 58 percent decline

[a]Caseloads as reported to HHS for January 1995 and June 2000 and rounded to the nearest thousand.

Oregon was one of the earliest states to begin welfare reform, starting in 1992 and going statewide with "Oregon Option" in July 1996 under federal waivers that remain in effect through June 2003. The program takes a "work-first" approach based on the state's premise that work is better than welfare—which is temporary—and that all welfare recipients are capable of, and responsible for, making progress toward economic independence and family stability.

To receive monthly cash assistance under the Oregon Option, adults must participate in work activities immediately. The maximum monthly assistance is $460 per month for a family of three, a level unchanged since 1991. Needy families with children whose adjusted incomes are below the monthly cash assistance levels are eligible for the program. The list of work activities under the state's waiver is broader than under TANF, and includes unlimited job search, education, and mandatory substance abuse and mental heath treatment as appropriate. Subsidized work is available, so some participants placed in temporary private sector jobs may receive subsidized wages instead of cash assistance and earn money in an individual account for their future education. Adults may receive cash assistance for no more than 24 out of 84 months, but under the state's waiver the time they spend in work activities does not count toward the 24-month limit. Families in crisis may receive diversion payments or services such as child care, transportation, or work tools in lieu of monthly cash assistance.

Program participants who find work and go off cash assistance may receive subsidized child care, called Employment Related Day Care (ERDC), and medical services under the Oregon Health Plan if they meet the eligibility criteria. Both were initiated prior to TANF and serve the state's low-income working poor. ERDC is available for families earning less than 185 percent of poverty. Income limits are higher for ERDC than for the Option Program, and families participating in the state's child care program are expected to contribute to the costs on a sliding scale, based on their incomes. The Oregon Health Plan is a demonstration program operating under a federal Medicaid waiver from 1994 through 2002. It is available to individuals with incomes up to 100 percent of the federal poverty level and to children in families with incomes up to 133 or 170 percent of poverty.

The state human services agency administers the Oregon Option program through its branch offices and prime contractors in 15 districts. The branch offices determine eligibility, arrange for electronic payments of cash assistance, assess families' needs, and refer families to local service providers. The prime contractors, such as community colleges and job training partnership agencies, provide training and job services directly and subcontract with local partner agencies for other services as needed. In 2001 the state human services agency reorganized to provide more integrated management and services at both the state and local levels.

In addition to supporting the Oregon Option program, TANF funds continue to be used for child welfare activities, such as family preservation, emergency care for children removed from their homes, and special foster care rates. In line with the new federal welfare goals, TANF funds are also used for pregnancy prevention and family formation programs statewide.

Supplantation in the State Budget

TANF funds used for the Oregon Option program and related activities appear to offer a greater variety of benefits and services to a greater number of families than might have been possible under AFDC. But the reduced cash assistance caseload also means that fewer TANF funds are needed to pay those benefits, which frees up more TANF funds that can be allocated to other state priorities. Since 1997, Oregon has used about $122 million, or 18 percent, of its total TANF funds, to replace state funds in a variety of programs that serve low-income individuals and families. According to state officials, Oregon has increased state funding in other budget priorities serving these same beneficiaries.

State officials said that Oregon began its welfare reforms early and invested more state funds in its employment programs and ERDC than required to obtain the maximum federal matching grants. According to these officials when the state's investment paid off and families started to become more self-sufficient and left the caseloads, less funding was needed to support the program. For example, in April 1999, the Governor's recommended budget was adjusted to take into account lower utilization rates projected for the state's EDRC child care program.[1] As a result of the lower projections, the state found that it had "over budgeted" the ERDC program by nearly $40 million. Oregon found that it could use the TANF funds to replace state general fund dollars in several other programs. In turn, the state general funds that were freed up helped support a $400 million increase in Oregon's support for K-12 education programs.

State officials emphasize that Oregon is able to meet its MOE requirement, despite shifts in funding, because the state continues to spend generously on services for needy families and individuals. Furthermore, even though K-12 expenditures are generally not allowable MOE expenditures, these officials argue that by shifting some state funds away from the Oregon Option program and into education they are investing in a prevention strategy that will help reduce poverty in the long run by ensuring that the next generation has the skills needed to enter the job market.

State officials said they have maintained their commitment to the state's poor by continuing to finance the Oregon Option Program that has proven very successful at reducing dependency on public assistance. Also they have maintained their commitment to improved access to health care through the Oregon Health Plan that serves many who would otherwise be ineligible, such as families not meeting the Medicaid income test, childless couples, and the elderly.

State officials also suggest that in freeing up state funds, Oregon was able to fund a variety of new programs and enhancements that would not otherwise have been funded. Examples include a $14.3 million program to provide services for high-risk youth, an $8 million expansion to the state's alcohol and drug treatment program, and an $8 million expansion to a

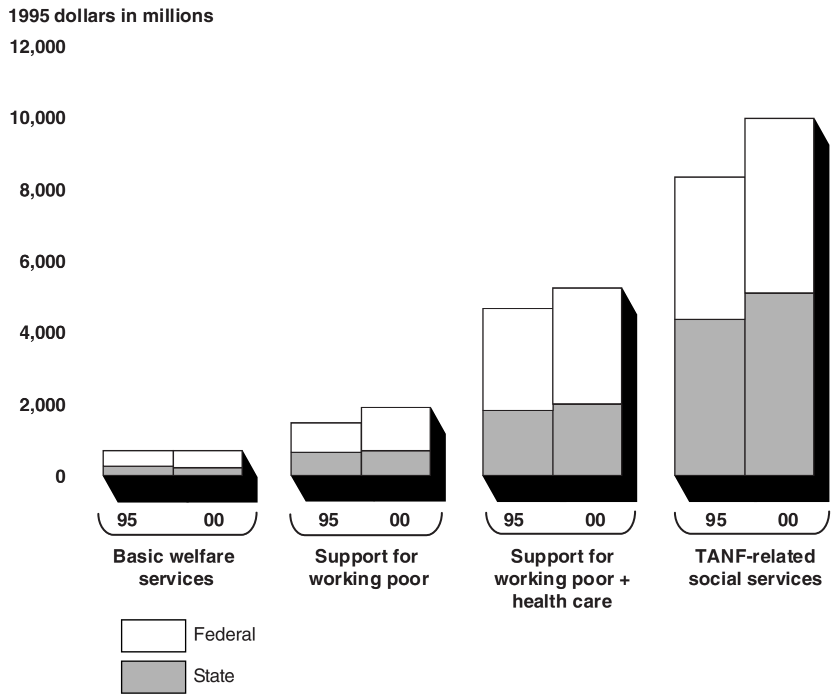
[1]Funds for Oregon Option and other state programs and services are appropriated by the state legislature every 2 years when the legislature meets and acts on its biennial budget. When the legislature is not in session, adjustments to the authorized spending levels can be made by the legislature's Emergency Board—this process is called *rebalancing*.

variety of early childhood development programs. The officials acknowledged that because money is fungible, it is impossible to say precisely which programs were funded with the freed up funds, but they emphasize that new state spending would have been very difficult in the absence of budgetary tradeoffs that reduced state funding of the Oregon Option program.

Welfare advocates agree that Oregon invested state funds early and on its own initiative to support the Oregon Option program, the Oregon Health Plan, and subsidized child care. They disagree, however, about the current level of funding needed to continue the programs. They believe that continued reliance on caseload reduction to measure success in the program is misplaced. They note that although the state's poverty rate is about the same as it was in 1995, the state's population is growing, so the number of families eligible for cash benefits must be increasing. The advocates believe the state should focus its efforts on reaching these families that are eligible but are not receiving assistance. Further, they note that many of the families who remain in the Oregon Option program are among the hardest to serve and need more services than are currently provided.

Spending Trends From 1995 to 2000

Figure 11: Oregon's TANF-Related Expenditures for State Fiscal Years 1995 and 2000



To assess how state budget decisions might have affected spending, we collected data on how Oregon used state and federal funds to finance TANF-related social services. The results are grouped into four categories, as shown in figure 11 in line with a methodology described further in appendix I. Each category is identified on the graph by two bars—one for spending that occurred in state fiscal year 1995 and one for spending that occurred in state fiscal year 2000. From left to right, the categories are cumulative. Expenditures for cash assistance and employment training are included in expenditures for support of the working poor. These expenditures in turn are included in expenditures for support of the working poor plus health care. Finally, all expenditures are included in social services expenditures.

Our review of state expenditures shows a marked decline in total spending on basic welfare services. Total spending on these programs declined about 45 percent in real terms since 1995. (See table 27.) But the state realized greater savings overall; real state spending declined by 82 percent while federal spending on these programs declined 27 percent in real terms. In 2000, Oregon financed 10 percent of these programs' costs, compared to the 32-percent share the state financed before welfare reforms.

Table 27: Oregon's TANF-Related Expenditures

Dollars in millions

	Nominal		Real (expressed in 1995 dollars)	
	1995	2000	1995	2000
Basic welfare services				
Total funds	$255	$155	$255	$141
State funds	$81	$16	$81	$15
Support for the working poor				
Total funds	$446	$430	$446	$392
State funds	$130	$97	$130	$88

Source: GAO survey and analysis of the state expenditure data.

While the cash assistance caseload has declined, programs that provide transitional welfare services—such as case management and the ERDC program—have experienced caseload growth, according to state documents. Our expenditure survey data confirm this observation. Although total spending declined dramatically (45 percent) in traditional welfare programs, spending on programs that broadly support the working poor declined by about 12 percent in real terms. However, the state continued to realize substantially more real savings than the federal government. As the state continued to shift its resources out of these programs, it has created a new fiscal balance. Before welfare reform, the state financed about 29 percent of the costs of programs broadly supporting the working poor and used federal funds to finance about 71 percent. In state fiscal year 2000, it financed 22 percent of the costs and uses federal funds to finance the rest.

State officials claim that the successes Oregon has achieved in its Oregon Options program have permitted it to transfer savings realized from a smaller caseload to other programs, such as the Oregon Health Plan. Indeed, looking at expenditures on programs that support the working poor as well as health care costs related to these same individuals and families shows a dramatic increase in spending. Total spending rose 72 percent in real terms from 1995 through 2000. (See table 28.) Real state spending rose about 81 percent, slightly more than federal spending, which increased 67 percent. State spending rose more than federal because, under Oregon's Medicaid waiver, the state is covering individuals who are not categorically eligible for Medicaid. As a result of this shift, the state now finances a larger share of the costs associated with programs supporting the working poor and their related health care costs; the state share was about 34 percent in 1995 and 36 percent in 2000.

Table 28: Oregon's TANF-Related Expenditures

Dollars in millions

	Nominal		Real (expressed in 1995 dollars)	
	1995	2000	1995	2000
Support for the working poor plus health care				
Total funds	$983	$1,849	$983	$1,687
State funds	$334	$664	$334	$605
TANF-related Social Services				
Total funds	$1,303	$2,304	$1,303	$2,103
State funds	$502	$909	$502	$829

Source: GAO survey and analysis of state expenditure data.

Our survey also captured spending on a number of other social service programs that are geared towards meeting the needs of states' low-income families and the working poor. These programs include child welfare, mental health, and substance abuse programs. When considered along with other programs supporting the working poor, we see that spending on all these social service categories has risen about 61 percent since 1995. Driven largely by the expansions in the Oregon Health Plan, state spending on social services rose 65 percent and the federal spending rose 59 percent. Remarkably, despite the significant shifts in the way the state finances these programs, the federal-state fiscal balance has remained stable since 1995. The state continues to finance about 39 percent of these programs and the federal government contributes about 61 percent.

Additional federal safety-net programs provide food assistance and supplemental security income for needy families with children in Oregon, but are not shown in figure 11. The federal government provided $250 million in food stamp benefits to low-income individuals in Oregon in 1995, and $174 million in 2000. In addition, from 1995 through 2000, federal supplemental security income payments increased from $181 million to $235 million in nominal dollars—about 85 percent of these benefits went to individuals under 65 years of age.

Rainy Day Funds

Senior budget officials in Oregon said that the state's policy is to spend all of its annual TANF grant, saving none of the federal moneys for a rainy day. Generally, state officials believe that cash assistance caseloads can be kept low if sufficient funds are invested in appropriate services to achieve families' long-term self-sufficiency. They are committed to helping recipients find work, retain their jobs, and obtain the skills necessary to ensure their resiliency, even in a changing economy.

The state's policy is to draw down all available funds, leaving nothing in reserve. Generally appropriation levels are set so that the full TANF grant will be spent. As with most states with biennial budgets, the "rebalancing process" in Oregon allows for the shifting of resources among program accounts outside the regular appropriations cycle. This allows the state to periodically reassess program needs even when the legislature is not in session. Oregon requires its agencies to regularly reassess its budgetary needs—or rebalance its budget—allowing for the transfer of funds into or out of program accounts. Each agency is required to submit its rebalance plan every 6 months.

Decisions made during Oregon's budget process highlight some of the factors considered and the procedures involved in aligning appropriations, obligations, and expenditures. In March 2000, the state agency again prepared for its rebalancing process and found that the ERDC child care utilization rate was lower than expected, which would have resulted in about $8.2 million in unspent TANF dollars. To absorb these funds, the agency reduced the copayments that poor families had to pay and increased the subsidies, thus increasing the amount of TANF funds expended per child. In this way, the agency accomplished the state's goal of spending all the TANF funds available, speeding the rate at which these TANF funds are spent and avoiding having to categorize them as unobligated balances.

Despite its lack of any contingency plans, Oregon reports that more than $40 million of cumulative TANF funds designated for the state as of September 30, 2000, remain unspent at the U.S. Treasury. Most of these unspent funds are shown as obligated but not liquidated because they have been committed through contracts or other agreements, or they are owed because services have been provided, although payments have not been made against these obligations. The remainder of Oregon's unspent funds are shown as unobligated from a single year—1999. (See table 29.)

Table 29: Unspent TANF Funds in Oregon as of September 30, 2000

Dollars in millions

Unobligated TANF funds	Unliquidated obligations of TANF funds	Total unspent funds	Unspent funds as a percent of annual TANF grant
$4.8[a]	$39.1	$43.9	2.6%

[a]Subsequent amended reports submitted by Oregon reduced the unobligated balance to zero.

Source: HHS'/Administration for Children and Families.

TANF funds dedicated to the Oregon Option program that are not used by the state agency or its branches are set aside for prime contractors in the 15 districts for specific training and employment services. These funds are shown as unliquidated obligations because they are tied up in contracts. The prime contractors in turn execute subcontracts for additional support services. The system of contracts and subcontracts results in an inevitable time lag before obligated funds are shown as liquidated. Some time lags occur because subcontractors and contractors must submit claims, and the claims must be processed before TANF payments can be made. Other time lags occur because TANF funds are obligated in contracts with start and end dates that do not coincide with the federal fiscal year, so that funds obligated in one quarter may not be paid until the following quarter.

Texas

Background

State fiscal year:	September 1-August 31
Budget cycle:	Biennial
TANF grant:[a]	$486 million
75% MOE:[b]	$236 million
Cash assistance caseload:[c]	280,000 families in 1995 128,000 families in 2000 54 percent decline

[a]Texas receives between $13 million and $39 million in annual TANF supplements because the state's pre-TANF expenditures per poor person were less than 35 percent of the national average. In addition, Texas received $16 million in federal TANF funds in 2000 and $24 million in 2001 as bonuses for successful outcomes.

[b]Texas did not meet required work participation rates for two-parent families in 1997 and 1998, but subsequently complied with corrective action plans, thus avoiding any financial penalty or increased MOE.

[c]Caseloads as reported to HHS for January 1995 and June 2000, rounded to the nearest thousand.

Texas implemented welfare reform between November 1996 and November 1997 with its employment and training program called CHOICES, an outgrowth of experiments started earlier under a waiver covering 1996-2002. CHOICES follows the work-first model, with the expectation that all Texans should support themselves and their families and that they should take the initiative in finding work, while program staff and services are available to assist them in achieving that goal. Under the program, the number of families receiving cash assistance declined until 1999 and leveled off. The caseload has declined again over the first few months of 2001.

To receive cash assistance, applicants must be willing to seek work as soon as they enroll in the program. Under the Texas waiver, those with young children have been exempt from TANF work requirements, but the exemptions are gradually being phased out. In 1999, the state approved the first increase in the monthly cash assistance level in 15 years; now a family of three can receive up to $201 a month. Needy families with children whose adjusted incomes are below the monthly cash assistance levels are eligible. In addition, a family may receive up to $50 a month in child support collected by the state agency on the family's behalf.[1] Texas also provides an annual $60 supplement for each TANF-certified child. If they meet poverty guidelines, grandparents 50 or older who care for TANF-eligible children may receive one-time cash supplements up to $1,000, but if they accept these payments they are ineligible for cash assistance for 1 year. Families in crisis may receive a one-time diversion payment of $1,000, but if so, they are ineligible for cash assistance for a year.

CHOICES participants engaged in work or work-related activities may receive services to facilitate their participation, such as transportation assistance and help with other work expenses. Subsidized child care is guaranteed for those in CHOICES who participate in work activities, and where funding is available, to other families with incomes at or below 85 percent of the state median income. Program participants may receive cash assistance for 1 to 3 years, depending on their education and prior work experience, at which time the adults become ineligible for 5 years. Those who lose cash assistance due to increased earnings or time limits may receive transitional medical assistance and subsidized child care for 12 to 18 months. To reduce the likelihood that these children will have to depend on welfare, Texas provides grants toward a college education for recent high school graduates in families eligible or receiving cash assistance.

Two state agencies cooperate in the administration of the program—one determines eligibility through its local offices and makes cash assistance payments electronically and the other provides work-related services, including child care subsides through contracts with 28 local workforce boards. The goal of the boards is to provide integrated services at each location that respond to local needs. The state requires that the local

[1]The remainder is retained by the state and federal governments as reimbursement for cash assistance payments made to these families.

workforce boards provide matching funds in order to receive the maximum in federal child care funds.

In addition to funding CHOICES, TANF funds support certain child welfare activities that were supported previously with federal welfare funds, such as child protective services. To prevent dependency and deal with the needs of hard-to-serve CHOICES participants, TANF funds are also invested in family formation, pregnancy prevention, mental health, developmental disabilities, and substance abuse treatment.

Supplantation in the State Budget

Texas has used the flexibility afforded by TANF financing rules to fund a number of state priorities for needy families but has also used these funds to replace a significant amount of state funds. From 1998 to 2001, Texas budget analyses show that about $275 million of federal TANF funds were used to replace state funds, including $115 million in the 1998-1999 biennium and $160 million in the 2000-2001 biennium. Texas budget officials and legislative analysts describe these shifts as changes in the way certain programs are financed—not supplantation—and note that state spending on social services has increased by more than this amount since federal welfare reform was enacted. For example, they claim that while $160 million in state funds was freed up as a result of shifts in TANF funds in the last biennium, this "refinancing" was part of a $400 million increase in state funding for health and human services programs for the needy in the last 2 years.

The development of the 2000-2001 budget in Texas illustrates the complex relationship among federal policies regarding TANF funds and state decisions on the use of state funds. Historically, cash assistance and job training programs were funded with a combination of state and federal dollars. In 1995, federal funds represented just over 63 cents and state funds represented almost 37 cents of every dollar spent on cash assistance in Texas. In 1997, when Texas first deliberated how it would use the new TANF funds in its welfare program, state officials believed that cash assistance and training would be a good place to direct state resources to count toward the state's MOE requirement. However, as caseloads dropped more quickly and steeply than anticipated, it became clear that the state funds appropriated for these purposes would not be sufficient to meet the state's MOE requirement. A decision was made to fund job training primarily with federal TANF dollars and to direct state funds to other priorities that had projected outlay rates that would provide a more stable base to use as their MOE.

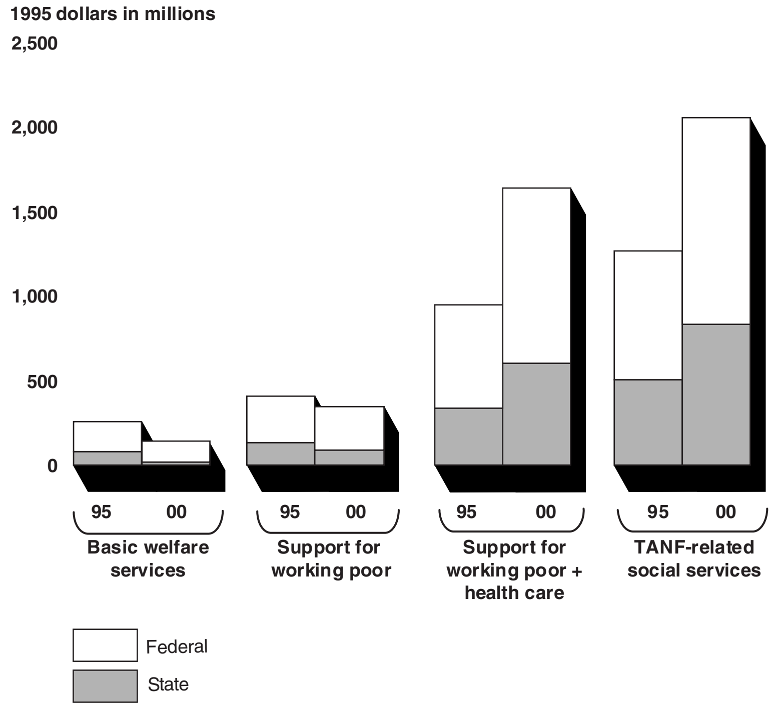
Child welfare programs were seen as a priority because of growing foster care caseloads and a state court ruling that called for heightened investigation and prevention of child abuse and neglect. Because spending on these programs was growing, these programs' expenditures were viewed as a better source of MOE financing than CHOICES. The legislature increased appropriations for an expanded child welfare program and directed the state agency to count the state's share of the increase towards it MOE. After reviewing final TANF regulations, however, state agency officials found that certain foster care expenditures included in the child welfare expansion could not be counted toward the MOE requirement. The state funds already appropriated for child welfare were not withdrawn, but state budget officials had to look elsewhere for allowable MOE expenditures. In the end, they identified as MOE a portion of state aid used to support preschool programs. Since this state aid is allocated based on the number of needy children in each district the state believes that a portion of it qualifies as an MOE expenditure. The state spent nearly $320 million on this effort in 2000.

Texas state officials maintain that the changes that they have made in program financing made it possible for the state to draw down more TANF funds. In so doing, the state reduced the levels of unspent balances remaining at the U.S. Treasury, but more importantly proponents of welfare program expansions gained political leverage to get new programs and program expansions enacted. A state official told us that the political environment in Texas makes it very difficult to fund program increases or new programs with state funds unless there are trade-offs in other programs to offset some of the new spending. The official said that the ability to refinance some existing programs with TANF funds in turn freed-up some state resources, which helped ensure enactment of new state spending in other areas that also serve the low-income population.

While the advocate community agrees with state officials that the state has expanded its investment in programs that serve the social services needs of low-income families and individuals, they also note that once state funds are freed up, it is impossible to tell with certainty how those funds are ultimately used. Their concern is that funds designated for needy families eligible under TANF may have been used for other purposes, thus diverting state funds to other priorities.

Spending Trends From 1995 to 2000

Figure 12: Texas' TANF-Related Expenditures for State Fiscal Years 1995 and 2000



To assess how state budget decisions might have affected spending, we collected data on how Texas used state and federal funds to finance TANF-related social services expenditures. The results are grouped into four categories, as shown in figure 12, and described in more detail in appendix I. Each category is identified on the graph by two bars—one for spending that occurred in state fiscal year 1995 and one for spending that occurred in state fiscal year 2000. From left to right, the categories are cumulative. Expenditures for cash assistance and employment training are included in expenditures for support of the working poor. These expenditures in turn are included in expenditures for support of the working poor plus health care. Finally, all expenditures are included in social services expenditures.

Texas is the only state in our study that saw nominal growth in total expenditures for basic welfare services—cash assistance and job training programs—between state fiscal years 1995 and 2000. Spending remained constant, in real terms, which is significant because Texas also experienced a 54 percent decline in the number of families receiving cash assistance over this same period. Spending on the training component of the CHOICES program drove this trend as the state invested heavily in these programs. The new investment was, in large part, financed with federal dollars. Our survey data show that while total spending on these programs grew from $710 million to nearly $780 million over the period, the state's contributions declined from $254 million to $216 million (see table 30). As a result, while the state financed about 36 percent of these programs in 1995, in 2000 it financed only about 28 percent.

Table 30: Texas' TANF-Related Expenditures

Dollars in millions

	Nominal		Real (expressed in 1995 dollars)	
	1995	2000	1995	2000
Basic welfare services				
Total funds	$710	$778	$710	$710
State funds	$254	$216	$254	$197
Support for the working poor				
Total funds	$1,476	$2,066	$1,476	$1,885
State funds	$638	$774	$638	$707

Source: GAO survey and analysis of state expenditure data.

As in other states we surveyed, Texas officials claim that most of the state funds freed-up with TANF funds were reinvested in programs that support the broad goals of federal welfare reforms. Total spending rose significantly—28 percent in inflation adjusted dollars—among a group of programs that include those same basic welfare services as well as programs that provide transitional support for families moving from welfare to work (e.g. child care and child development, transportation subsidies, and other post-employment services). Although it is impossible to tell with any certainty what programs a freed up state dollar funded, the state did substantially increase its own investment in programs that broadly support the working poor—state spending rose by about 11 percent in real terms from 1995 to 2000. (See table 30.) In line with the state's budget strategy to maximize the use of federal funds, in 2000 federal funds represent a much larger share of these programs' finances than before welfare reform. In 1995 the state financed about 43 percent of these programs, in 2000 the state share receded to 38 percent.

State spending on health care for the working poor rose faster than federal spending between 1995 and 2000 chiefly because the Medicaid match rate changed requiring the state to finance a greater share of that program than it did in 1995. When these state expenditures are combined with state spending on other programs supporting the working poor, the rate of spending outpaced inflation. Total federal and state spending rose—in real terms—by 12 percent, while state spending rose by 11 percent. (See table 31.)

Table 31: Texas' TANF-Related Expenditures

Dollars in millions

	Nominal		Real (expressed in 1995 dollars)	
	1995	2000	1995	2000
Support for the working poor plus health care				
Total funds	$4,648	$5,722	$4,648	$5,221
State funds	$1,800	$2,181	$1,800	$1,990
TANF-related social services				
Total funds	$8,333	$10,908	$8,333	$9,953
State funds	$4,361	$5,574	$4,361	$5,086

Source: GAO survey and analysis of state expenditure data.

As noted previously, Texas has focused recently on expanding its child welfare programs and other social services. TANF funds can be used in all these programmatic areas provided they are used on TANF-eligible families. For example, Texas devoted more than $173 million of its TANF funds to child welfare activities in 2000 (39 percent of TANF funds spent in 2000 compared to 14 percent of Title IV-A funds spent in 1995). In addition, these programs received a large share of state funding as well. For all social services, total federal and state spending rose 19 percent in real terms; real state spending kept nearly the same pace, rising 17 percent. As a result, the fiscal balance across the broadest category of social services spending has remained stable since 1995; the state financed 52 percent in 1995 and in 2000 it financed about 51 percent.

Additional federal safety net programs provide food assistance and supplemental security income for needy families and children in Texas. For example, the federal government provided $2.3 billion in food stamp benefits to low income individuals in Texas in 1995 and $1.2 billion in 2000. In addition, from 1995 to 2000, federal supplemental security income payments to Texans increased from $1.4 billion to $1.6 billion, about 73 percent of which went to individuals under the age of 65.

Rainy Day Funds

The state has a statutorily established contingency fund for TANF expenditures. However, the state has not funded this account based on projections of future program needs. Rather an appropriation equal to the balance of all federal TANF funds not already appropriated for other purposes is made for this purpose every 2 years. The contingency appropriation requires that the expenditure of funds from this account be made only upon approval of the Governor and the Legislative Budget Board.[2] Although state general revenues are another potential source of rainy day funds, their use for cash assistance is limited by the state constitution to 1 percent of the total biennial budget.

After other state priorities were funded for state fiscal years 2000-2001, budget analysts estimated that $107 million would be available for the contingency fund. Federal regulations require that states report all rainy day funds as unobligated balances and therefore these funds are commingled with all other funds the state reports as unobligated. Soon after the beginning of the second year of its biennium (September 1, 2000), Texas reported $141.2 million in unobligated balances. (See table 32.)

[2]The 10-member Legislative Budget Board was created by statute in 1949 for the primary purpose of developing recommended legislative appropriations for all agencies of the state government. Membership of the LBB is provided by law. The Lieutenant Governor is the Chairman, and the Speaker of the House of Representatives is Vice Chairman. Chairs of the House Appropriations Committee, House Committee on Ways and Means, Senate Finance Committee, and Senate State Affairs Committee are automatically members. The Lieutenant Governor appoints two additional members of the Senate, and the Speaker appoints two additional members of the House to complete the 10-member Board.

Table 32: Unspent TANF Funds in Texas as of September 30, 2000

Dollars in millions

Unobligated TANF funds	Unliquidated obligations of TANF funds	Total unspent funds	Unspent funds as a percent of annual TANF grant
$141.2	$41.6	$182.8	37.6%

Source: HHS' Administration for Children and Families.

An analysis of the balances Texas has left unobligated at the U.S. Treasury for future needs is complicated because these reported balances also represent funds the state has budgeted but has not yet spent. TANF funds for Texas are shown on federal reports as obligated to the extent that they are contracted out to state workforce boards for the CHOICES program, but are shown as unobligated where they are awaiting disbursement by state agencies that provide cash assistance and other services. About one-quarter of TANF funds are contracted through the workforce boards and the remainder are split among several state agencies.

Generally, CHOICES is run by local workforce boards that offer job training and education programs, child care subsidies, and other supportive services designed to help welfare recipients transition from welfare to work. Each year the state executes performance-based contracts with these boards, providing a variety of federal and state funds. When the state contracts with the boards for TANF-funded services, the state appropriately records this in reports to HHS as an obligation of federal funds.

However, many other services are funded with TANF through state social service, child welfare, and substance abuse treatment agencies. Because these are state agencies, the TANF funds needed to provide services must be recorded as unobligated balances until the agencies have spent the funds or have contracted for provision of the services.

Wisconsin

Background

State fiscal year:	July 1-June 30
Budget Cycle:	Biennial
TANF Grant:[a]	$318 million
75% MOE:	$169 million
Cash Assistance caseload:[b]	74,000 families in 1995 16,000 families in 2000 78 percent decline

[a]Wisconsin received about $16 million in federal TANF funds in 2001 as a bonus for successful program outcomes.

[b]Caseloads as reported to HHS for January 1995 and June 2000 and rounded to the nearest thousand.

Wisconsin was one of the first states to reform its welfare program, starting in 1987, and went statewide with its current program, Wisconsin Works (W-2), in September 1997. As a result, the decline in the state's cash assistance caseload began at an earlier date and proceeded at a faster rate than in many other states, but by 2000 the number of families receiving cash assistance was relatively stable. In accordance with the state's work-first philosophy, the program serves those who are willing to work to their full capability.

Eligible families receive cash assistance payments that are equivalent to hourly wages for time spent in work and other assigned activities, such as education or drug treatment. All families with children and incomes under 115 percent of the federal poverty level are eligible. Once enrolled, the maximum monthly assistance a family can receive is $673, regardless of family size. This amount is paid when a family member performs community service work for 30 hours a week and participates in 10 hours of education and training. The amount is a 30-percent increase over the amount Wisconsin paid in 1995 for a family of three, making it one of the highest cash assistance payments in the nation. However, the payment is reduced for each hour that the family member fails to attend the assigned activity. In addition to cash assistance, parents may receive any child support that the state collects on their behalf.[1] Families participating in

[1]The state and federal governments may retain collections as reimbursement for cash assistance payments made to these families. Wisconsin has chosen instead to give its full state share to W-2 families.

W-2 who have received monthly cash assistance payments for the equivalent of 5 years are ineligible for further receipt of cash assistance, in line with TANF law.

For recent legal immigrants, the state has set aside its own state funds to pay cash assistance because federal law prohibits use of TANF funds for this purpose. Children receiving cash assistance whose parents are not eligible for TANF, such as those receiving supplemental security income, are served in a separate program and are not enrolled in W-2.

Services and benefits available to W-2 participants include case management, job training, transportation assistance, and matching grants of up to $500 for vocational training. In addition, subsidized healthcare, called Badger Care, and child care are available to W-2 participants and other families with children and incomes up to 200 percent of the poverty level. Other support services were made available to families with incomes below 200 percent of poverty starting in mid-1999 under the state's community reinvestment program. TANF funds are also used to support an earned income tax credit (EITC) as well as child welfare, juvenile justice, mental health programs, services for the developmentally disabled, substance abuse treatment activities, and incentives for contractors who meet performance goals.

Most of the federal and state funds for the W-2 program are obligated by a single state agency in contracts with local agencies that determine eligibility and provide cash assistance and services to program participants. W-2 is administered by over 70 local agencies, primarily county social services agencies, under 2-year, performance-based contracts with the state.

Supplantation in the State Budget

The dramatic changes in Wisconsin's cash assistance caseload as well as the breadth of services the state had decided to fund prompted budget officials to begin looking for creative ways to finance state programs for the working poor. In Wisconsin's 1999-2001 biennial budget, the state used about $164 million of its TANF grant to replace state general funds. The state plans to continue using about $52 million of TANF funds per year to change the source of financing for these programs.[2] The largest single

[2]About $48 million of the total $164 million was used retroactively to adjust the appropriations level in the final year of the previous budget.

program affected by the refinancing was the state's tax credit program, the EITC. Each year Wisconsin plans to use about $52 million in federal TANF funds to finance the state tax credit that previously had been financed with state funds. Under current projections for use of TANF funds, the state will use about 16 percent of its annual block grant in this manner.

The circumstances surrounding the state's decisions to use its federal funds in this way are illustrative of the nature of budget negotiations and the role that federal funds can play in influencing trade-offs among a variety of financing options. According to legislative members and staff we interviewed, when TANF was enacted in 1996, Wisconsin was already spending less than the MOE required them to spend because they had already instituted substantial reforms and had already achieved significant savings as a result of their reforms. So when MOE levels were pegged to state spending levels in 1994, it created a fiscal burden for Wisconsin. The state had to raise its spending in order to meet the 75 percent MOE level.

During the 1999-2001 budget deliberations, state budget analysts projected that the state would not meet its MOE requirement because the number of W-2 families receiving cash assistance had fallen so dramatically. Even with agreement on several new spending proposals, budget analysts calculated that the state would run $40 million short over the biennium. A shortfall of this size presented the state with a challenge.

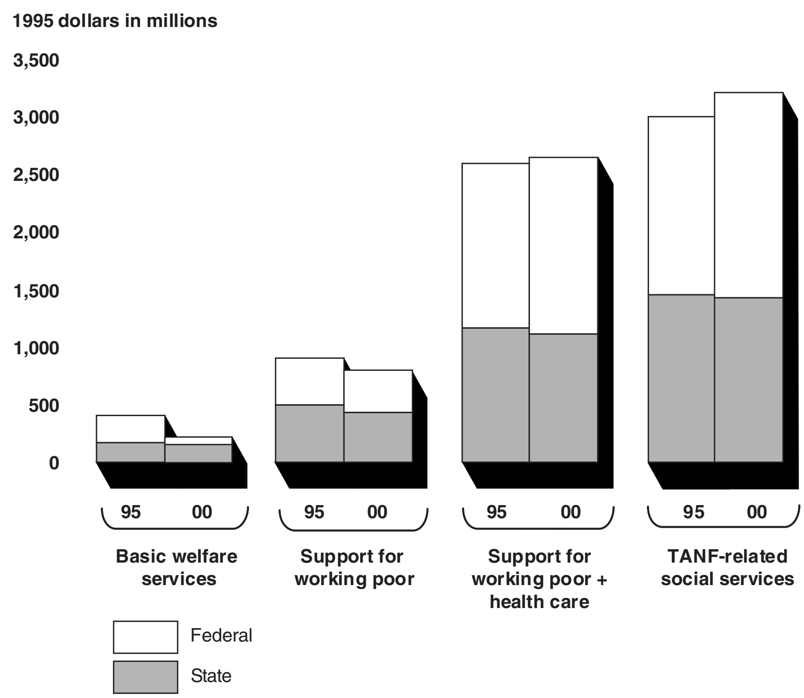
State budget officials predicted that it would be difficult to gain bipartisan approval in the legislature for new social service programs that required an investment of new state funds. The legislature had already enacted expansions to the state's subsidized child care program to serve more low-income families and had approved a new health care program for low-income families—BadgerCare. Budget officials looked to existing programs already in the budget that might be used to meet the MOE.

In the midst of the state's budget negotiations, the final TANF regulations were issued that allowed use of TANF funds to establish or expand state EITC programs. State officials realized that the regulations permitted them to replace about $53 million a year in state funds that they were spending on their EITC with federal TANF funds. However, doing so still left them short of meeting their MOE requirement. The state had a shortfall to begin with, and the shift in funds only served to increase the shortfall. However, the legislative committee leadership realized that freeing up state general revenues provided funds it could use as leverage to ensure bipartisan support for a package of spending and revenue options. Some of the freed-up state general funds could be used for a property tax cut, and the rest to expand certain programs for the state's low-income population. In addition, the expanded programs serving the low-income population could be used to meet the state's MOE requirement so there would be no shortfall.

According to the committee leadership, the compromise also resulted in increased investment of the federal TANF funds in a variety of programs. The package presented during the negotiations afforded the committee the opportunity to bring TANF spending on new programs up even farther thereby increasing the state's investment on low-income families. The leadership stressed that these new programs could not have been funded during the 1999-2001 biennium in the absence of the options arising from the freed-up state general funds.

Spending Trends From 1995 to 2000

Figure 13: Wisconsin's TANF-Related Expenditures for State Fiscal Years 1995 and 2000



To assess how state budget decisions might have affected spending, we collected data on how Wisconsin used state and federal funds to finance TANF-related social services. The results are grouped into four categories, as shown in figure 13 and described further in appendix I. Each category is identified on the graph by two bars--one for spending that occurred in state fiscal year 1995 and one for spending that occurred in state fiscal year 2000. From left to right, the categories are cumulative. In other words, expenditures for cash assistance and employment training are included in expenditures for support of the working poor. These expenditures in turn are included in expenditures for support of the working poor plus health care. Finally, all expenditures are included in social services expenditures.

Given the dramatic decline in the cash assistance caseload, the decline in total spending on these basic activities would be expected. Since fewer families are receiving cash assistance, spending on cash assistance has plummeted despite the higher monthly assistance payment level. The decline in total real spending was 46 percent. (See table 33.) The decline in spending on cash assistance was partially offset by spending on job training, which more than tripled. In 2000, for every dollar spent on cash assistance, three dollars were spent on job training. Notably, however, and in line with the state's struggles to meet its MOE requirement, state spending declined only marginally—about 4 percent—in real terms. As a result, the state now finances a greater share of these costs. Whereas the state financed 41 percent of the costs of these services in 1995, in 2000 it financed about 72 percent.

Table 33: Wisconsin's TANF-Related Expenditures

Dollars in millions

	Nominal		Real (expressed in 1995 dollars)	
	1995	**2000**	**1995**	**2000**
Basic welfare services				
Total funds	$412	$244	$412	$223
State funds	$167	$176	$167	$161
Support for the working poor				
Total funds	$898	$881	$898	$804
State funds	$497	$485	$497	$443

Source: GAO survey and analysis of state expenditure data.

Total federal and state spending on programs that more broadly support the working poor also declined over the same period. However, when viewed cumulatively, the steep decline in spending on basic welfare services was moderated by large investments in other programs. For example, spending on child care alone has increased by about $123 million. However, state spending on all components of support for the working poor declined by 11 percent, roughly the same decline seen in total spending. This indicates that the state has maintained its own investment in these programs. Wisconsin continues to finance about 55 percent of the costs of these programs with state funds.

In 1999, Wisconsin began enrolling certain low-income families without health insurance in a new statewide program called Badger Care. The program is supported by state funds and by two federal funding sources—Medicaid and the State Children's Health Insurance Program (SCHIP).[3] Budget forecasts projected that spending would rise by about $100 million a year—a substantial new investment—once the new program was fully implemented. About a third of the increase was projected to have been funded with state funds. Given the nature of the matching grants, it is not surprising that federal spending would rise faster than state spending. (See table 34.) Overall, combined spending on support for the working poor plus health care grew by about 2 percent, while state spending declined about 3 percent in real terms. The state's share of these total expenditures fell from 45 percent in 1995 to 43 percent in 2000.

[3]The two federal programs are matching grants: the federal government finances about 71 percent of SCHIP program in Wisconsin and about 59 percent of the Medicaid program. In January 2001, the state received approval for its request to waive provisions of federal law that prohibit the use of SCHIP funds for services provided to adults. The state can now use the more favorable match rate (71 percent) to finance a larger share of its program.

Table 34: Wisconsin's TANF-Related Expenditures

Dollars in millions

	Nominal		Real (expressed in 1995 dollars)	
	1995	2000	1995	2000
Support for the working poor plus health care				
Total funds	$2,591	$2,908	$2,591	$2,653
State funds	$1,163	$1,238	$1,163	$1,129
TANF-related social services				
Total funds	$3,006	$3,518	$3,006	$3,210
State funds	$1,455	$1,578	$1,455	$1,440

Source: GAO survey and analysis of state expenditure data.

The decline in the state's share of funding for programs supporting low-income families that was first shown in our analysis of programs that support the working poor is reflected in the state's spending on social services. Total spending on social services grew by about 7 percent; but state spending decreased by about 1 percent. Wisconsin's share of spending on all social services that support the goals of TANF declined from about 48 percent in 1995 to about 45 percent in 2000.

Additional federal safety-net programs provide food assistance and supplemental security income (SSI) for needy families with children in Wisconsin, but are not shown in figure 13. The federal government provided $227 million in food stamp benefits to low-income individuals in Wisconsin in 1995, and $115 million in 2000. In addition, from 1995 to 2000, federal supplemental security income payments increased from $362 million to $374 million in nominal dollars—about 88 percent of these benefits went to individuals under 65 years of age.

Rainy Day Funds

In 1997 Wisconsin created a $50 million reserve account for (1) its W-2 program, (2) additional benefit payments for Milwaukee, and (3) benefits to children of SSI recipients. The state drew down most of the reserves it had set aside for the benefit payment for Milwaukee and children of SSI recipients by the end of the first biennium. The state approved a $102 million deposit to the Contingency Fund for the 1999-2001 biennium for the W-2 program. These funds are available to W-2 agencies in the event of an economic downturn.[4] However, disbursement from this fund must be approved by the Joint Finance Committee. In addition to the Contingency Fund—which is specifically set aside for a rainy day—the state left about $16 million in TANF funds unbudgeted over the biennium.

State funds that are set aside for a rainy day must, under HHS regulations, be reported as unobligated balances. The state's most recent submission for the end of federal fiscal year 2000 is difficult to reconcile with the state's own budget outline. (See table 35.) This difficulty highlights the inadequacy of HHS' financial reports to offer any insight into the states plans for their unspent balances.

Table 35: Unspent TANF Funds in Wisconsin as of September 30, 2000

Unobligated balance	Unliquidated obligations	Total unspent funds	Unspent funds as a percent of annual TANF grant
$40.5	$252.2	$292.4	92%

Source: HHS' Administration for Children and Families.

The data in table 35 is prepared at the end of the federal fiscal year and as such represents a snap shot in time rather than a flow of funds. A state budget official said that to avoid listing too much as "unobligated" it treats its Contingency Fund more like a revolving fund. For example, the balance in the Fund is always $102 million, but by the end of the federal fiscal year the state would obligate the balance to pay for ongoing program needs and then use the next fiscal year's grant for the Contingency Fund. This state official said that, in part, the motivation to record obligations in this manner stems from regulations that limit the use of any unobligated TANF

[4]Unspent federal funds held in reserve for a rainy day must remain on deposit at the U.S. Treasury until the state needs them to make a payment.

balances. He also expressed concern that if they reported significant unobligated balances, it might send a signal to Congress that those funds were not needed.

The vast majority of Wisconsin's unspent balances are claimed as unliquidated obligations. As noted previously, Wisconsin operates W-2 through local contractors who provide the services available under the program. At the time the state signs the contracts, it reports the full amount of the federal funds involved as obligated, in accordance with federal regulations. The reported obligations are shown as unliquidated, however, until the local contractors provide or purchase services for W-2 families. These contracts extend for 2 calendar years. In September 1999, the state signed 75 contracts that covered the period from January 1, 2000, to December 31, 2001. The total value of the contracts for 2 years of services and benefits is about $370 million, only $60 million more than the state's annual block grant.

But the state has other TANF-related expenditures that cannot be recorded as obligations because of the nature of the expenditures. For example, child care subsidies are paid as the services are rendered. While the state has an underlying commitment to pay child care subsidies to eligible families, the amount of the subsidy and the recipient's eligibility for the subsidy depend on the recipient's income and therefore a legal obligation, as required under the regulations, does not exist until the payment is made. So even though the state might project considerable outlays in its child care program, these future expenditures do not represent an obligation as defined by federal regulations until those expenditures are due.

No funds have been drawn from the Contingency Fund, and the Governor proposed to eliminate it for the 2001-2003 biennium. The $102 million on deposit will be transferred out of the state's Contingency Fund and is projected to be spent on existing programs over the 2001-2003 biennium. The Governor's proposed 2001-2003 budget projects that about $66 million will be left unbudgeted in the biennium's first year, but that by the end of the second year of the biennium, projected spending will rise leaving only about $600,000 unbudgeted.

Survey Instrument

Attachment 1

State Social Services Spending Survey
General Instructions

When completing the survey, please keep the following in mind:

1. Identify all state programs serving social service needs, particularly programs targeted towards reducing dependence on public assistance.
2. Distribute a copy of the survey to all agencies that oversee these programs. Please explain to these agencies what MOE means and what funds should be shown in the MOE column.
3. Include all federal, state and local expenditures *that are incorporated in the state budget*. For local expenditures, include local spending of locally raised revenue that is incorporated in the state budget such as a local match. Include expenditures or estimated expenditures only (not amounts budgeted or authorized).
4. Include TANF and MOE expenditures, as well as expenditures from any other funding source for each program. Include *all* TANF spending; if some expenditures do not fit into one of the specific program categories, include them in one of the lines labeled "other."
5. Provide expenditures for the state fiscal years of 1994-1995, 1998-1999, and estimated expenditures for 1999-2000 (not the federal fiscal year).
6. Do not include capital expenditures.
7. Do not include indirect administrative costs or management information systems (MIS) expenditures, but do include direct administrative costs such as case management expenditures in relevant program line items. If case management was included in administrative expenditures in 1994-1995, estimate and include where relevant.
8. Include the costs of fringe benefits for state personnel. (A rough estimate of fringe benefit costs is all that is necessary.)
9. Identify funding streams included in the columns labeled "Other" on a separate worksheet.
10. For columns labeled "SSBG" (Social Services Block Grant): If state officials cannot isolate spending on individual programs, obtain either estimates for these amounts, or totals and document the general areas in which SSBG funds are spent. For TANF funds transferred from TANF to SSBG document as SSBG expenditure with note on level attributable to the transfer.
11. Compile and provide copies of all supporting documentation for the data entered in the survey: e.g. expenditure reports, annual financial statements, or enacted budgets (for fiscal year 2000 estimates).
12. When possible, identify caseload and eligibility criteria for each program in supporting documentation.

Attachment 1

Suggested format for data submission:

For example, *Line 2b*, *Training*, could include expenditures from several programs across two or more agencies. Each of these agencies would complete the survey as well as provide the supporting documentation.

Agency 1

Dept of Social Services	I	II	III	IV
Work Preparation and Education				
b) training				
Program w	0	0	18,000	6,000
Program x	250,000	0	2,000	0
Total	250,000	0	20,000	6,000

Agency 2

Dept. of Family Employment	I	II	III	IV
Work Preparation and Education				
b) training				
Program y	650,000	40,000	0	4,000
Program z	100,000	10,000	0	0
Total	750,000	50,000	0	4,000

The various agencies' contributions could be compiled centrally and summarized

State Summary Totals	I	II	III	IV
Work Preparation and Education				
b) training	1,000,000	50,000	20,000	10,000

Glossary of column headings:
IV-A: Former Aid to Families with Dependent Children (AFDC) program
IV-F: Former Job Opportunities and Basic Skills (JOBS) program
SSBG: Social Services Block Grant, title XX of the Social Security Act
TANF: Temporary Assistance for Needy Families
TANF-MOE: TANF Maintenance of Effort, see your state TANF director or http://www.acf.dhhs.gov/programs/ofa/funds2.htm
MOE-SSP: Maintenance of Effort – Separate State Programs

Attachment 2

State Social Services Spending Survey
Specific Instructions

***Line 1*: Poverty Relief**

Line 1a: cash assistance.
Include expenditures on cash payments or vouchers provided to families to meet ongoing, basic needs, net of child support collections. Any cash assistance program that was formerly funded by IV-A should be included here. (Note: This definition is adapted from the definition of basic assistance in line 5a of the ACF-196 Financial Report.)

Line 1b: child support payments.
Include all child support collections from non-custodial parents that are passed on to custodial parents who are receiving cash assistance through TANF, in excess of $50 per monthly payment.

Line 1c: emergency assistance.
Include all expenditures for emergency assistance (the former IV-A program), including prevention of eviction, utility cut-off, etc. Document, to the extent possible, how emergency assistance funds are allocated.

Line 1d: food assistance.
Include expenditures on programs designed to provide food or nutritional assistance to low-income people. Include state administrative expenses for Food Stamps. If known, also provide federal expenditures on Food Stamps in your state fiscal year.

Line 1e: housing assistance.
Include expenditures on programs designed to provide housing assistance to low-income people, such as vouchers, state low-income housing tax credits, or any other state support for low-income housing efforts.

Line 1f: SSI supplements.
Include expenditures on state supplementation of the federal Supplemental Security Income program. Do not include federal expenditures.

Line 1g: other.
Include expenditures on any other programs related to poverty relief that are not included above. Describe such programs on an attached sheet.

***Line 2:* Work Preparation and Education**

Line 2a: education.
Include expenditures on educational activities that prepare the recipients for work. For example, include secondary education (including alternative programs); adult education, GED, and ESL classes; education directly related to employment; education provided as vocational educational training; and post-secondary education. Do not include education

Attachment 2

programs for children below high-school age. *In this instance, limit spending to TANF-eligible people.*
(Note: This definition is adapted from the definition of education in line 6a2 of the ACF-196 Financial Report.)

Line 2b: training.
Include expenditures on programs to prepare people who are not yet working with skills to make them employable. Examples include skills development programs, community service placements, etc. Do not include expenditures on people who are in the paid workforce.

Line 2c: other.
Include expenditures on any other programs related to work preparation and education that are not included above. Document programs descriptions on an attached sheet.

***Line 3*: Employment Support**
Cells are shaded. Include expenditures in this category on lines 3a-3e below.

Line 3a: post-employment services.
Include expenditures on programs designed to keep people employed after they have found employment. Examples include coaching to ensure that individuals arrive at work on time, counseling to address problems that may arise in the workplace, and any other case management services for this working population. If known, include spending for on-the-job training.

Line 3b, c: state EITC.
Include expenditures on state earned income tax credits paid to families. Include state and local tax credits that are designed to defray the costs of employment for low-income families.

Line 3d: transportation.
Include the value of transportation benefits (such as allowances, bus tokens, car payments, auto insurance reimbursement, and van services) provided to employed families (related either to their work or related job retention and advancement activities) and provided as a nonrecurring, short-term benefit to non-working families (e.g. during applicant job search). (Note: this definition is adapted from the definition of transportation in line 6c of the ACF-196 Financial Report.)

Line 3e: wage subsidies.
Include payments to employers or third parties to help cover the costs of employee wages, benefits, supervision, or training. Also include any wage-related tax credits that benefit employers.
(Note: This definition is adapted from the definition of work subsidies in line 6a1 of the ACF-196 Financial Report.)

Attachment 2

Line 3f: other.
Include expenditures on any other programs related to employment support that are not included above. Describe such programs on an attached sheet.

***Line 4:* Poverty Prevention**
Cells are shaded. Include expenditures in this category on lines 4a-4d below.

Line 4a: diversion payments.
Include expenditures on nonrecurrent, short-term benefits to families in the form of cash payments, vouchers, or similar form of payment to deal with a specific crisis situation or episode of need. An example is an emergency rent payment to prevent eviction.
(Note: this definition is adapted from the definition of diversion payments in line 6g of the ACF-196 Financial Report.)

Line 4b: family formation and pregnancy prevention.
Include expenditures on programs aimed to keep families together, prevent teen pregnancy and prevent single parenthood. Examples of program expenditures are: responsible fatherhood initiatives that will improve the capacity of needy fathers to provide financial and emotional support for their children; premarital and marriage counseling, and mediation services; counseling services or classes that focus on teen pregnancy prevention; media campaigns to encourage young people to delay parenting or to encourage fathers to play a responsible role in their children's lives; and incentives for single parents to marry or for two-parent families to stay together.
(Note: this definition is identical to the section in ACF's "Helping Families Achieve Self-Sufficiency" guide entitled, "Appropriate Uses of Funds/Family Formation and Pregnancy Prevention" at http://www.acf.dhhs.gov/programs/ofa/funds2.htm)

Line 4c: other.
Include expenditures on any other programs related to poverty prevention that are not included above. Describe such programs on an attached sheet.

***Line 5*: Child Protection/Juvenile Justice**
Cells are shaded. Include expenditures in this category on lines 5a-5c below.

Line 5a: child welfare.
Include expenditures on adoption assistance, foster care, and independent living programs; on any program intended to prevent out-of-home placements, promote reunification of families, or provide a safe environment for children; and on programs that focus on child abuse prevention and neglect prevention. Examples of expenditures include using funds for family counseling; parent support programs; appropriate supportive services (e.g., referral services, child care, transportation, and respite care) to caregiver relatives who can provide a safe place for a needy child to live and avoid his or her placement in foster care; and screening families for risk of child abuse or neglect and providing case management. (Note: Any cash assistance program that was formerly funded by IV-A, such as cash assistance to needy caretaker relatives, should be included in the "cash assistance" category.)

Attachment 2

Line 5b: juvenile justice programs.
Include expenditures on social services programs for youth who have violated the state juvenile code. Do not include institutional spending.

Line 5c: other.
Include expenditures on any other programs related to child protection/juvenile justice that are not included above. Describe such programs on an attached sheet.

***Line 6*: Other**
Cells are shaded. Include expenditures in this category on lines 6a-6c below.

Line 6a: provider profits.
Include all bonuses, incentive payments or profits to contractors for provision of services to low-income people.

Line 6b: substance abuse prevention and treatment.
Include expenditures on programs aimed to prevent alcohol, drug and tobacco abuse and to provide intervention services to individuals with alcohol, drug and/or tobacco dependency in their families. Examples of prevention programs are media campaigns, educational programs and community-based planning programs. Examples of expenditures on treatment include counseling, treatment facilities, and outpatient medical care.

Line 6c: developmental disabilities.
Include expenditures on programs that provide services to individuals with developmental disabilities and their families, including outpatient care and public education, but excluding institutional facilities.

Line 6d: mental health services.
Include expenditures on programs that provide prevention and/or intervention services to the mentally ill and their families, including community-based treatment facilities, outpatient care and public education. Exclude all expenditures provided at/through mental health institutions.

Line 6e: other
Include expenditures on any other programs that are not included above. Describe such programs on an attached sheet.

Child Care/Child Development Spending Survey

Instructions for Child Care/Child Development:

Include expenditures on any child care or child development program, either custodial or educational, in-home or out-of-home, aimed at either working or non-working people, including pre-K programs, after-school programs, vouchers for child care, state expenditures on Head Start, and subsidies to child care centers, and child care tax credits (if available). Include programs for both TANF-eligible and non-TANF-eligible people. Please identify each child care/child development program in the spaces below and identify their funding streams. Please identify eligibility criteria for these programs, as well as caseloads (numbers of children, not families, if possible), on an attached sheet.

1994 - 95 Child Care/Child Development Spending

	Federal Expenditures		State Expenditures		TOTALS
Program Names	CCDBG	Other			
TOTALS	0	0	0	0	0

1999 - 00 Child Care/Child Development Spending

	Federal Expenditures		State Expenditures			TOTALS
Program Names	CCDF	Other	CCDF-MOE	CCDF-Match	Other	
TOTALS	0	0	0	0	0	0

CCDBG - Child Care and Development Block Grant
CCDF - Child Care Development Fund

Healthcare Coverage Spending Survey

Instructions for Healthcare Coverage Spending Survey:

Include expenditures on any healthcare program, in-home or out-of-home, aimed at either working or non-working people and their children, excluding long-term care. Include programs for both the TANF-eligible and non-TANF-eligible non-elderly population. Identify each program in the spaces below and their funding streams. Identify eligibility criteria for these programs, as well as caseloads on an attached sheet. For Medicaid-funded programs, identify target populations (e.g. "transitional assistance," "expansion population") where possible. State expenditures should capture local spending if it flows through the state budget (e.g. a local match).

1994 - 95 Healthcare Coverage Spending

	Federal Expenditures			State Expenditures			TOTALS
Program Names	Title XIX	Title XXI	Other	Title XIX	Title XXI	Other	
TOTALS	0	0	0	0	0	0	0

1999 - 00 Healthcare Coverage Spending

	Federal Expenditures			State Expenditures			TOTALS
Program Names	Title XIX	Title XXI	Other	Title XIX	Title XXI	Other	
TOTALS	0	0	0	0	0	0	0

State FY 1994 - 95 Social Services Spending Survey										
	Federal Expenditures				**State Expenditures**			**Local Expenditures**		**TOTALS**
	I IV-A	II IV-F	III SSBG	IV Other	V IV-A	VI IV-F	VII Other	VIII IV-A	IX Other	X
1 Poverty Relief										
a) cash assistance										
b) child support payments										
c) emergency assistance										
d) food assistance										
e) housing assistance										
f) SSI supplements										
g) other (please specify)										
h) total	0	0	0	0	0	0	0	0	0	0
2 Work Preparation and Education										
a) education										
b) training										
c) other (please specify)										
d) total	0	0	0	0	0	0	0	0	0	0
3 Employment Support										
a) post-employment services										
b) state EITC- non-refundable										
c) state EITC- refundable										
d) transportation										
e) wage subsidies										
f) other (please specify)										
g) total	0	0	0	0	0	0	0	0	0	0
4 Poverty Prevention										
a) diverson payments										
b) family formation/preg. prev.										
c) other (please specify)										
d) total	0	0	0	0	0	0	0	0	0	0
5 Child Protection/Juvenile justice										
a) child welfare										
b) juvenile justice programs										
c) other (please specify)										
d) total	0	0	0	0	0	0	0	0	0	0
6 Other										
a) provider profits										
b) substance abuse prev. & treat.										
c) developmental disabilities										
d) mental health services										
e) other (please specify)										
f) total	0	0	0	0	0	0	0	0	0	0
7 **TOTALS**	0	0	0	0	0	0	0	0	0	0

State FY 1999-2000 Social Services Spending Survey (estimated)									
	Federal Expenditures			**State Expenditures**			**Local Expenditures**		**TOTALS**
	I TANF	II SSBG	III Other	IV TANF-MOE	V MOE- SSP	VI Other	VII TANF-MOE	VIII Other	IX
1 Poverty Relief									
a) cash assistance									
b) child support payments									
c) emergency assistance									
d) food assistance									
e) housing assistance									
f) SSI supplements									
g) other (please specify)									
h) total	0	0	0	0	0	0	0	0	0
2 Work Preparation and Education									
a) education									
b) training									
c) other (please specify)									
d) total	0	0	0	0	0	0	0	0	0
3 Employment Support									
a) post-employment services									
b) state EITC- non-refundable									
c) state EITC- refundable									
d) transportation									
e) wage subsidies									
f) other (please specify)									
g) total	0	0	0	0	0	0	0	0	0
4 Poverty Prevention									
a) diverson payments									
b) family formation/preg. prev.									
c) other (please specify)									
d) total	0	0	0	0	0	0	0	0	0
5 Child Protection/Juvenile justice									
a) child welfare									
b) juvenile justice programs									
c) other (please specify)									
d) total	0	0	0	0	0	0	0	0	0
6 Other									
a) provider profits									
b) substance abuse prev. & treat.									
c) developmental disabilities									
d) mental health services									
e) other (please specify)									
f) total	0	0	0	0	0	0	0	0	0
7 **TOTALS**	0	0	0	0	0	0	0	0	0

Comments From the Department of Health and Human Services

DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

AUG - 3 2001

Mr. Paul L. Posner
Managing Director--
Federal Budget Issues,
Strategic Issues
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Posner:

Enclosed are the Department's comments on your draft report, "Welfare Reform: Challenges in Maintaining the Federal-State Fiscal Partnership." The comments represent the tentative position of the Department and are subject to reevaluation when the final version of this report is received.

The Department also provided extensive technical comments directly to your staff.

The Department appreciates the opportunity to comment on this draft report before its publication.

Sincerely,

Michael Mangano

Michael F. Mangano
Acting Inspector General

Enclosure

The Office of Inspector General (OIG) is transmitting the Department's response to this draft report in our capacity as the Department's designated focal point and coordinator for General Accounting Office reports. The OIG has not conducted an independent assessment of these comments and therefore expresses no opinion on them.

COMMENTS OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES ON THE GENERAL ACCOUNTING OFFICE'S DRAFT REPORT, "WELFARE REFORM: CHALLENGES IN MAINTAINING THE FEDERAL-STATE FISCAL PARTNERSHIP" (GAO-01-828)

General Comments

The Department of Health and Human Services appreciates the opportunity to comment on this draft report, which addresses an important topic. The Department has actively supported States in using the flexibility afforded by the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 to develop effective services for recipients at risk of reaching their five-year time limit (or less, at State option) through guidance, technical assistance, facilitating communication among States, and research.

See comment 1.

1. The General Accounting Office (GAO) report advises that "The MOE requires states to maintain a significant portion of their own historic financial commitment to their welfare programs as a condition of receiving their full TANF allotment." (emphasis added). We suggest adding the nature of this commitment to the body of the report, instead of elaborating on it in a footnote. Therefore, we suggest saying that each State is required to maintain 80 percent (75 percent, if required work participation rates have been met) of their Fiscal Year (FY)1994 spending level as a condition of receiving their full Temporary Assistance to Needy Families (TANF) allotment. We believe that it is worth being specific, since aspects of the maintenance-of-effort (MOE) requirement could be taken up during the reauthorization debate.

See comment 2.

2. We suggest providing a summary of certain current law provisions such as the MOE requirement, the "new spending" limitation on the countable MOE expenditures, and the limitation on the use of reserve or "carry-over" funds at the beginning of GAO's report. This would help to provide context to the information in the report and help the reader assess whether State practice has been satisfactory.

See comment 3.

3. Frequent reference is made to the "broader goals (purposes) of the TANF program," without stating what the four purposes are. At the beginning of this report we suggest adding that States have broad discretion to use TANF funds in ways they believe can accomplish a purpose of the TANF program. Then, we suggest stating the four TANF purposes. They are to: (1) provide assistance to needy families so that children may be cared for in their own homes or in the homes of relatives; (2) end the dependence of needy parents on government benefits by promoting job preparation, work, and marriage; (3) prevent and reduce the incidence of out-of-wedlock pregnancies and establish annual numerical goals for preventing and reducing the incidence of these pregnancies; and (4) encourage the formation and maintenance of two-parent families.

See comment 4.

4. Discussion about and analysis of the reserves does not include any mention of the statutory and regulatory limitation on the use of these carry-over funds. States may only use these funds to provide "assistance" and to pay for administrative costs directly related to the

provision of such "assistance." This limitation could be a factor in explaining why States are using Federal funds to pay an increased share of the costs of basic cash assistance.

See comment 5.

5. On page 27, the report mentions that "As of September 30, 2000 states reported leaving $8.7 billion in unspent TANF funds at the U.S. Treasury; ...." We suggest adding some information at the beginning of the report that defines "unspent," "unliquidated balances," and "unobligated balances" (for example, pursuant to the definitions in 45 CFR Part 92). For clarity, the terms should be defined and used consistently throughout the report.

See comment 6.

6. Throughout the report, there is reference to the "new spending" limitation. Yet, the first explanation of it in any detail does not appear until page 17, where the explanation is not entirely accurate. We suggest revising the explanation to say that the new spending requirement limits the expenditures in a preexisting program that a State may count toward their MOE requirement. Basically, for programs a State operated in FY 1995 that were not authorized and allowable under the former title IV-A or IV-F programs, the State may only count expenditures in the current fiscal year on behalf of eligible families that exceed total FY 1995 expenditures in the program. (See comment 2, above, where we also suggest adding an explanation of the "new spending" limitation at the beginning of GAO's report.)

   The report mentions, in different places, that the MOE requirement limits States' ability to use State funds for programs States had initiated prior to TANF, without specifying that this may be due to the "new spending" limitation. The report also recognizes that the limitation also contributes to States using Federal TANF funds instead of MOE funds (for example, Michigan, Wisconsin). These are reasons why it is important to include an explanation of the "new spending" provision at the beginning of the report.

See comment 7.

7. The report mentions that some States have difficulty meeting the MOE requirement in light of declining caseloads. Basically, "caseloads" are families receiving "assistance" (as defined in 45 CFR 260.31). The report does not point out that States must spend MOE funds on "eligible families." The definition of "eligible family" encompasses more families than just those that are in the "caseload," that is, receiving "assistance." Rather, States may expand services to virtually any financially eligible family that consists of, at a minimum, a child living with a relative (or consist of a pregnant woman). Thus, the definition of "eligible family" enables a family to receive a variety of benefits and services that the State wishes to provide.

GAO Recommendations:

- In order to inform decision-makers on the status of the federal-state fiscal balance the Secretary should consult with the states to explore ways to periodically gather data revealing the federal-state fiscal balance relevant to achieving the broader programmatic goals of the TANF program.

- We also reiterate our prior recommendation that the Secretary work with the states to provide for more transparent reporting by the states of their plans for the unspent TANF balances.

2

Department Comments:

We agree that comprehensive, timely data from the States will be essential during TANF reauthorization. The Department works closely with the States to obtain required data in a way that maximizes the information that can be gathered while minimizing costly reporting burdens for the States. However, there are restrictions in current law that impact the Department's ability to undertake new data collection. Furthermore, additional data collection would have resource implications on the Federal, State and local levels. We would suggest that the report's recommendation to periodically assess "...the federal-state fiscal balance relevant to achieving the broader programmatic goal of the TANF program." include a cost estimate.

3

GAO Comments

1. As we reported, many aspects of the MOE requirement play a significant role in the maintenance of the federal-state fiscal balance. We agree with HHS that many aspects of the MOE could be taken up during the forthcoming TANF-reauthorization debate. We believe that footnote 2 provides adequate information for the reader to understand the specifics of the states' financing requirements. We also refer readers to our previous report for additional information on this important provision in the law.

2. We added footnote 8 on page 9 to clarify that HHS regulations restrict the use of TANF carry-forward funds and clarified our discussion of the "new spending test" on pages 23-24 of the report.

3. Now on page 7 of the report.

4. See footnote 8. HHS suggests that the restriction on the use of state carry-forward funds may be a factor in explaining why states are using federal funds to pay an increased share of the costs of basic cash assistance. Clearly, regulations play an important role in state decision-making. However, in many of the states we reviewed this restriction was not the primary factor that influenced their budget decisions. Furthermore, many factors—regulations, the economy, and other state budgetary constraints—influence state decision-making; the fiscal balance is not static and will continually evolve. This is the primary reason we recommend that the department work with the states to gather data periodically to assess the federal-state fiscal balance relevant to achieving the broader goals of the TANF program. Such assessments will provide important information on how the myriad factors that influence state decision-making affect the fiscal balance.

5. We added footnote 20 to distinguish the two components of "unspent funds"—unliquidated obligations and unobligated balances. The body of report discusses our view that such distinctions have significant limitations because states do not report this information in a consistent manner.

6. We clarified our discussion of the "new spending test" on pages 23-24 of the report.

7. In our discussion on pages 25-26 of this report we address the lack of nonduplicative case counts and the implications it has on our analysis.

Specifically, it becomes problematic when one tries to compare the level of effort under TANF with the level of effort under AFDC on a per case basis. Absent better data on caseloads, our focus on the fiscal balance was designed to address the extent to which states were using their TANF funds to supplant their own funds controlling for some changes to the program's workload.

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