"RAINY DAY" AND OTHER SPECIAL TANF ISSUES

HEARING

BEFORE THE

SUBCOMMITTEE ON HUMAN RESOURCES

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

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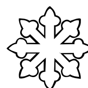

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"RAINY DAY" AND OTHER SPECIAL TANF ISSUES

THURSDAY, APRIL 26, 2001

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON HUMAN RESOURCES,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:02 a.m., in room B–318 Rayburn House Office Building, Hon. Wally Herger (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON HUMAN RESOURCES

FOR IMMEDIATE RELEASE
April 19, 2001
No. HR–3

CONTACT: (202) 225–1025

Herger Announces Hearing on “Rainy Day” and Other Special TANF Funds

Congressman Wally Herger (R–CA), Chairman, Subcommittee on Human Resources of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on “rainy day” and other special funding issues under the Temporary Assistance for Needy Families (TANF) program. **The hearing will take place on Thursday, April 26, 2001, in room B–318 of the Rayburn House Office Building, beginning at 10:00 a.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Witnesses will include representatives of the U.S. General Accounting Office and State welfare administrators, as well as other experts on State welfare funding issues. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. 104–193), commonly referred to as the 1996 welfare reform law, made dramatic changes in the Federal-State welfare system designed to aid low-income American families. The law repealed the former Aid to Families with Dependent Children program, and with it the individual entitlement to cash welfare benefits. In its place, the 1996 legislation created a new TANF block grant that provides fixed funding to States to operate programs designed to achieve several purposes: (1) provide assistance to needy families, (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 (4) encourage the formation and maintenance of two-parent families. Associated changes included individual time limits and work requirements intended to reinforce the new focus on work and independence for families needing assistance.

In addition to the basic TANF block grant, the 1996 law included several separate funds to assist States with special needs. These include two programs authorized through the end of Fiscal Year 2001: a Federal contingency (or “rainy day”) grant fund and supplemental grants for fast-growing or relatively poor States. States also may save any amount of their TANF block grant for future needs, which many States have done, or borrow from a Federal contingency loan fund.

The Subcommittee hearing will explore “rainy day” and other special funding issues, including changes that might permit or encourage States to save more for their own future needs. Due to the fixed TANF block grant and more than 50 percent caseload decline since the 1996 welfare reform law, many States already have saved a significant portion of their block grant for such purposes.

In announcing the hearing, Chairman Herger stated: “Given current concerns about the economy, it is important for us to examine how the new law is working

to encourage States to save for 'rainy days' to come. Fortunately, given the steep caseload decline, many States have been able to do so. Our remaining tasks include assessing whether incentives to save during good times can be improved so every State has adequate funding for times to come."

FOCUS OF THE HEARING:

The focus of this hearing is to examine "rainy day" and other special funding issues under the TANF program.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect or MS Word format, with their name, address, and hearing date noted on a label, by the close of business, Thursday, May 10, 2001, to Allison Giles, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Human Resources office, room B–317 Rayburn House Office Building, by close of business the day before the hearing.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-inch diskette WordPerfect or MS Word format, typed in single space and may not exceed a total of 10 pages including attachments. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press, and the public during the course of a public hearing may be submitted in other forms.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman HERGER. Good morning. Welcome to today's hearing on "rainy day" and other special welfare funding issues.

Today we will hear about several related matters requiring our attention this year and next, as we consider the future of the 1996

welfare reforms. Two provisions in the 1996 law will expire at the end of the current fiscal year: the Federal contingency grant fund and the supplemental grants to fast growing or relatively poor States.

These programs are part of today's agenda, but they really point us toward larger issues and questions: how should our Nation's cash welfare program be funded as we go forward, and what signals and incentives should Washington give on spending or saving TANF funds?

The latter question is one I want to explore in depth today, so I have encouraged witnesses to do some deep thinking on ways to encourage States to save more for rainy days. Fortunately, as we will hear, many are doing just that, aided by the more than 50 percent national caseload decline and fixed block grant funding.

What a change this is. Under the former AFDC system, spending rose in good times and bad. In fact, the very idea of saving cash welfare funds for rainy day was almost unimaginable.

Still, there are complications. This Committee fought back attempts to cut the TANF block grant when others saw welfare "surpluses" as inviting targets for budget cuts. We won that fight, so now both sides have upheld their end of the 1996 deal, when we traded fixed Federal funding for more responsibility to produce results.

What remains is to find ways to help States save more of their block grants, while insulating such savings from Washington budget cutters. That would leave States better able to assist needy families in the event of tough times, and it should help protect taxpayers' interests in the long run as well. So I am eager to hear the testimony of all of our witnesses on these important issues.

Without objection, each Member will have the opportunity to submit a written statement and have it included in the record at this point.

[The opening statement of Chairman Herger follows:]

Statement of Hon. Wally Herger, M.C., California, and Chairman Subcommittee on Human Resources

Good morning, and welcome to today's hearing on "rainy day" and other special welfare funding issues. Today we will hear about several related matters requiring our attention this year and next as we consider the future of the 1996 welfare reforms.

Two provisions in the 1996 law will expire at the end of the current fiscal year—the Federal contingency grant fund and supplemental grants to fast-growing or relatively poor states. These programs are part of today's agenda. But they really point us towards larger issues and questions:

- How should our nation's cash welfare program be funded as we go forward? and
- What signals and incentives should Washington give on spending or saving TANF funds?

The latter question is one I want to explore in depth today. So I have encouraged witnesses to do some deep thinking on ways to encourage States to save more for rainy days. Fortunately, as we will hear, many are doing just that, aided by the more than 50 percent national caseload decline and fixed block grant funding. What a change this is. Under the former AFDC system, spending rose in good times and bad. In fact, the very idea of saving cash welfare funds for a rainy day was almost unimaginable.

Still, there are complications. This Committee fought back attempts to cut the TANF block grant when others saw welfare "surpluses" as inviting targets for budget cuts. We won that fight. So now both sides have upheld their end of the 1996 deal, when we traded fixed Federal funding for more responsibility to produce results.

What remains is to find ways to help States save more of their block grants, while insulating such savings from Washington budget cutters. That would leave States better able to assist needy families in the event of tough times, and it should help protect taxpayers' interests in the long run, too. So I am eager to hear the testimony of all of our witnesses on these important issues.

Chairman HERGER. Mr. Cardin, would you like to make an opening statement?

Mr. CARDIN. Thank you, Mr. Chairman.

I would request that my entire statement, along with a letter from Governor Perry, the Governor of Texas, be put into the record.

Chairman HERGER. Without objection.

[The information follows:]

OFFICE OF THE GOVERNOR
AUSTIN, TEXAS
March 16, 2001

Honorable Tommy G. Thompson
U.S. Secretary of Health and Human Services
Department of Health and Human Services
Washington, DC 20201

Dear Secretary Thompson:

I am writing to urge you to extend the Temporary Assistance for Needy Families (TANF) supplemental grants through fiscal year 2002. These grants play an important role in helping hardworking men and women achieve self-sufficiency. They were designed to address the needs of States with especially high population growth or historically low welfare benefits, and are critical to enable us to help even more Texans move from welfare to work.

It is imperative that these grants be extended while we work toward overall welfare reform reauthorization. I know you have heard from several Governors on this issue already, and I appreciate your consideration of this matter.

Please let me know if I can be of any assistance to you.

Sincerely,

RICK PERRY
Governor

Mr. CARDIN. Let me say first that I thank you for holding this hearing. I think it is a very important subject that we need to deal with this year, and I agree pretty much with everything you have said, on the framework within which we have to operate.

I, too, share your joy that the commitment we made to the States has been upheld by Congress, that we have lived up to what we said we were going to do. We did fight off efforts by others to violate that commitment. The results, I think, have been very, very positive.

I am not certain why, when we passed the legislation on the contingency fund and the supplemental grants, we had an expiration date in this year when TANF expires next year. It seems to me that it would be better suited for us to take up the longer term commitments on supplemental grants and contingency funds when we take up TANF. They are very much related.

On the other hand, I do not want to see either of those programs expire, because if they do, then I think we are violating the basic understanding we have with the States.

The supplemental grants, for example, would reduce TANF funds basically for 17 States by about 10 percent. It doesn't affect my State of Maryland, but it does affect many States in this country. I asked permission to put Governor Perry's letter in the record, where he strongly urges us to continue the supplemental grants because it is very important for the State of Texas.

In regards to the contingency fund, we all know that the contingency fund was a major part of the TANF compromises that were reached, to take into consideration that we may go through a tough economic time. We haven't since we passed TANF. We haven't tested the contingency funds, as to how they might be called upon to be needed.

Several States, most States, have put some money away just in case. That's exactly what we wanted them to do. They put some of their TANF money away and some of their own funds away. I have the figures here for Maryland, my own State, and we have reserved about $50 million of TANF funds and have dedicated about $80 million of our own resources in the event the economy moves into a difficult position. So the States are doing what we asked them to do.

If you take a look at the total dollars that have been unencumbered, I think it's about $3 billion, that is available to the States collectively, and about $9 billion has not been spent. That's not a large sum of money when you consider that, since the inception of the program, about $80 billion has been made available to the States.

So I think the programs have been working, and they have been working well. I would hope that we would either extend the supplemental grant and contingency fund for one more year, until we can get the TANF reauthorization, or we should really take a look at both of these programs, update for the current situation, look at some of the trigger mechanisms and determine whether those trigger mechanisms are appropriate, look at the appropriate funding levels—which might be difficult for us to do this year. But if we can't agree on an extension for 1 year, then I think we will need to do that.

I very much look forward to the witnesses.

[The opening statement of Mr. Cardin follows:]

Opening Statement of Hon. Benjamin L. Cardin, M.C., Maryland

Mr. Chairman, I want to thank you for calling us together today to consider how the States and the Federal government should respond to the obvious pressures that a recession would impose on our Nation's ongoing efforts to reform welfare. I don't think there is any doubt that the strength of our economy—which has seen the lowest unemployment levels in three decades—has played a critical role in helping people leave welfare for work.

Should the recent slowdown in our economy turn into a recession, it will have an immediate impact on the TANF program. In fact, it has been projected that welfare caseloads will increase by five to seven percent for every single percentage point increase in our Nation's unemployment rate.

Both the States and the Federal government have a role in planning for this possibility. States should reserve a sensible amount of TANF funding to meet the challenges of an economic downturn. This of course does *not* mean that States should leave vast amounts of TANF funds untapped when there are current, pressing needs for those resources. There is currently about $3 billion in *unobligated* Federal TANF spending nationwide, and we should have a discussion about whether that amount is too high, too low, or about right.

Needless to say, any analysis of this issue must recognize the enormous variation between the States in how much they are reserving in "rainy day" funds. I would note that my home State of Maryland has both a reserve of Federal TANF funds (about $50 million) and a dedicated reserve fund of State dollars for TANF purposes (about $80 million).

In support of State efforts to plan for the future, the Federal government can do two things. First, we must stop threatening to take back Federal money that States are holding in reserve. During past Congressional debates about the budget, there have been proposals to raid TANF surplus dollars, which obviously has a chilling effect on State plans to save money for a possible recession.

And second, recognizing that we need a Federal backstop to help States encountering economic difficulties, we should extend and improve the Federal contingency fund. This fund expires in only five months, meaning we need to move quickly to reauthorize it. We also should consider making changes to the current contingency fund, such as better triggers and more realistic maintenance-of-effort requirements, to make it more accessible to States that need help.

Before I conclude, let me mention one other important issue that our Subcommittee will consider today—the TANF Supplemental Grants, which go to States with low Federal funding per poor person and/or population increases. If our Subcommittee does not extend these grants, which expire at the end of this fiscal year, 17 States will have their annual TANF allocations cut by up to 10 percent.

Whether we are talking about helping States meet current needs or plan for the future, a cut in their TANF funding is clearly a step in the wrong direction. On this issue, I would like to place in the record a letter urging the extension of the TANF Supplemental Grants from Governor Rick Perry, who succeeded President Bush as the Governor of Texas.

Thank you.

Chairman HERGER. Thank you, Mr. Cardin, for your comments.

Before we go on to the testimony this morning, I want to remind the witnesses to limit their oral statements to 5 minutes. However, without objection, all the written testimony will be made a part of the permanent record.

Will the witnesses please have a seat at the table.

On today's panel, we will hear from Paul Posner, Director of Federal Budget Issues at the U.S. General Accounting Office; Elaine Ryan, Acting Executive Director, American Public Human Services Association; Joel Potts, TANF Policy Administrator at the Ohio Department of Job and Family Services; and Harry Holzer, Professor of Public Policy, Georgetown University, and Visiting Fellow, The Urban Institute. Mr. Posner, we will now hear your testimony.

STATEMENT OF PAUL L. POSNER, MANAGING DIRECTOR, STRATEGIC ISSUES, U.S. GENERAL ACCOUNTING OFFICE

Mr. POSNER. Thank you very much, Mr. Chairman. It is a pleasure to be here today.

I am reporting to you about the study that we have done for the Subcommittee, revisiting ten States that we had looked at several years ago, as part of our effort to monitor the unfolding of the TANF block grant.

This particular testimony, as you indicated, focuses on the potential challenges posed for this new partnership when we do have a downturn, the potential cushions available for both Federal and State governments to deal with the specific contingency mechanisms that were alluded to, and options to promote savings for a rainy day.

Fundamentally, the challenge is framed by the shift in Federal funding from an open-ended to a closed-ended program, which

means that additional costs that might visit us in a time of recession are no longer available on an open-ended match from the Federal Government to the States. Once States exhaust their TANF balances, they are more or less on their own to fund those additional costs, which is why the Federal government provided a contingency fund as part of the bargain, if you will.

Although the extent of the new program's response to a potential downturn still remains highly uncertain—conjectural, if you will—most observers and researchers and State officials agree that a downturn will put pressure on the program.

Against this backdrop, we know that State budgets tend to be pro-cyclical. What do we mean by that? Unlike the Federal budget, States have balanced budget requirements, bond markets, other fiscal limitations, that prompt them to make painful choices during times of downturn. As people become needier, States have less money. Simply put, absent a deficit, they can lower spending, raise taxes, or seek Federal help. Sometimes these shocks come abruptly in the middle of a State's fiscal year on biennium.

For States, fiscal planning is the key to smoothing out the impacts of business cycles, both for their overall budget and for programs like this that are sensitive to economic shocks. Rainy day funds dedicated to general budget stabilization funds are a normal part of State budgeting. Five percent of State money is generally in those funds, as well as rainy day funds dedicated to specific programs, with the general idea that you "fix the roof while the sun is shining."

The Federal government, too, has an interest, even in an era of devolution in promoting savings for the future, as you indicated. That is why we provided the contingency fund, in fact, to buffer the impact of a cyclical change.

Recognizing that the Federal Government is often viewed as a funder of last, and sometimes first resort, in the event of a downturn, encouraging savings now helps smooth out the Federal obligation as well.

Notwithstanding the contingency and loan fund, ironically it is not that fund that has been the main source of potential savings but, rather, the surprising unspent TANF balances that have come to play the role of an "accidental" rainy day fund for this program. They now total about $9 billion, or almost 15 percent of the grant since its inception.

Let me caution two things about those unspent balances. There is less here than meets the eye. First of all, these balances are highly uneven among the States. Ten States have zero or almost zero balances left. They have drawn down almost all their funds.

Second, we know there are inconsistent definitions reporting across States as to what these balances consist of. HHS has offered a few categories for States to report. Some are calling them unobligated, some are calling them unliquidated. The idea is to try to capture how many of those balances are really pre-committed.

The problem we have, when we go behind that data and look at the States, there is much uncertainty and confusion about the nature of these balances. States reporting money as unobligated, in fact, are reporting things that are, in fact, committed, like pre-contracts to child care. On the other hand, States reporting items as

unliquidated obligations, in fact, are reporting spending to counties that are still largely uncommitted.

So what I have to say here is just like we said 2 years ago: nobody really knows how much of that $9 billion is really available as a cushion.

Why does this matter? The lack of clarity of balances puts them potentially at risk in the budget process, particularly when spending is constrained and numerous other demands press for attention. The notion that it is "the State's money" might not be enough to protect it for the future in this competitive environment.

Unspent funds in any budget process create the presumption—and I would argue a legitimate presumption—that funds aren't needed. Every program has a burden of showing why these balances, in fact, are not only part of a bargain struck by the States, but part of a national reserve to address contingencies and cyclical pressures.

So we argue that the unique cyclical nature of this program argues, first of all, for better reporting of the nature of these balances, particularly how much would States be planning to set aside for future contingencies. We recommended this in 1998 and we have not seen any progress really along this score.

Secondly, we think that improved planning by the States themselves is important as well. We noted that States largely have not dedicated any reserves from their own money, partly because they can't count those reserves for their maintenance of effort requirements. Only Maryland really has found a way to do this. The Federal Contingency and Loan Fund is largely not available because of the overly stringent requirements.

So what we say in conclusion here is we provide some options for you to think about, changing the contingency fund, providing a little more flexibility for States to dedicate rainy day funds as part of their MOE, and ultimately provide some better information so that we know going forward what we really have to buffer the future in a downturn.

Thank you.

[The prepared statement of Mr. Posner follows:]

Statement of Paul L. Posner, Managing Director, Strategic Issues, U.S. General Accounting Office

Mr. Chairman and Members of the Subcommittee:

Thank you for inviting me here today to discuss states' plans for operating their welfare programs in the event of an economic downturn. In the block grant environment, the federal government has an interest in encouraging states to save for future contingencies, but within a framework that recognizes that the size of the reserve will remain largely a state determination made under conditions of inherent uncertainty. In 1998 we reported on states' plans for financing their welfare programs in the event that the economy unexpectedly turned down.[1] At that time most states' budget forecasts predicted that the robust economy would continue providing strong revenue growth potential and, more important for states' Temporary Assistance for Needy Families (TANF) budgets, diminishing costs in many social services programs. Last year, this subcommittee asked us to revisit the states examined in our 1998 report and to, among other things, look anew at their contingency plans. In part, my statement today includes research we conducted in 10 states (California,

[1] *Welfare Reform: Early Fiscal Effects of the TANF Block Grant* (GAO/AIMD–98–137, August 22, 1998).

Colorado, Connecticut, Louisiana, Maryland, Michigan, New York, Oregon, Texas, and Wisconsin).

As we will discuss more fully later in this testimony, the data available on the levels and adequacy of states' reserves is insufficient and misleading. Furthermore, our case studies suggest that most states have done little planning for economic contingencies. Because states' new welfare programs remain untested in times of downturn, these uncertainties make it difficult for anyone to predict how states will respond and how former welfare recipients will be affected if and when economic conditions change. Despite the significant changes made to the nation's welfare program, the economy will no doubt play a role in determining how many people return to the welfare rolls and how long they, and those currently on the rolls, will remain if there are fewer job opportunities available.

As economic forecasts have begun to change, there is some concern that the states might not be as prepared as they could be to manage the new fiscal challenges under welfare reform. Many adults have left the rolls for work since TANF was implemented—caseloads have dropped more than 50 percent nationwide—and those remaining on the rolls have increased their work efforts. Greater emphases on work implies a tighter link to work and hence the economy. This could make TANF more sensitive to an economic downturn than Aid to Families with Dependent Children (AFDC) if former recipients return to the rolls when they are laid off, causing state TANF budgets to rise. However, the flexibility of the grant combined with significant unspent TANF balances may help mitigate the fiscal fallout from economic downturns.

In today's testimony I plan to address three points:

- The shifting fiscal balance between the states and the federal government and the challenges this new partnership poses in financing and strengthening the safety net during times of economic stress.
- The potential for states to draw on their TANF grants and state reserves to cushion fiscal and economic shocks to the program.
- The complexity in the design of existing TANF contingency mechanisms that limits the effectiveness of these mechanisms in responding to uncertainties in the economy.

Finally, I would like to conclude with some options this Subcommittee might consider that could lead to refinements in the new fiscal partnership on welfare, giving the states more incentives to save while maintaining the federal role in the safety net.

New Fiscal Partnership Poses Challenges

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. No. 104–193) (PRWORA) made sweeping changes to national welfare policy. Principally, these reforms gave states the flexibility to design their own programs and the strategies necessary for achieving program goals, including how to move welfare recipients into the workforce. But because the act also changed the way in which federal funds for welfare programs flow to the states, most of the program's fiscal risks also shifted to the states. PRWORA created the TANF block grant, a fixed federal funding stream that replaced the AFDC and related programs in which federal funding matched state spending and increased automatically with caseload. Under AFDC, which entitled eligible families to aid, the federal funding was largely open-ended so that if a state experienced caseload and related cost increases, federal funds would increase with state funds to cover expenditures for the entire caseload. This open-ended federal commitment provided that financing for every dollar spent on these programs was shared by the federal government and the states, thereby limiting the states' exposure to escalating costs. In contrast, the TANF block grant eliminated the federal entitlement to aid. The federal government provides a fixed amount of funds regardless of any changes in state spending or the number of people the programs serve. While the states must also provide a fixed level of funds from their own resources—their maintenance of effort (MOE)[2]—they are now responsible for meeting most of the costs associated with any increase in caseload on their own. How they plan to manage this fiscal risk is what I refer to in this testimony as contingency planning.

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[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/JOBS child care programs: AFDC-Child Care Program, Transitional Child Care, and At-Risk Child Care programs. A state that does not meet PRWORA's work participation rates must maintain at least 80 percent of its MOE. A state that meets its work participation rate must maintain at least 75 percent of its MOE.

In this new welfare partnership, it is tempting to suggest that since welfare reform devolved decisions regarding eligibility and program services to the states, the potential volatility of the caseload is no longer a federal concern. However, in light of both federal requirements and their own fiscal limitations, states will be challenged during a downturn to maintain or increase state funds for benefits when they are most needed. States' decisions regarding who to serve, for how long, and with what services will surely depend on how much flexibility they have with the resources—state and federal—that are available to finance their welfare programs. Although considerable uncertainties exist about the impacts of downturns, the potential cyclical nature of program costs as well as the fiscal constraints states face in responding to hard times heightens the importance of fiscal planning. Helping states maintain their programs was indeed recognized as a federal interest by Congress when it included the Contingency Fund and Loan Fund—mechanisms for states to gain access to additional federal funds—in TANF.

Impact of Economic Cycles on TANF Caseloads Is Uncertain

It is unclear what impact a major economic downturn or recession will have on welfare participation given the significant reforms in national welfare policy. Recent studies have tried to establish a link between caseload trends and certain macroeconomic indicators in part to determine how sensitive welfare programs might be to changes in the economy. While the research literature generally suggests that caseloads may very well increase in an economic downturn, there is substantial uncertainty regarding the extent of the impact. These studies point to the variety of other factors affecting caseload levels, particularly with the advent of welfare reform.

For example, a 1999 Council of Economic Advisors (CEA) report suggests that a 1 percent increase in the unemployment rate could produce a 5 to 7 percent increase in welfare caseloads. However, this same study noted that changes in family structure and welfare policies can significantly mitigate the impact of an economic downturn on caseloads. In fact, the recent caseload drop was at least partly due to reforms ushered in by TANF—the study suggests that about one-third of the caseload reduction from 1996 through 1998—independent of the strong economy.[3]

Just as the reforms may have prompted reduced caseloads during times of economic expansion, greater emphases on work implies a tighter link to work and hence the economy, making TANF more sensitive to an economic downturn than AFDC. On the other hand, the reforms may pose significant disincentives for people to return to the welfare rolls or to apply even if they are eligible during downturns. For example, PRWORA imposes a 5-year lifetime limit on federal assistance on individuals receiving on going assistance;[4] many may try other options first before returning to the welfare rolls. In addition, many states now offer a variety of work supports such as child care, transportation subsidies, and an earned income tax credit (EITC) to families not receiving cash assistance. These supports may be enough to allow earnings from even a part-time job to support a family without returning to the cash assistance rolls.

State Budget Processes Could Have an Impact on TANF Programs

Budgetary stress caused by caseload volatility may be compounded by the limitations placed on most states by constitutional or statutory requirements to balance their general fund budgets. During a fiscal crisis, state policymakers face difficult choices regarding whom to serve, for how long, and with what services. But more important to the discussion today is that each of these "hard choices" must be financed in the context of fiscal limitations—including legislative restrictions, constitutional balanced budget mandates, or conditions imposed by the bond market—on 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

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[3] A recent survey of the research literature on this topic notes that there is a "mixed bag" of evidence regarding policy reform's influence on caseload size. Some studies found that policy reforms did not independently cause—or have an influence—on caseload declines. See Bell, Stephen H. "Why Are Welfare Caseloads falling?" Urban Institute, March 2001.

[4] In promulgating regulations concerning TANF, the Department of Health and Human Services (HHS) makes a distinction between TANF- or MOE-funded activities that are considered assistance and TANF- or MOE-funded activities that are not considered assistance. The distinction is important because activities that are considered "assistance" are subject to a variety of spending limitation and requirements—including work, time limits, child support assignments, and data reporting. Activities considered to be nonassistance would not have the same requirements associated with them. Assistance includes benefits directed at basic needs even when based on participation in a work experience or community service activity. It also includes childcare, transportation, and supports for families that are not employed.

often motivate states to both reallocate resources within their budgets and cut program spending or increase taxes during recessions. Such difficulties, I am sure, come as no surprise to many of the members of this Subcommittee who have had to make many of these difficult choices while serving in state legislative bodies. For these reasons prudent fiscal planning, especially contingency budgeting for a fiscal "rainy day," becomes particularly important.

In a 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.[5] 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.

Reserves Are Key to States' Contingency Plans but States Cite Disincentives To Save

Finding the right balance between saving and investing resources in programs that help people make the transition from welfare to work continues to be one of the main challenges for states as they develop strategies to address the needs of low-income families. To set aside reserves for future welfare costs, states have two options: they can save federal TANF funds and/or they can save their own funds. However, states noted significant disincentives to save associated with both of these options. State officials told us that there is concern that accumulating unspent TANF balances might signal that the funds are not needed and that they have been under considerable pressure to spend their TANF balances more quickly to avoid the accumulation of large unspent balances in the U.S. Treasury. States have accumulated a portion of their own funds in general purpose rainy day funds, but welfare would have to compete with other claims for these dollars when these dollars are released from state treasuries.

Flexibility of TANF Grants Allows States To Build Reserves

Under TANF, the amount of each state's block grant was based on the amount of federal AFDC funds spent by the state when caseloads and spending were at historic highs. Because caseloads have fallen so dramatically, generally states have been able to reap the fiscal benefits of welfare reform by parlaying abundant federal resources into new programs and savings. Any federal funds they choose to reserve must remain at the U.S. Treasury until the states need them for low-income families.[6] As of September 30, 2000 states reported leaving $9 billion in unspent TANF funds at the U.S. Treasury; this amounts to 14.5 percent of the total TANF funds awarded since 1996.[7]

Although many might view these balances as a de facto rainy day fund for future welfare costs, in fact there is probably less here than meets the eye. First, as we will discuss in more detail, the data reported by the states is misleading. Second, the reported balances themselves vary greatly among the states, suggesting that some states may not be as prepared to address the fiscal effects an economic downturn may have on their welfare programs without additional federal assistance while others may have saved substantially more than they might need. For example, some states report spending all their federal funds—essentially holding nothing in reserve—while others report accumulated reserves totaling more than their annual block grants. For example, Wyoming reports that nearly 70 percent of the TANF funds it has been awarded since 1997 remain unspent whereas Connecticut reports spending all of its TANF funds.

Reliable Data on Adequacy of State Reserves Are Not Available

States do not report unspent balances in a consistent manner making it difficult to ascertain how much of these balances is truly uncommitted and available for future contingencies. Therefore, federal policymakers lack reliable information to help assess states' plans for economic contingencies, whether the levels of available funds are adequate, and whether all states have access to these funds.

Department of Health and Human Services' (HHS) regulations require that if a state has allocated a portion of its TANF grant to a rainy day fund, the state should

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[5] *Budgeting for Emergencies: State Practices and Federal Implications* (GAO/AIMD–99–250, September 30, 1999).

[6] HHS regulations stipulate that a state must obligate by September 30 of the current fiscal year any funds for Expenditures on Non-Assistance. The state must liquidate these obligations by September 30 of the immediately succeeding federal fiscal year for which the funds were awarded. Unobligated funds from previous fiscal years may only be expended on "assistance" and the administrative costs related to providing "assistance".

[7] These data are based on preliminary analysis of state-reported data. As of April 2001, HHS' Administration for Children and Families (ACF) has not publicly released this data.

report these balances as *unobligated.*[8] But, state rainy day funds for welfare programs represent only a portion of the total reported unobligated balances. These balances can represent funds the state has saved for a rainy day, funds for which the state has made no spending plans, or funds the state has committed for activities in future years. 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. This is a case where a reported unobligated balance provides very little information about whether these funds are committed or simply unbudgeted.

States also report unspent TANF funds as *unliquidated obligations*, which means that, 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. But it is unclear how much of what is currently obligated is committed for future needs. For example, both California and Colorado have county-administered welfare systems. These states pass most of their annual block grant directly to the counties. As caseloads have continued to decline in both states, the budgets over-estimated expenditures leaving considerable balances unspent. Although these funds remain in the U.S. Treasury until a 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 the state reports no *unobligated balances*, implying that all these funds are earmarked. Recently, California amended its state statute to allow the state to deobligate some of these funds, if necessary, and make them available to other counties. Likewise, as of September 30, 2000 Colorado reports about $95 million in *unliquidated obligations*, but passes virtually all TANF resources to the counties. As of June 30, 2000 the state estimated that counties hold about $67 million in reserves—or about 70 percent of the total *unliquidated obligations*—for future contingencies.

As highlighted in the above examples, the difference between *unobligated balances* and *unliquidated obligations* is often unclear and varies by state. Significant portions of California's and Colorado's unspent funds are not yet actually committed for specific expenditures 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.

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

Even though some states might consider their *unobligated balances* for TANF to be rainy day funds, it does not appear that the amounts reserved were based on any kind of contingency planning or analysis. For example, 5 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 were not determined through a fiscal planning process that reflects budgetary assumptions about projected future needs. Instead, these states' statutes merely designate all TANF funds not already appropriated by the state legislature for other purposes as constituting the state's welfare rainy day fund, a method that clearly is not based on anticipated needs or contingencies.

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. 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 im-

[8] HHS regulations require states to report on the status of their unspent TANF funds. Under HHS regulations the states use two categories to report on the status of these 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.

plementing this recommendation and HHS' final regulations, issued on April 12, 1999 did not address this 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.

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.[9] 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 reportedly has prompted some states to draw down and spend their TANF funds rather than leave them in the Treasury.

States Have Few Incentives To Create State-Funded Welfare Reserves

Although many states have healthy general rainy day funds from 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. Setting aside state funds in reserve for welfare requires tradeoffs for state decisionmakers among competing needs for the funds during a downturn. In addition, 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. Therefore, it is a very expensive proposition indeed for a state to budget both for a welfare reserve and to meet its MOE because it then would have far fewer resources available to finance other state priorities.

Maryland found a way to transfer the costs of saving state funds to the federal government. In state fiscal year 2001, the state 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.

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 fiscal year 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.[10] 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

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[9] *Block Grants: Federal-State Cooperation in Developing National Data Collection Strategies* (GAO/HRD–89–2, November 29, 19998) and *Block Grants: Federal Data Collection Provisions* (GAO/HRD–87–59FS, February 24, 1987).

[10] 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)

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. 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 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 could consider turning to the Contingency Fund. In 1997 eight states qualified for contingency funds.[11] 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' federal medical assistance percentage (FMAP) rate[12] 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 1).[13] Prorating a state's draws from the Contingency Fund—especially if the state qualifies for a period that spans two 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.

Figure 1: 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 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

[11] These states are Alaska, California, District of Columbia, Hawaii, New Mexico, New York, North Carolina, and Washington.

[12] 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 80 percent for poorer states.

[13] For more information see GAO/AIMD–98–137.

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.

Options To Strengthen Contingency Planning

Although PRWORA struck a new fiscal balance between the federal government and the states in terms of welfare spending, both the states and the federal government have a significant interest in preparing the program to meet challenges in times of fiscal distress. Contingency planning is about being prepared for the unknown—as the economy shows possible signs of weakening, we need to begin to think about how prepared we are to maintain this important aspect of the nation's safety net. Although many view the states' large unspent TANF balances as the de facto contingency fund, these balances vary across states; this implies that some states may be better prepared for a recession than others. More important, current reporting requirements do not give us reliable, consistent information regarding states' actual plans for these monies. According to NGA, few states have engaged in a systematic fiscal planning process to project their needs under a variety of economic scenarios. While we don't know how states' welfare programs will respond to a weakened economy, we know both the federal government and the states have a responsibility to ensure the viability of TANF in good times and bad.

Before addressing how contingency planning can be improved for the future, the federal government needs better information on states' current plans. At the same time, Congress could consider ways to both strengthen federal contingency mechanisms and give states greater incentives to save for the future.

Improved National Reporting

In 1998, we recommended that the Secretary of Health and Human Services explore with the states various options to enhance information regarding states' plans for their unused TANF balances. We said that such information could

- include explicit state plans for setting aside TANF-funded reserves for the future,
- provide more transparency regarding these funds and enhance congressional oversight, and
- provide states with an opportunity to more explicitly consider their long-term fiscal plans for TANF.

Although HHS concurred with our recommendation, to date, we have seen no progress in this area. We continue to believe that Congress would benefit from more complete information on states' plans for future contingencies, including unspent TANF balances. While states often face burdens with respect to federal financial reporting requirements, states have historically recognized the benefits of cooperative data collection and reporting efforts and worked successfully with federal agencies to collect data that can give oversight officials a broad, national perspective of how they are using federal block grant funds. Allowing for more transparency regarding states' fiscal plans for TANF funds could enhance congressional oversight over the multi-year timeframe of the grant and provide states with an opportunity to more explicitly consider their long-term fiscal plans for the program. While the opportunity to more clearly signal their intentions for these funds could prompt states to save, Congress must have some assurance that states' estimates of their contingency needs were developed using credible, realistic estimating procedures.

In order for a state to report to the federal government a balance in a rainy day fund, and in order for the federal government to have some level of confidence in such a figure, the federal government could give states guidance on how it could designate its TANF balances as a valid rainy day fund. Such guidance could include requirements that a state rainy day fund (1) include criteria both for estimating the appropriate reserve balances and for releasing funds and (2) be auditable. This guidance could help states signal that much of these balances are, in fact, committed. Furthermore, requiring that reserves be determined by credible, transparent estimating procedures would help provide better estimates of the potential need for federal contingency funds.

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 Contingency 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 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 their MOE and (2) allow states to draw down their entire TANF grant and save these funds in their own treasuries.

Allowing states to count rainy day funds towards their MOE would give them a greater incentive to save. However, "maintenance of effort" implies an actual expenditure, and is a critical aspect of PRWORA. 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 they save for the future. However, this outcome can be mitigated by limiting the amount of rainy day funds that states could count towards their MOE. In addition, as we suggested earlier when discussing the TANF balances saved by states, states could also be required to certify that state rainy day funds are in fact auditable and include criteria for estimating and releasing the funds.

Some state officials have argued that their incentive to save TANF funds for the future could be bolstered by allowing states to keep unspent TANF funds in their own accounts rather than at the U.S. Treasury. They believe that this might reduce incentives for Congress to rescind unspent balances since the outlays would be recognized earlier at the time of the grant award, not when the money is actually spent for a program need. State officials also told us that this would alleviate the perceived pressure to spend TANF funds rather than save them. However, it is important to note that, regardless of where these federal funds are "stored," states are accountable for these funds. As such, Congress still needs consistent, reliable, and auditable information on these funds.

There are significant issues associated with this proposal. First, if states draw down all unspent balances in the current year, the rate of outlays recorded for the TANF program would shift forward. Accordingly, the federal budget surplus would be proportionately lower in the near term. Second, the federal government would incur interest costs while states could realize interest earnings. The Cash Management Improvement Act of 1990 (CMIA) helps ensure that neither the states nor the

federal government incur unnecessary interest costs or forgo interest income in the course of federal grant disbursement by prohibiting states from drawing down funds until they are needed. If Congress permitted states, notwithstanding CMIA, to draw down their TANF balances to establish reserves, it could also require states to reimburse the U.S. Treasury for any interest they earn on the drawdowns. This would maintain the spirit of the CMIA by preserving fiscal neutrality for the federal government and the states, since the states could use interest earnings they gain on investing the drawdowns to reimburse the Treasury.

Essentially, states would have to justify why TANF deserves an exemption from a governmentwide grant policy that settled years of intergovernmental conflicts between federal and state administrators. The permanent nature of the appropriation to each state as well as the significant devolution of responsibilities to states for addressing the program's fiscal risks may argue for such a change, but other federal interests would have to be weighed as well. For example, some may argue that CMIA promotes transparency by ensuring that states' unspent balances remain in the federal Treasury rather than in state treasuries. This concern could be addressed through federal reporting on states' expenditures and reserves.

Contacts and Acknowledgments

In conclusion, the TANF program has established a new fiscal partnership that has supported the transition to work-based welfare reforms. Because the partnership has yet to be tested in times of fiscal stress, now is the time for both federal and state governments to consider actions to prepare for more uncertain times and the possibility of higher program costs. Although TANF currently contains certain mechanisms to provide a fiscal cushion, the options we have presented provide an opportunity to promote greater assurance that all states will be poised to respond to future fiscal contingencies affecting their TANF programs.

Mr. Chairman, this completes my prepared statement. I would be happy to respond to any questions you or other Members of the Subcommittee may have at this time.

For future questions regarding this testimony please call Paul L. Posner at (202) 512–9573. Individuals making key contributions to this testimony included Thomas M. James, Bill J. Keller, Jacqueline M. Nowicki, Patricia L. Elston, Gale Harris, Marcus Melton, and Raymond G. Hendren.

Chairman HERGER. Thank you very much, Mr. Posner.

We will now hear from Miss Ryan.

STATEMENT OF ELAINE M. RYAN, ACTING EXECUTIVE DIRECTOR, AMERICAN PUBLIC HUMAN SERVICES ASSOCIATION

Ms. RYAN. Good morning, Mr. Chairman, and Members of the Subcommittee.

First, let me begin by expressing the American Public Human Services Association's (APHSA) sincere thanks for all of your efforts to keep the deal, to make sure the Federal TANF funds remained in place, and for your efforts today to try to restore Social Service Block Grant funding that is very important to States.

I am Elaine Ryan, the Acting Executive Director of APHSA, a nonprofit, bipartisan organization representing State and local human service professionals for more than 70 years. Thank you for the opportunity to testify.

Given the cycles of the economy, it is appropriate that today's hearing focuses on TANF financial issues and the hope that progress can be sustained in the future or in a recession. Because there is an unfinished agenda of welfare reform—to provide ongoing supports to working families, to aid those with multiple bar-

riers to overcome, to strengthen families, and to reduce future welfare dependency. In periods of economic downturn, these challenges may intensify. Rising caseloads and fixed Federal funding may pressure States to reduce critical investments. That is why APHSA supports measures to increase State flexibility to create State TANF "rainy day" funds and supports the continuation of the TANF contingency fund.

Shortly after the enactment of welfare reform, many States felt the need to create reserve funds during periods of economic downturn. In 1998, APHSA conducted its first survey and found that 26 States had established some kind of TANF rainy day fund. Seventeen States set aside Federal funds, 7 States reserved State funds, and 2 used a combination of State and Federal funds. But by 1999, States had changed their strategies, and our most recent survey finds that while many States still have some reserve funds, many also plan to fully obligate those Federal funds by the end of next fiscal year.

This change in strategy I think may be attributable to several factors. First, the Federal regulations create disincentives to reserve funds. Second, reports of the unobligated fund balances made TANF the target of congressional cuts in '98 and '99. And although the welfare reform law says specifically that States may carryover funds fiscal year to fiscal year, without limitation, the message from Washington has been "spend your TANF funds or risk losing them."

Let me just briefly describe some of the regulatory barriers that were imposed on States. States are not permitted to use TANF Federal dollars for rainy day funds. They may carryover funds from year to year, but the Federal regulations attach a narrow definition of assistance, which means those unobligated funds that you referred to can only be used for cash-like assistance. They can't be used for teenage pregnancy prevention, they cannot be used for work supports, they cannot be used for child care.

States may not allow counties to reserve funds for rainy days. A proposed Federal rule even goes so far as to require States to spend new State dollars to draw down prior year funds. These are all disincentives to rainy day funds.

I would also say that rainy day funds, like Maryland's, where they're funded with 100 percent State dollars that do not count toward Maryland's State maintenance of effort unless they're expended. Therefore, APHSA requests that you consider the following actions: to afford States the flexibility to draw down TANF dollars to fund these rainy day funds; to afford States the flexibility to establish county rainy day funds; to allow States to use unobligated TANF funds for any purpose under the Act; to maintain Federal funding for child care and the social services block grant, and do not add any set aside requirements that will force States to spend rather than reserve those dollars.

When thinking about a contingency fund, I think it's important to try to deduce how much of those unobligated dollars are truly unobligated. The real story of State spending, is illustrated in the CBO baseline, that shows that TANF funds are leaving the Treasury at a rate such that outlays will exceed the authorized level in fiscal year 2002 and beyond.

TANF caseload data that you may look at, showing a 50-percent decline, only measures families receiving cash assistance, and not the families served by every other kind of TANF program.

Some States may need to access a TANF contingency fund during periods of economic downturn, and we support its continuation. However, it needs to be a viable source for States. The level of funding should be sufficient. The MOE requirements should be modified to be the same as TANF. And the unemployment triggers and food stamp triggers ought to be modified as well.

Finally, I would say that APHSA urges Congress to extend the TANF supplemental grants to the 17 high-growth, high-poverty States. Allowing these supplements to expire would not only result in a significant reduction in block grants, but it also would impede their ability to transfer funds to other block grants and it would reduce their high performance bonus award.

I would like to close by just saying that the example of one State, Tennessee, typifies an experience that many States have had—the choice to spend in order to prove the need for the funds, versus to draw down, to save for a rainy day.

In 1996, prior to the enactment of law, Tennessee engaged a noted economist to try to forecast caseloads, to try to figure out how much money they should reserve in the event of an economic downturn. They established a State fund, and then they used Federal funds to establish Federal reserves, and then threatened Federal cuts inspired them to start to spend down their reserves.

Since last June, Tennessee has experienced a 7 percent increase in their welfare caseloads, and today they face the prospect of losing their TANF supplemental grant to States. It's a double-bind, that States spend or risk losing funds. Perhaps there could be a better way.

We have outlined a number of recommendations in our Association report, "Crossroads: New Directions in Social Policy," and a full range of all the reauthorizations pending before this Committee, food stamps and others. We look forward to working with you in the future.

Thank you.

[The prepared statement of Ms. Ryan follows:]

Statement of Elaine M. Ryan, Acting Executive Director, American Public Human Services Association

Good Morning, Mr. Chairman and members of the Subcommittee. I am Elaine Ryan, Acting Executive Director of the American Public Human Services Association, a non-profit bipartisan organization representing state and local human service professionals for more than 70 years. Thank you for the opportunity to testify on the subject of "rainy day" funds and other special funding issues under the Temporary Assistance for Needy Families (TANF) program.

Background

Under the Aid to Families with Dependent Children (AFDC) program, families were trapped in a pattern of dependency that few believed could be reversed; states could give families little more than a check to help them provide for their children and the federal rules discouraged work. Since the enactment of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, states have achieved noteworthy success in implementing welfare reform. According to the Administration for Children and Families, the percentage of working welfare clients reached an all-time high in 1999 and their average monthly earnings and hours of work continued to rise. The percentage of Americans living in poverty continued to decline and child poverty recorded its biggest five-year drop in 30 years. The percentage of

the population on welfare fell to its lowest point since 1965, child support collections increased dramatically, and states continued to provide critical TANF-funded supports to millions of families who exited welfare for the workplace. Teenage pregnancy rates have steadily declined during this period and some states have begun to achieve progress in an effort to reduce the number of out-of-wedlock births. While much has been achieved, states recognize that there are challenges ahead.

Some have credited welfare reform for the progress that has been achieved in recent years, while others point to a robust economy as the reason so much has been achieved in such a short period of time. I expect the debate will continue without any clear resolution for some time to come. However, an unknown of perhaps a more pressing nature is whether progress will continue, and if there is a prolonged economic downturn, will there be sufficient resources available to states to meet the needs of the children and families served under TANF?

Creation of State "Rainy Day" or "Contingency" Funds

Understanding the cycles of the economy, in the years following the enactment of welfare reform, more than half of the states planned to establish TANF "rainy day" funds to protect against economic downturn or caseload increases. Based on an APHSA survey conducted in 1998, 26 states had established reserve funds. Fifteen states created the state contingency funds in statute and eleven did so in budget language. Seventeen states planned to set aside federal unobligated funds, seven planned to set aside state funds for contingency purposes, and two planned a combination of federal and state contingency funds. For example, Georgia initially established a reserve fund with an up-front set aside of 2.5 percent of its FY 1997 federal TANF block grant allotment to be available in periods of future economic downturn. Maryland created a "Dedicated Purpose Account" to reserve unexpended state TANF MOE funds. And prior to 1996, Tennessee established a reserve fund using state and later a combination of federal and state funds to ensure that adequate funding would be available if caseloads increased. By 1999, states were altering their plans; some created funds and others eliminated their funds altogether. But the preliminary findings of our most recent state survey indicate that while some states still have reserve funds, the majority of respondents plan to obligate or expend all of their federal TANF funds by the end of FY 2002.

This shift in state plans to fund "rainy day" funds may be attributable to several factors. First, the federal TANF regulations and other federal regulations created disincentives to reserve funds. Second, in recent years, concerns have been expressed about the level of state spending, and misleading reports of "unobligated" TANF funds made the block grant the target of congressional attempts in 1998 and 1999 to cut or rescind unspent TANF funds. Although the welfare reform law allows states to reserve TANF funds "without fiscal year limitation," the message sent from Washington to the states has been spend the TANF funds or risk losing them.

State Spending Under TANF and Regulatory Disincentives to Reserve Funds

Over the past several years, federal agencies have restricted state flexibility to reserve federal and state funds in order to plan for periods of economic downturn or caseload increase. The final TANF regulations, the application of the Cash Management Improvement Act to the TANF block grant and ACF program instructions have limited states' ability to draw down, obligate, and expend federal TANF funds. Examples of restrictions include:

1. In welfare reform, states agreed each year to maintain their historic level of spending, known as maintenance of effort or MOE, and in exchange they would receive a fixed level of TANF block grant funding from the federal government. Since the enactment of the law, every year, every state has met the maintenance-of-effort requirement. However, even after a state has satisfied its MOE in a given fiscal year, any unobligated block grant dollars remain in the federal treasury, conveying the false impression that these funds are unmatched or unnecessary. And in past years, these unobligated federal TANF funds have been targeted for cuts or rescissions.

2. States are not permitted to draw down these funds into their state treasuries in order to fund "rainy day" or contingency funds because these funds are not considered to be obligations under the federal rules.

3. Exacerbating this situation, the final TANF regulations prohibit states from spending unobligated federal funds from a prior year on any purpose other than cash-like "assistance" payments. None of the several billion of TANF carryover funds can be used to fund work supports, such as child care, education and training or mentoring, substance abuse treatment and prevention, two parent family preservation, parenting education, or any other noncash service. Under this restriction,

even if states reserve TANF funds in a contingency fund, the use of those funds would be severely limited, largely to ongoing cash assistance. However, in an economic downturn, it is likely that states would need to increase spending not only on cash but also on such one-time emergency payments to prevent evictions and homelessness and to create work experience and training programs.

4. Under welfare reform, the federal government devolved authority to the states and, in turn, a number of states devolved authority to counties and local governments. In January 2001, the Administration for Children and Families issued a Program Instruction to states, (TANF–ACF–PI–01–02) that would prevent states from permitting counties to fund "rainy day" funds at the county level.

5. And last October, a proposed federal rule relating to the draw down of TANF funds promised to make it even more difficult for states to draw down TANF funds and by imposing yet another obstacle to the funding of a TANF rainy day fund with federal funds. The proposed rule would require states to spend additional state funds to draw down unobligated TANF funds from the previous year even though the MOE requirement has already been met for these dollars. And as previously stated, those dollars could only be used to fund "assistance" benefits.

6. Finally, under federal rules, states may not count the state expenditures placed in "rainy day" funds toward their annual MOE until these funds are expended. Similarly, local funds reserved for these purposes cannot be counted toward the state MOE.

Therefore, APHSA asks Congress to consider the following actions:

- Afford states the flexibility to draw down TANF dollars to fund "rainy day" or contingency funds after the annual state MOE requirement has been satisfied and consider these funds as obligated;
- Similarly, afford states the flexibility to establish county "rainy day" funds;
- Remove the federal "assistance" restriction on the use of unobligated federal funds so that states may use these funds for any purpose under the TANF act; and
- Allow state and local expenditures for state or local "rainy day" funds to count toward the states' MOE requirement.

Finally, let me underscore the importance of maintaining federal funding for related human service block grants such as the Child Care and Development Fund (CCDF) and the Social Services Block Grant (SSBG). If these block grants are reduced, states will be unable to reserve funds for rainy days because funding will be needed to offset federal cuts. As a related issue, we urge Congress to reject adding "set-aside" language to the TANF block grant that requires states to spend federal or state dollars for a particular benefit, service, or purpose. These requirements will limit funds that could be reserved to protect against periods of caseload increase or recession.

The Real Story of State Spending

After federal welfare reform was enacted, states needed time to transition from a system of check-writing that existed under AFDC into a program where time-limited assistance and work were the primary focus. Time was needed to adopt state legislative changes, redesign programs, train caseworkers, inform clients, and implement new program rules. After this initial period of transition, welfare reform was well underway in the states. As TANF caseloads declined dramatically, some states may have been slow to obligate their federal block grant funds, but again, it is important to note that all states met their state maintenance-of-effort requirements. As TANF funds collected interest in the federal treasury, state funds financed the early success of welfare reform.

The "True" TANF Caseload

In recent fiscal years, however, the pace of spending under TANF has changed. While some in Washington have focused on the "unobligated" TANF funds, the real story of state spending is illustrated by the CBO baseline that shows TANF funds are leaving the treasury at a rate such that outlays will exceed the authorized level of funding in FY 2002 and beyond. After an initial period of transition and program planning, many states are investing funds in a wide range of programs to support self-sufficiency and prevent dependency and transferring a significant amount of funds to the Child Care and Development Fund and Social Services Block Grant. For example, from FY 1997 through the first two quarters of FY 2000, 44 states transferred more than $4.3 billion of TANF funds to CCDF and an additional $3 billion to SSBG.

Perception and Reality

Contrary to what federal caseload data might suggest, the work of the TANF agency does not end when families exit the cash assistance caseload. Federal data on the size of the TANF caseload are limited to the number of families receiving

TANF cash assistance. The data do not report the "true" TANF caseload that includes families that receive TANF-funded child care, employment and training, counseling, programs for noncustodial parents, teen pregnancy prevention, family support and other critical services to children and families. Moreover, the TANF "assistance" and "non assistance" caseloads do not reflect the thousands of families who receive child care assistance funded with TANF transfer funds. The amount of unobligated funds and TANF caseload decline should not give policymakers false hope that all states could manage their TANF programs in periods of severe economic downturn. The reported amount of unobligated funds does not accurately reflect the planned and current state investment of TANF funds. The federal caseload data do not include the millions of children and families supported with services such as employment and training, counseling, substance abuse counseling, family formation, parenting education, teenage pregnancy prevention, transportation, and child welfare services. Nor does the caseload include the thousands of children who receive child care services funded with TANF transfer funds. Some have suggested that the demand for services, such as child care, will lessen in an economic downturn. This may not be the case. As long as there is a requirement that parents are engaged in a meaningful work activity while on welfare, there will be a need to provide child care for their children. In periods of severe economic downturn, there may not be sufficient TANF funds available in some states to meet the need of rising caseloads and to maintain current investments.

Extend and Restructure the Contingency Fund

The TANF Contingency Fund was created in 1996 to ease the risk states faced in accepting a fixed amount of block grant funding over a period of six years. The risks may be as great today as they were then for some states. While a strong economy has obviated the need for states to seek contingency funding, in a period of economic decline the current TANF Contingency Fund would be of little use to states. While APHSA supports the continuation of a federal Contingency Fund, significant changes are needed to ensure that it would be a viable and sufficient source of funds for states during periods of economic downturn or recession. First, the level of funding for the fund should be sufficient to provide support to a number of states that may need to draw from the fund at the same time. Second, the eligibility requirements should be revised. Specifically, the MOE requirements for access to the fund should be the same as the TANF MOE requirement and the definitions of qualified state expenditures should be aligned as well. Third, the unemployment and food stamp triggers should be modified. Considering the current U.S. unemployment rate, states would be long into an economic recession before meeting the current trigger of 6.5 percent. And in that instance, given the MOE requirement, few, if any, states would be eligible.

Extend TANF Supplemental Grants to States

Under the welfare reform law, Congress provided a modest annual supplement to seventeen rapidly growing states and high poverty to help them achieve TANF goals. The supplemental grants included in the 1996 law were authorized only through fiscal year 2001, while the law generally was authorized through fiscal year 2002. Allowing the TANF supplements to expire this year would not only result in a significant reduction in block grant funds, but states' ability to transfer funds would be reduced and their TANF High Performance Bonus would be reduced as well. APHSA urges Congress to extend these grants.

Closing Comments

In February, APHSA released *Crossroads: New Directions in Social Policy* containing recommendations for the reauthorization of the welfare reform law and other human service programs pending reauthorization by this Congress. With respect to the TANF block grant, our members have endorsed maintaining the current TANF baseline plus inflation for the next six years. We support the extension of the TANF supplemental grants to states and believe that this funding should be in addition to the current block grant allocation. We support the renewal of a TANF contingency fund and are working with our members to develop new criteria for accessing these funds.

While much has been achieved, there is an unfinished agenda of welfare reform—one that involves on-going supports to low-income working families, one that seeks to remove the barriers for clients with multiple barriers to overcome, and one that seeks to strengthen families and eliminate welfare dependency for generations to come. In order for early success in the workplace for TANF families to evolve into extended periods of job retention and earnings progression, continued federal and state investments are needed. In future years, a sustained commitment of on-going TANF work supports, such as transportation and education and training, may be

required. And for those families who have not made the transition from welfare to work—those with multiple barriers to overcome—intensive services and supports will be costly.

In periods of economic downturn, these challenges may intensify and rising caseloads may pressure states to reduce current investments in child care or other critical support services. Increased state flexibility in the drawdown and expenditure of TANF program funds could afford state and local administrators with the necessary tools to manage during periods of increasing caseloads. A viable contingency fund could enable states to continue program investments during period of severe economic downturn. Above all, the federal commitment to maintain TANF block grant funding levels and related human service programs will enable states to their work to improve the future for millions of low-income children and families in this country.

Thank you for the opportunity to testify. I would be pleased to respond to any questions you may have.

Chairman HERGER. Thank you very much, Miss Ryan.
Mr. Potts.

STATEMENT OF JOEL POTTS, TANF POLICY ADMINISTRATOR, OHIO DEPARTMENT OF JOB AND FAMILY SERVICES

Mr. POTTS. Good morning, Mr. Chairman, and Members of the Committee. My name is Joel Potts and I am the TANF Policy Administrator for the State of Ohio, and I, too, would like to thank you for keeping the commitments.

I think that the Personal Responsibility and Work Opportunity Reconciliation Act is the best piece of social policy that has come out of Washington, and I think that it has made a huge difference, not for States, not for caseworkers, not for us in government, but for the people that we serve. I hope that we can continue to work together to continue this approach.

In Ohio, we have successfully implemented the Personal Responsibility Act. It has allowed us to move forward with a fundamental reform to the welfare system. And while that safety net still remains in place for families and children who cannot work, the primary focus of welfare reform in Ohio has moved from a system that was focused previously in providing cash assistance and cash payments to a system that now is bringing stability and self-sufficiency to people's lives through the promotion of work, and we obviously want to continue that.

Today, there are fewer Ohioans receiving public assistance than at any time since 1967. When our caseloads peaked in the early nineties, there were 748,000 individuals dependent on the old AFDC system, at an average cost to the State and Federal coffers of $82 million a month in Ohio. Today, that number is 210,000 individuals, with an average cost of $27 million per month. Obviously, this reduction in caseloads provided us with significant funding that we have been able to shift, along with the flexibility provided by Congress, and it has resulted in a model for welfare reform which is highlighted with more families being served, fewer welfare-dependent families, increased earnings, decreased poverty for those formerly on the system, and broad community and business support.

I think we have taken a very responsible approach in Ohio to implement our welfare reform program and the block grants. Our

strategy has been to provide this tremendous flexibility and funding for programs and services never before possible, while still maintaining a responsible cash reserve to protect against a major downturn in the economy. We didn't really look to the Federal Government and say, "Boy, we're just going to spend it, and in the event our caseloads keep going up or something changes, we'll just turn back to our congressional delegation and say Ohio is in trouble." We accepted the challenge of the Act and we think what we're doing in TANF is the right approach. We wanted to be able to manage that within our own program.

Our approach has been responsive to meet the needs of the clients, and I think it has been responsible to the integrity of the TANF program, and it has been fiscally prudent. For the first time in Ohio's history, we are spending more welfare dollars to support work than to support dependency. Our caseloads continue to decrease and we are able to shift more and more revenues to families to help them stabilize their lives and prevent long-term dependency.

At the beginning of the TANF program, we did decide that we should have some type of contingency reserve in place. We set aside about 10 percent, or $75 million, a year for the first 4 years in the contingency reserve. That reserve amount is now around $300 million.

In the event of an economic downturn, we have gone back for the past 30 years and looked at our worst economic situations. We looked at the recessions of the late 1970's and the early 1990's and determined we have enough cash reserve that we can continue to provide public assistance in Ohio for 27 to 45 months, while still continuing to maintain the existing programs to support work, without having to take away from those types of approaches.

We have had a tremendous change in the way we're doing things, and I think one of the frustrations for States is that we still continue to be measured on arbitrary data, and in some cases I think the wrong things. In former public assistance programs, we did not measure success. Frankly, we measured failure. We looked at what was needed for public assistance programs by looking at caseloads. The larger your caseloads, the more money we got.

We measured clients in the same way. When they came to us and said, "We need help", our response was something to the effect of, "You know, what you need really isn't important to us. What's important to us is that you fill out this 35-page application. We will take that information, we will put it into our computer system, the system is going to tell us what you're eligible for, and if what you're eligible for addresses what you need, then we can provide you service."

We don't do that any more. In fact, we do a lot more in prevention and retention programs, to prevent people from ever becoming dependent on the system than we ever could have possibly imagined under the old AFDC program. We would like to continue to do that.

We have been able to make that fundamental shift in administering our programs. We didn't make the mistake in Ohio of rushing out and spending the block grant on short-sighted programs without significantly altering the former programs in place under

AFDC. We have been able to increase services to support families, help families move out of poverty, train and prepare individuals for work, and provide support services. In addition, we have been able to accomplish the successes of welfare reform in Ohio with an adequate reserve in place to ensure that funding is available in a manner which can successfully address unforeseen problems or crises.

I would like to finish by saying that I think what the Committee is doing is obviously very vital to all the States. It is where all the conversations are going right now—follow the money. It's going to dictate what we do for the next several years. It affects our communities, it affects our legislatures, and it affects us as administrators.

But I would contend that it's not about the money only. Welfare reform under the TANF program, I don't think it's about time limits, I don't think it's about sanctions, I don't think it's about flexibility. I think it's about all of those things. The thing that is the common denominator in all of those is personal responsibility. States need to be held personally responsible, as do the clients. Part of that personal responsibility is in being responsible for the funding and in the flexibility you have provided.

Thank you.

[The prepared statement of Mr. Potts follows:]

Statement of Joel Potts, TANF Policy Administrator, Ohio Department of Job and Family Services

Good morning, my name is Joel Potts and I am the TANF Policy Administrator for the Ohio Department of Job and Family Services. I am here today to discuss TANF funding issues and the unspent reserves in Ohio.

Ohio's 88 counties and the state have successfully implemented the Ohio Works First welfare reform program. The unprecedented flexibility and approach afforded the agency by Congress in the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 has allowed Ohio to move forward with fundamental reform in the welfare system. While a safety net remains to serve children and those who cannot work, the primary focus of welfare reform in Ohio moved from a system focused on providing cash payments to a system bringing stability and self-sufficiency to people's lives through promotion of a work first/work force philosophy.

Today, there are fewer Ohioans receiving monthly benefits than at any time since 1967. When our caseloads peaked in March of 1992, 748,717 individuals were receiving cash assistance at an average cost of $82 million per month. Today, that number is below 210,000 at an average cost of $27 million per month. The reduction in caseload has provided the state significant funding to go along with the flexibility provided by Congress. The result is a model for welfare reform highlighted with more families being served, fewer welfare dependent families, increased earnings, decreased poverty for those formerly on the system and broad community support and involvement.

Ohio's welfare reform program is divided into two major categories. The first category provides temporary cash assistance to families for a maximum of three years and is referred to as Ohio Works First. During their time on assistance, families must sign a self-sufficiency contract outlining work activities and other obligations recipients must fulfil as a condition of receiving cash assistance.

On October 1, 2000, Ohio passed a significant milestone in the implementation of Ohio Works First. That was the first date on which households faced the risk of cutoffs as a result of utilizing all three years of eligibility. On October 1, 1997, there were 117,000 families that potentially faced termination on October 1 of 2000. Of that 117,00, fewer than 4,000 families ultimately utilized all 36 months of eligibility. The 88 counties deserve tremendous credit for the manner in which the 36 month limit was implemented and for the care that they showed in working with these families.

Ohio is reinventing welfare by reinvesting in its communities. Ohio's counties have been given more flexibility than ever before in designing and implementing a service delivery system that addressees the needs of the people they serve.

The second category of our welfare reform program is referred to as Prevention, Retention and Contingency, or PRC. The PRC program focuses on providing people with the help they need to stay off of public assistance and assume personal responsibility. Counties determine what services to provide and also set eligibility levels. Individuals do not have to receive cash assistance to qualify for this portion of the program.

To meet the needs of poor families, counties have made use of the program in a wide variety of ways to deal with problems unique to their local communities. For example:

Hamilton County—This metropolitan county contracts with a private non-profit consortium of providers to work with "hard to serve" families. These families are generally recognized as multiple needs families that have a long-term history of public assistance dependency. In the past four years, nearly 3,000 families have been served with only 150 families returning to public assistance.

Appalachian Counties—To address the chronic need to improve attendance in Appalachian schools, most Appalachian counties have implemented head-lice programs. (Head lice is the number one cause for absenteeism in Appalachia Ohio.) PRC programs have aggressively dealt with this problem and in many school districts absenteeism has declined by as much as 50 percent.

Cuyahoga County—The Cleveland area has effectively used their PRC program to address the needs of families facing welfare cut-offs by partnering with numerous county organizations and developing programs to ensure that every family has access to services they desire or need to succeed. Their time-limit cut-off plan includes providing immediate employment opportunities for work ready clients, transitional employment for those that are not necessarily ready to enter the job market and short term transitional assistance. Additionally, a child safety review process is in place which provides home visits by community based agencies, linking families to support services and assessing the viability of a family's plan for meeting its basic needs.

Montgomery County—Only 6 percent of low income families have a computer in their home compared to 56% of families earning more than $50,000 per year. In an effort to provide computers, technology and training to poor families, Montgomery County has developed a program that provides inner-city youth with the opportunity to "earn" a new computer by participating in an intense computer training program that includes education in software and hardware as well as exposing teenagers to the computer field and possible employment opportunities after graduation. Students that complete the course and meet all of the requirements will get to keep the computer they actually build during the 4 week course. This program has the endorsement of local community and business leaders and costs the county less than $600 per student.

PRC is now the largest program in the state providing assistance to poor families in Ohio (excluding Medicaid). Through county departments, the state anticipates expenditures in the current biennium of nearly $700 million dollars with nearly half of the money being utilized for employment, training, work support and diversion. (Please see attached report on the utilization of the PRC Program in Ohio.) During the Fall of 2000, the Ohio Legislative Welfare Oversight Council, Co-chaired by State Representatives Netzley and Boyd, visited with 19 separate counties to discuss the progress of welfare reform. Without exception, PRC was highlighted by each county as one of the most significant programs in addressing the challenges counties face in meeting the challenges of long-term dependency.

Additional major categories of expenditures include youth education and support, emergency services, pregnancy prevention, child welfare, non-custodial parent services and domestic violence counseling. Furthermore, it should be noted that Ohio has been one of the leading states in the nation for actively involving the faith-based community in welfare reform. Counties project expenditures for the current biennium of nearly $90 million in contracts with faith-based organizations to provide many of the services mentioned above.

In short, Ohio's welfare reform program is paying off for families and communities. According to studies commissioned by ODJFS and mandated by the General Assembly, Ohio Works First's emphasis on employment, personal responsibility and community support is working. According to a study produced by Macro International of families formerly participating in Ohio Works First, we found:

They're working

- Two thirds of former recipients report working

A full week

- They work an average of 38.4 hours per week

Their earnings are up

- They earn, on average, $8.65 per hour or $1,410 per month

Their kids have health care

- Most (83%) indicated their youngest child had health care coverage

They're not coming back

- Most (84%) say they don't intend to return to OWF in the future.

A cornerstone of welfare reform in Ohio was to make work pay and we're meeting that goal. A family of three on welfare receives a maximum benefit of $ 373 per month. A typical former recipient who works, earns in excess of $1400 per month. In addition, expansions in health care coverage for working families, child care and PRC help to assure a family's transition to the workforce have the critical supports needed to be successful.

The most important point in understanding the federal TANF program is to realize that TANF is a program and NOT a funding stream. Over the past few years the Ohio Department of Job and Family Services has received numerous innovative ideas for use of the TANF funds that, while worthy of consideration, were not within the federal parameters for the TANF program.

In order to make use of TANF funds, the federal law outlines the four goals of the program that must be met in order to be a qualified expenditure.

1. End dependence of needy families on government benefits by promoting job preparation, work and marriage.
2. Provide assistance to needy families so children may be cared for in their own homes or in the homes of relatives.
3. Prevent and reduce the incidence of out-of-wedlock families.
4. Encourage the formation and maintenance of two parent families.

Ohio has taken a responsible approach to welfare reform and the block grant. Our strategy has been to provide tremendous flexibility and funding for programs and services never before possible, while still maintaining a responsible cash reserve to protect against a major downturn in the economy. Our approach has been responsive to meet the needs of the clients, responsible to the integrity of the TANF program and fiscally prudent.

For the first time in Ohio's history we are spending more welfare dollars to support work than to support dependency. As our caseloads continue to decrease we are able to shift more revenues to families to stabilize their lives and prevent long-term dependency.

In Ohio, over the past several months, the primary focus of the welfare reform debate is the TANF surplus. How much is it, what is obligated, what's available, how should we spend it and who should spend it are just a few of the many questions being asked. I wish I could provide you with an easy answer to all of these questions but unfortunately understanding the block grant and the surplus is not simple.

Each year, Ohio receives a $728 million federal TANF grant. To secure those funds, Ohio spends an additional $400 million in General Revenue Funds to meet our federally mandated maintenance of effort (MOE). During the term of the block grant, especially during the first couple of years of the TANF block grant, Ohio had accumulated a significant cash reserve.

According to the federal expenditure report filed at the end of the last federal fiscal year, Ohio's TANF surplus stands at $721 million. However, that figure does not take into account obligations that have not yet been charged to that account, nor does it reflect what Ohio has to spend. The myth that $721 million exists for Ohio to spend continues to mislead, confuse and threaten the Ohio Works First program.

The Ohio Department of Job and Family Services accounts for TANF in much the same manner as an individual balances a check book. At any point in time, the bank may say you have $721 in the account, but if you've written checks for xx amount and those checks haven't cleared the process, then you know the bank's statement is not what you actually have available to spend. The TANF block grant and the State's surplus are no different. Since TANF dollars can only be drawn down to the state based on actual expenditures delays the process and thus balloons what appears to be unspent revenues when in fact, the funds have been spent but not yet billed.

At the beginning of the TANF program, Ohio has decided to set aside $75 million annually in a caseload contingency fund to protect against an economic downturn. With $300 million currently in the contingency fund, prudent reserves are set aside for the remaining two years of the grant. Based on historic economic downturns in Ohio, this reserve could be used up in 27 to 45 months for caseload increases, based on the severity of the recession. Furthermore, we felt that this was fiscally responsible based on the fact that we have the lowest caseloads in the past 34 years in Ohio and one of the best economic conditions since the end of WWII.

Additional obligations to the unspent TANF reserve include county incentives for exceeding state and federal mandates. In an effort to ensure meeting federal re-

quirements, avoid penalties and encourage creative and innovative approaches to serving poor families, Ohio has made available $45 million annually for counties that exceed performance standards. In many instances counties are utilizing these dollars as their own contingency accounts in the event of local economic downturns or funding decreases so that they may continue to operate successful prevention or retention programs. By the end of Federal Fiscal Year '01, Ohio estimates that $130 million of the federal reserve will be obligated to counties as incentives but not drawn down.

Finally, the federal estimate of Ohio's reserve does not reflect nearly $300 million made available over the past 18 months to address the 36-month time limit which went into effect on October 1, 2000. Counties utilized these funds to ensure the safety of children and families facing termination, provide job mentoring, training, education and work support. Many of these expenditures have not yet been submitted to the state and thus have not been drawn down from the federal reserve.

Obviously, while the appearance in Washington is that Ohio has substantial reserves, the reality is that we have fully committed all of the available TANF funds. Clearly, the federal estimate of Ohio's reserve is overstated. In fact, for the next biennium we anticipate deficit spending for TANF programs which could result in our contingency reserve being reduced.

Understanding the unspent TANF reserves is difficult, managing such reserves is even more challenging. A lot of attention has been paid to the amount of cash reserves available to states through the TANF program. Unfortunately, for various reasons, rarely are the stories we read in the papers or hear about through various sources, accurate.

TANF fundamentally changed the way we look at, manage, measure and operate public assistance programs. One of the more significant changes in administering the program through PRWORA was to get away from the one size fits all approach of a federally run system and move to a state driven program. Thus, in order to truly and fully understand a state's welfare reform program, including spending, you must look at each state on a case by case basis state. However, states continue to be measured on arbitrary data that does not necessarily reflect the local programs, standards or outcomes the states are attempting to achieve.

This lack of understanding has resulted in tremendous pressure from various sources including the federal government to spend the TANF funds or risk losing them. This pressure comes at a time when there is tremendous uncertainty of reauthorization, the definition of "supplantation" and the status of the economy. States have become sitting ducks for federal, state and advocacy leaders to find ways to spend the money.

Many states, including Ohio, have funded one-time only type programs without reoccurring expenses. However, we have found that even with this approach a state establishes a level of demand and expectation. This is also difficult given the parameters of the TANF program.

The pressure put on states to spend the money now also puts at risk some potentially effective long-term programs that could prove to be highly effective in working with youth to prevent out-of-wedlock births and to encourage the formation of two parent families. Without a long-term funding commitment, or the ability to operate an effective long-term reserve, states and providers are discouraged from attempting meaningful prevention programs.

Throughout the past few years we have been able to utilize surpluses to avoid potential crises and address others. Through the use of the surplus we have been able to shift funds to cover expansions in day care programs, and operate expanded Summer school programs, thereby helping students prepare for grade advancement and proficiency testing. Furthermore, we have been able to administer the PRC program, which has enabled counties to more thoroughly address the needs of their communities.

Ohio has made the fundamental shift in administering welfare reform programs. We did not make the mistake of rushing out and spending the block grant on short-sighted programs without significantly altering the programs that were already in place under the old AFDC program. We have been able to increase services to poor families, help families move out of poverty, train and prepare individuals for work, and provide support services. In addition, we have been able to accomplish the successes of welfare reform with adequate reserves in place to ensure that funding is available in a manner which can successfully address unforseen problems or crises.

[The attachment is being retained in the Committee files.]

Chairman HERGER. Thank you very much for your testimony, Mr. Potts.

Mr. Holzer.

STATEMENT OF HARRY J. HOLZER, PROFESSOR OF PUBLIC POLICY, GEORGETOWN UNIVERSITY, AND VISITING FELLOW, URBAN INSTITUTE

Mr. HOLZER. Thank you, Mr. Chairman, and Members of the Committee.

I would like to argue broadly that there is a need for a continued Federal role in terms of providing contingency funds in the event of a downturn, and also that some changes should be made in what triggers State participation in that fund, and also in the level of funding.

Very briefly, if a recession occurs, we know that employment rates could drop very substantially for welfare recipients. Job availability will certainly decline and the welfare caseload will rise. Now, of course, the big question is by how much, and unfortunately, that's very hard to predict. It depends on the severity of the recession, the duration of the recession, but also how States respond to it.

I have seen estimates that say, in a mild recession, the caseload could rise anywhere from 10 to 30 percent, and in a more serious recession, like the one in the early eighties, it could be 30 to 40 percent or even higher.

The important thing to remember is that these caseload increases will not just be for 1 year but could last for several years. It takes several years to recover from a major recession. The caseloads actually lag behind recovery in the economy. So the problem of higher caseloads could be around for a while.

Several of the other speakers have addressed the adequacy of the TANF surpluses that have accumulated and the ways in which those moneys have already been committed. The point I would like to make is that, in a recession, States will be under pressure to make a very difficult choice—either between cutting some of those spending programs they have taken on with their extra surplus money, for things like child care and other things with broad political support, or making it more difficult for women to get back on the TANF rolls.

We know that at least part of the reason that TANF rolls have declined over the last 5 years is that States have made it more difficult administratively to get on the rolls. That may make perfect sense in an economy where there is a lot of jobs. I think it makes a lot less sense in an economy where a lot of those jobs have dried up. So I think there is not only a good argument for States to do more to help welfare recipients get money, but for the Federal government to help the States out in this regard, because it is so hard to plan for the size of a recession.

We recognize that in other cases we don't want the States to do it on their own. In fact, we have an unemployment insurance program that recognizes this. Unemployment insurance is our primary program to protect workers and States in times of recession, and

part of the unemployment insurance program is an extended benefits program that is automatically triggered by State insured unemployment rates. I think that provides a strong parallel to the contingency fund and the need to maintain something in the event of recessions.

Now, in terms of the specifics of that contingency fund, I would like to argue that the triggers that were enacted in 1996, which basically were either that the State had to have an unemployment rate of 6.5 percent, or that they have to have food stamp caseloads 10 percent higher than their peak levels in 1994 and '95, I think those triggers really did make a lot of sense in 1996. Looking back from 1996, most States, in the recession of the early nineties, would have qualified with that set of triggers. About 35 States would have qualified just on the basis of their unemployment rates, and several more would have qualified on the basis of their food stamp caseloads.

Looking forward, however, now, that is much less likely to be the case, because food stamp caseloads have declined so dramatically, and because unemployment rates have also declined so dramatically. Twenty-five States have had unemployment rates below 4 percent over the last few years, and ten States have had them below 3 percent. So in a moderate recession, like the last one we had, it would be very difficult for most States to reach those triggers and most States would not be covered.

Similarly, the level of the funding under the contingency fund, $2 billion, really may be inadequate, even when added to the amounts of the TANF surpluses, in the event of a serious recession, in the event of a recession where caseloads really do rise by very substantial amounts, and stay high over a period of several years.

At least one possibility to consider is uncapping the contingency fund and relying on the matching mechanism, to create incentives for States to economize. I think all of us agree that there needs to be incentives for the States to economize and be responsible, but we don't want those incentives to be too severe to the extent that they would force States to turn away women who can't find jobs and who really might be in need.

I would like to close by saying I think there's a strong argument for incentives for States to do the right thing, but also for Federal support. We should not only reauthorize the contingency fund, but we should also make some changes, which I think would update it and recognize some new realities.

Thank you.

[The prepared statement of Mr. Holzer follows:]

Statement of Harry J. Holzer, Professor of Public Policy, Georgetown University, and Visiting Fellow, Urban Institute

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 created a fixed level of block grant funding to states to pay for the Temporary Assistance to Needy Families (TANF) program. Since the size of the block grant itself does not vary in response to changing economic circumstances (such as a downturn) that might create greater caseloads, the 1996 legislation also established a contingency fund of $2 billion to provide states with an additional source of revenue in case of unforeseen developments.

The contingency fund is currently set to expire in five months, at the end of FY2001. Should it be reauthorized? Despite the unspent TANF surpluses that have been accumulated by many states, does there continue to be a need for an additional

federal funding source for TANF in the event of an economic downturn? If so, what conditions should trigger the availability of these funds to the states, and how large should the fund be?

Below I argue that the contingency fund should be reauthorized, with a somewhat different set of triggers than were established in 1996, and with an uncapped level of funds available to states in need. The TANF supplemental grants to 17 relatively poor or rapidly growing states, due to expire this year, should be extended for at least a year as well.

An Economic Downturn Could Increase TANF Caseloads Substantially

A recession is a nationwide economic contraction that would be felt in virtually all states, though to varying degrees. A recession could be relatively mild, in which case the national unemployment rate might rise by just 2–3 percentage points (as in 1990–92); or it could be more severe, in which case the increase in the national rate could be 4–5 points (as in 1981–82) or more. During the most recent recession, unemployment rates rose by a percentage point or less (in annual terms) in about a third of the states, but they also rose by 4 points or more in many others.

If a recession occurs, job availability for those seeking employment will decline, and unemployment will rise among all groups, especially less-educated workers and those with limited skills or labor market experience. The increased unemployment would be what economists often refer to as *involuntary* unemployment—i.e., unemployment reflecting economic conditions rather than the choices made by workers themselves about whether or not they want to work. Particularly, employment will decline significantly among disadvantaged women, and the welfare caseloads will rise (Holzer, 2000).

But the sizes of these prospective caseload increases are uncertain, since we cannot predict the severity of the recession, or how states will respond (in terms of the ease with which they allow women to return to the welfare rolls). One recent study by the President's Council of Economic Advisers predicts that the rolls will rise by 5–7 percentage points for every one-point increase in the national unemployment rate. This estimate is based on a statistical analysis of the extent to which a stronger economy is responsible for the caseload decline of over 50% since 1994. Other estimates suggest that the strong economy of the late 1990's was an even larger factor in the caseload decline, and therefore that the rolls could increase by as much as 8–10 percentage points for each percentage-point increase in unemployment.[1] Again, the increases will almost certainly be larger in some states than others. Furthermore, these increases may persist for several years, since changes in welfare rolls tend to lag behind changes in the unemployment rate (which themselves can persist for several years during and after a downturn).

The Need for a Federal Response To Limit the Financial Strains on States

During recessions, state revenues decline while their expenditures on social services and support (such as TANF) generally rise. But, since most states need to balance their budgets annually, these economic fluctuations can create serious financial strains. Indeed, many states will face an incentive to limit the extent to which they allow low-income women (and men) to return to the rolls, and may use various administrative means of diverting them from doing so. If this occurs to a large extent, the hardships experienced by low-income women could be very substantial.

Of course, many states have been accumulating unspent TANF surpluses since 1996, as their caseloads have declined substantially while their federal block grants have been fixed (at $16.5B annually). The most recent numbers available (through the end of FY2000) show cumulative *unobligated* surpluses of under $3B nationwide, and *unliquidated* obligations of about $5B (Lazere, 2001). As the latter have been at least nominally obligated to various expenditure categories, their availability in case of a downturn will be uncertain. Furthermore, the sizes of the surpluses vary dramatically across states. For instance, several of the states with the largest caseloads (such as California, Pennsylvania and Florida) have virtually no unobligated surpluses and fairly small unliquidated sums (measured as percentages of TANF grants in any year).

In addition, state spending on related matters, such as child care assistance, have risen substantially in the past few years. Thus, a large majority of states spent virtually their entire TANF block grant in FY2000, and a dozen states even dipped into their surpluses to finance these activities. In the event of a downturn, states will likely face unpleasant tradeoffs between continuing these supports for working families v. reducing them to fund rising caseloads.

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[1] These studies are reviewed and critiqued in Bell (2001).

In sum, many states would face serious financial strain in the event of a downturn, and choices between continuing spending on popular and legitimate work-support activities v. increased spending on a rising caseload. Though the magnitude of the hardship will depend on the severity of the recession, its distribution across states, and their accumulated surpluses, a strong case can certainly be made for continuing the option of federal assistance to many of these states in need.

Are the Earlier Triggers for Receiving Aid Still Valid?

According to the 1996 law, states would have to meet several criteria before they could qualify for contingency funding during a downturn. For instance, the state's unemployment rate would have to be at a *level* of 6.5% or more and at least 10% *higher* than it was in either of the previous 2 years. Alternatively, states could qualify based on increases in their food stamp caseloads, as long as the caseloads were at least 10% higher than in FY 1994 or 1995 (adjusting for changes in eligibility enacted as part of the 1996 law). In addition, states must be spending at least as much on TANF as they were in FY1994 of their own money (Falk, 2001).

Do these triggers make sense in the current environment? All of these conditions have become more difficult to meet than they might have been in 1996, due to either declining unemployment rates or declining TANF and Food Stamp caseloads nationwide. For instance, the required 6.5% state unemployment rate was chosen in a year (1996) when the nation's unemployment rate was 5.4%—which was virtually identical to the national unemployment rate in 1989, right before the previous recession occurred. During the 1990–92 recession, over 30 states would have met the unemployment rate requirements for access to the contingency fund (Falk, 2001), as they represented average increases of only 1.2 percentage points above the existing national rate.

However, the nation's unemployment rate has averaged just about 4% during the past 2–3 years. If a recession of the same magnitude as that in 1990–92 were to now occur, it is likely that most states would fail to meet the 6.5% threshold. For instance, during the year 1999, 25 states had annual average unemployment rates below 4%, and 10 states had rates below 3%. The former group would need to have unemployment rates increase by well over 50%, and the latter would need increases of well over 100%, in order to qualify for contingency funding. Unemployment increases smaller than these would still generate hardship for these states and for the low-income women seeking employment there, but the states would not qualify for contingency fund assistance under those circumstances.

Meeting the food stamp and expenditure-level criteria would be more difficult than earlier as well. Food stamp caseloads have declined by roughly 40% since the mid-1990's, vastly more than was expected on the basis of eligibility changes. While these will no doubt rise again during the next downturn, it seems highly unlikely that they will increase by 80% above their current levels (which would be required to reach 110% of the FY1994 or 1995 caseloads). And, with most states currently spending 75–80% of what they were spending out of their own funds in the pre-1996 period, increasing their expenditures back up to 100% (given the reallocations of money to other areas that have occurred since that time) would be difficult as well for many states.

Under these circumstances, what kinds of changes in the triggers would be most appropriate? One possibility is to have a lower threshold *level* for state unemployment rates—such as 5%—perhaps combined with a more stringent threshold for *increases* in the rate (e.g., 20% rather than 10%). A 5% threshold level would constitute an increase in average unemployment relative to the recent 4% benchmark of roughly the same magnitude as a 6.5% threshold constituted relative to the 5.4% unemployment rate of 1996. However, since a 5% threshold may still be very difficult for states to meet that currently have unemployment below 3%, an alternative threshold based only on increases in the state rate (such as 50%) might be appropriate as well.

Similarly, a threshold for increases in the Food Stamp caseload that is more stringent than the current required increase, but calculated relative to the current base rather than the FY1994–95 base, might make sense as well. For instance, a required increase of 20–30% over current levels should be large enough to exceed any increases that might occur for other reasons (such as improved outreach) and would therefore capture labor market difficulties for unskilled workers that may not be fully reflected in the overall state unemployment rate. Finally, a state spending requirement of 75–80% of FY1994 levels (the same as current "maintenance of effort" requirements under TANF) would be a more realistic reflection of spending levels and obligations for most states than a return to 100% of the FY1994 levels.

Should the Fund Be Capped at $2B?

In the event of a recession, it is possible that a $2B fund, in addition to accumulated TANF surpluses and access to the limited TANF loan fund, might be sufficient to meet state needs. On the other hand, if the downturn is relatively more severe and lasts for a number of years, it is also possible that this level of funding will prove grossly insufficient to meet the extra financial needs of states.

For instance, the $2B funding level constitutes less than one-eighth of one year's TANF block grant, and well under that percentage of total spending for cash and related assistance at the state level. Yet, in a recession, caseloads could rise by 10–30% (using the Council of Economic Advisers' estimates) or by significantly more (according to other estimates), and could persist for several years. Such increases could easily swamp the $2B contingency fund and available TANF surpluses, especially in the large states that have accumulated little to date in the way of surpluses.

A more sensible approach would probably be to leave the total amount of the contingency fund uncapped. Given that the funding mechanism in the current law already requires (and should continue to require) a match from the states, there are incentives in place for the states to economize on their use of these funds. An uncapped contingency fund would ensure sufficient availability to meet the legitimate needs of states without encouraging wasteful spending on their part.

Other Concerns Regarding TANF During a Downturn

While an uncapped contingency fund with appropriate trigger mechanisms would help alleviate the financial difficulties faced by states during an economic downturn, other concerns would remain, especially about the well-being of low-income women who would have difficulty gaining employment at that time.

At least a few of these concerns are as follows (Holzer, 2000):

(1) Many women who have been on TANF may be ineligible for further funds, if they have reached their five-year lifetime limits; and most of them will also not qualify for Unemployment Insurance, either because they have too little work experience or because their reasons for leaving their previous jobs make them ineligible;

(2) States will have more difficulty meeting their caseload work requirements under TANF during a recession. Many states have met the current requirements through caseload reductions rather than work among current recipients. Both will be harder to achieve when the economy turns downward.

While resolving these issues lies outside the scope of the current hearings, they need to be addressed to ensure the existence of a realistic safety net during a downturn for low-income women. Some options that we might want to consider to alleviate these potential problems include:

- Reforms in the Unemployment Insurance system to ensure higher rates of coverage for low-income women with at least some labor market experience;
- Reforms in TANF (perhaps implemented during reauthorization in 2002) that would temporarily suspend time limits in states with high unemployment and/or enable states to count a wider range of education and training activities towards their work requirements; and
- The provision of technical assistance and/or funding to states that want to implement Community Service Jobs programs to welfare recipients during a downturn, as a way of meeting work requirements and providing meaningful work experience to women who will have more difficulty finding it in the private sector.

Other Funding Issues: Supplemental Grants

Though my testimony today has focused primarily on funds that would be available to states during a downturn, a separate issue involves the status of TANF Supplemental Grants to 17 states that are either relatively poor or rapidly growing. Like the contingency fund, the supplemental grants are also due to expire this year; and their expiration would entail cuts in TANF block grants of roughly 10% to most of the states receiving these funds.

While these issues are discussed in greater detail elsewhere (e.g., Primus and Lazere, 2001), the supplemental grants should be extended by at least one more year, at a cost of roughly $400M, to ensure that current funding streams remain in effect until TANF reauthorization that will occur in FY2002.

Conclusion

At this point, it is impossible to know whether or not a recession is on the immediate horizon, or how severe it will be and how long it will last, if it actually occurs. Nevertheless, a strong case can be made for reauthorization of a contingency fund that would provide some federal assistance to states that face financial burdens from rising caseloads during that time period. Furthermore, the triggers that would

enable states to access these funds should be updated in light of developments that have occurred during the past five years; and the level of funds should be uncapped, to ensure that they are sufficient to meet the needs of states.

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Chairman HERGER. Thank you very much, Mr. Holzer.

We will now turn to our panel for questioning. I would like to remind the members that they each have 5 minutes for witness questioning.

The gentleman from Oklahoma, Mr. Watkins.

Mr. WATKINS. Thank you, Mr. Chairman.

I have a couple of questions, and one for Mr. Potts of Ohio. Under title XX, I think you can switch up to 10 percent of TANF funds. Do you shift that amount?

Mr. POTTS. Mr. Chairman, Members of the Committee, absolutely. The title XX monies are even more flexible than TANF dollars, and the way that our county agencies are set up, we have a county-administered system and most of our counties will have a child welfare system and a public assistance system that will be tied together, so we do try to maximize the flexibility.

Mr. WATKINS. Is that title XX by county, or by the State?

Mr. POTTS. Actually, Mr. Chairman and Members of the Committee, we do both. Some of it will be allocated to the counties, and at the State level we have what we refer to as consolidated funding. We try to get away from that kind of "one size fits all" approach to providing these services. The counties—

Mr. WATKINS. That's the point I was trying to make. I think some counties in the poor and economically depressed areas, in small town and rural depressed areas, are probably not getting the transfer of that money down to them in the delivery system.

I would like to ask the staff, if it's all right, Mr. Chairman, to take a look at the transfer of TANF and what title XX is doing in some areas.

I have a question for Mr. Holzer. You said the trigger for some of these various funds depends on the economic conditions, et cetera. You said those triggers are based on State unemployment. What about the county level of unemployment?

Mr. HOLZER. My impression is it's the State level that determines it, and it is the State insured unemployment rate which, of course, differs from the State's overall unemployment rate. Some States have different levels triggering their amounts, but it is my impression that it's mostly at the State level.

Mr. WATKINS. That's another concern I have, that it has to be the State figures which triggers it, where out in the small towns and rural areas it may have been triggered a lot earlier. I think that's something else we should look into and it may be something we can correct.

I apologize for the hoarseness in my voice. Thank you, Mr. Chairman.

Chairman HERGER. Thank you, Mr. Watkins.

Mr. Cardin would you like to inquire?

Mr. CARDIN. Thank you, Mr. Chairman. I thank all the witnesses for their testimony.

Mr. Holzer, I was struck by your comparison between what we should do on TANF and unemployment insurance and the role the Federal Government plays as somewhat of an equalizer nationwide.

You know, if we go through a recession, it is going to be different in different parts of the country. You pointed that out, that there will be some parts where there's a much higher impact on their cash assistance needs than other parts of the country. The unemployment rates will be different around the Nation.

Mr. Potts, I really applaud what Ohio has done. As you pointed out, if there's a mild recession, you can still maintain your basic commitment not only to the cash assistance caseload increase, but also to the noncash assistance programs. That's wonderful. That's what you want to do.

But it wouldn't take much of a change in the economy to increase dramatically the cash assistance rolls, if I understand the correlation about a one-percent increase in unemployment relates to somewhere around a five to ten percent increase in the cash assistance welfare rolls. Again, that's a rough calculation. So if we see a two percent or three percent increase in unemployment, you will have a dramatic impact on cash assistance.

It is true that there should be State accountability. When you get flexibility, there should be State accountability. I think you're absolutely correct on that, Mr. Potts, and States should prepare for changes in economic conditions. But we do need to have the Federal Government as a partner in trying to make sure that those areas that are hit the hardest have a partner in the Federal government, so that they can continue to provide not just the cash assistance, but also the other services.

It would be tragic if we lost the other related services because we had to put so much into the cash assistance rolls. So I really do appreciate very much your comments and the challenge to us.

Mr. Holzer, I agree with you. The triggers need to be revisited. We need to bring it up to where we are currently and take a look at the dollars, the circumstances. I would be wondering whether you have any specific recommendations you would like to make on trigger mechanism changes, either now, if you would like, or submit it to our Committee. I would appreciate that.

Mr. HOLZER. Briefly, I do have them in my written testimony.

On the unemployment side, if you want to maintain the logic of the original triggers, but update them to the new circumstances, a five percent trigger level for unemployment would be very comparable, because it would be roughly a one percentage point in-

crease above the average national unemployment rate right now. But you might also want to have an additional mechanism for the States that are starting it at 2.5 or three percent, that will never reach even five percent. You might want to have any State that has a 50-percent increase, or a 75-percent increase in their unemployment rate, they might trigger as well.

Finally, on the food stamp side, I would argue that I might live with even more stringent increases than the ones in the current law, maybe 20 to 30 percent rather than 10 percent, but starting at the current base rather than the base 1994–95. I think those would be sensible, would maintain the logic of the earlier triggers, but update them to new circumstances.

Mr. CARDIN. Miss Ryan, let me ask you a question.

I understand that nine of the 17 States that receive supplemental grants are already spending at least at their base amount and most more than that. So if we were to eliminate the supplemental funds, I'm curious as to what impact it would have on the services being provided, at least in those nine States, if not in all 17 States.

Ms. RYAN. That's exactly right. For example, in Louisiana, given the way they are planning to transfer funds they estimate they would have to reduce their child care spending by $5 million if they lost their TANF supplemental grant.

Other States are looking are looking to reduce or to consider reducing other programs, such as a mentoring program or ongoing work supports.

I would say that, given the fact that 44 States transfer funds to child care and SSBG, I think there would be a significant pressure on those States to actually reduce their child care investments, or reduce their amount of transfer. Though those children are not reflected in total caseload data, they are certainly children who won't be cared for when their moms go to work or training.

Mr. CARDIN. Thank you.

Mr. Posner, very quickly, because my time is evaporating, you mentioned Maryland as one of the ten States, and you mentioned they had a combined model. I'm curious as to what States you felt had good models that we could use as examples.

Mr. POSNER. Well, Maryland was the only State that provided a rainy day fund from their own money. Now, they did it by shifting funds so that they freed up their own money by replacing it with TANF money, but as you indicated, Maryland has a $70 million rainy day fund, with a requirement that it be reviewed by the legislature and the Governor before it's being used.

Mr. CARDIN. I just wanted to get a plug in for Maryland. That's fine.

[Laughter.]

Mr. POSNER. Glad to do it.

Chairman HERGER. Well taken. Thank you very much, Mr. Cardin.

Mr. Potts, do you have any specific suggestions for us to encourage more State savings?

Mr. POTTS. I have several, I guess. I think the main thing that would really benefit those of us who are trying to administer public assistance programs would be some type of direction from Con-

gress. The only thing our State legislatures and our Governors are hearing is “spend the money or lose it”.

We have tried to put together a very responsible program. Our Governor is very supportive. We have term limits that have taken effect in Ohio. Forty-seven of our 99 House Members are brandnew this year. They don’t remember double-digit inflation in Medicaid. They don’t remember caseloads that actually went up instead of going down. They don’t remember the promises of five years ago.

When the constant, consistent message from Washington is, “You’re sitting on substantial reserves and you ought to be spending those”, I think it’s a real challenge for us. So some type of indication of what your wishes are for those. And it doesn’t even have to be “we think you ought to keep a reserve”, as much as if we would just get word from Washington that, if a State chooses to do a reserve, we think that that’s allowable, or that that’s something that we recognize as being important. It has put States in a rather awkward situation as we go through our budget debates, and especially in Ohio with term limits, it has had a huge impact on us.

The other thing that really has States sitting out there nervous is the entire definition of what you refer to as “supplantation”, something that didn’t exist when we first started developing our programs. I think the sooner we can all decide what exactly we mean by that, the better we can respond to your wishes and the better we can administer these programs.

So I think the two major pieces—and I think both of those don’t require a law change as much as they do that partnering you referred to and just a working back and forth.

Chairman HERGER. Good. Thank you very much, Mr. Potts. Hopefully we’re beginning to do that.

Mr. Lewis of Kentucky will inquire.

Mr. LEWIS. Thank you, Mr. Chairman.

Mr. Potts, you mentioned a program in some of your counties in Ohio that were designed to cure head lice. How did that come to your attention and what has been the results of those programs?

Mr. POTTS. Mr. Chairman and Members of the Committee, this is actually probably one of the biggest surprises, but I think one of the stories that I like to talk about quite often, of how different welfare reform is now from before.

We require each of our 88 counties to have a public forum before we hand over some of the flexibility in the TANF program to them. They go to the communities and say what’s available, what can we do. We’ve got these types of funds that will now be available to provide service to poor families.

At one of those meetings, a juvenile justice judge stood up and said, “Well, if you want to start dealing with problems in the juvenile justice system, don’t look to me. You really ought to be looking to the schools, because I’m telling you right now, the kids who are consistently absent from schools will be the ones in my system within the next few years.”

So they started looking at the schools and asked if that was an accurate statement, and the superintendents in the room agreed. They sat down and worked on how they could address some attendance problems.

They found the number one problem of attendance in Appalachian schools in the State of Ohio was head lice. A child that contracts head lice in their school districts at the beginning of the school year can expect to miss 35 to 40 days in the year. Once a child is identified by the school system as having contracted head lice, they are sent home automatically. They are given a note that says you have to go out and buy these expensive shampoos, and you need to take care of that problem before the child is allowed to come back in.

Even if they do the shampoos, it is very similar to—If you have ever had a dog with fleas, you give it a bath, you see the dead fleas, you feel pretty good about it, and 2 days later the dog is scratching again. Head lice are no different. Not only does the child have it, but generally so do the parents, so do the siblings, so do the pets. So it's a constant recurring problem.

The counties were able to take some of their TANF dollars for poor families, and when they contracted head lice, they actually send a nurse to the home. They will actually show and, in some cases, bathe the children, show them how to rid the head lice. They will give them vouchers for dry cleaners to get the bed clothes cleaned. They will bring in carpet cleaners or a carpet cleaning company, to clean the carpets and do those types of things. As I said in the written testimony, in some cases we've had school districts who reduced absenteeism by about 50 percent in the first year of that program.

You know, I've been asked what exactly does that have to do with welfare reform. We know that children who are consistently absent from school are mostly likely to be held back. We know those who are held back are the most likely to be dropouts. We know dropouts are the most likely to be teen parents. We know that over half of the teen parents wind up on welfare at some point in their life, and we also know that 80 percent of the people in the child welfare system, the children, their parents either recently were or are on public assistance.

We thought head lice had everything to do with welfare reform in Ohio. I thought the real advantage of that program was that it was created not because we figured it out in Columbus or here in Washington. This program came about because we told the community what are the problems you're facing. I thought it was a very unique and, frankly, very inexpensive way to address a very serious problem in those areas.

Mr. LEWIS. I agree. It is a very innovative way of dealing with the problem. Other States could do similar things.

Can you project savings like with this particular program, or other programs that you've been able to put in motion?

Mr. POTTS. Mr. Chairman and Members of the Committee, probably the biggest challenge, and from all the States I'm talking to, is how do you measure whether or not a prevention program really prevented somebody from coming on.

There are some programs that are probably the right thing to do—and we have a difficult time trying to figure out how would that fit within the TANF parameters—but how do you really know, and do you know in a short term or a long term.

One of the greatest challenges when we talk about preventing the incidence of out-of-wedlock births, it is something we take very seriously, it's something we want to do a lot of work with, but it is going to be a long time before we can successfully determine the effectiveness of our programs. People aren't going to stop doing things just because we say so. We have tried to manipulate caseloads historically by changing the parameters and that hasn't been real successful. I think we really need to change our approach, and it has been a real challenge.

I think one measurement in the long run will be the number of community partners that are involved. We do a lot with faith-based organizations in the State. In fact, about $90 million this biennium is going through faith-based contracts. The more we can get the local communities, the churches and the families involved, the better we will be long term. But we don't have a real good way of measuring that.

Mr. LEWIS. One last question.

Prior to welfare reform, would this have been possible to do?

Mr. POTTS. Mr. Chairman, Members of the Committee, no. No, there wasn't any flexible funding. Our money was all going into caseloads, so we were looking at ways to reduce the immediate caseload. And when you talk about prevention programs, especially a long-term prevention program, there weren't any funds that would allow us to do that.

Mr. LEWIS. Thank you.

Chairman HERGER. Thank you very much, Mr. Lewis.

The gentleman from Texas, Mr. Doggett.

Mr. DOGGETT. Thank you, Mr. Chairman.

It was troubling that President Bush did not include in his budget the continuation of the supplemental TANF funds. I am pleased that Senator Bob Graham of Florida, joined by Senator Hutchinson from Texas, have amended, as all of you probably know, the budget resolution over in the Senate, to add it back in for this next year, and hopefully the conferees on the budget resolution will follow the Senate version of the bill.

Mr. Cardin has already entered into the record the statement of the current Governor of Texas, Rick Perry. I think there is a feeling among the people that I talk to in my home State that we would really jeopardize funding particularly for child care or child protective services, with reference to abused children, if we don't have the TANF supplemental grants restored for next year.

I believe, in response to Mr. Cardin's question, Miss Ryan that you have already spoken to this. Mr. Holzer, could you elaborate as to what will happen in other States if the Congress does not act promptly this year to continue the supplemental funding?

Mr. HOLZER. As was indicated earlier, the supplemental funds constitute about 10 percent of the overall funds going to those 17 States on average. Now, a 10 percent cut, even at the current caseload level, would again put States in this bind, either having to make it more difficult for people to enter the welfare caseloads and with cash assistance, or to cut from other areas, other kinds of expenditures, child care and the like, which are both politically popular and have bipartisan support, and also are probably reasonably cost-effective in what they do, so the States would face those dif-

ficult trade-offs, even in the absence of any kind of economic downturn.

Mr. DOGGETT. I guess, if there is continued trouble with the economy and the former welfare agencies, acting now more as employment agencies, experience a greater number of people returning to the rolls who are unemployed, that there will be further pressure to cut into child care and other work supports, correct?

Mr. HOLZER. That's correct, absent these other contingency funds and other funds that might be available to cushion those increases.

Mr. DOGGETT. It seems to me that perhaps the best short-term solution is to have Congress continue the supplemental TANF funds for another year, and then, as a part of the overall revision of TANF, make adjustments in the formula to take care of this problem over the longer term, rather than having these two separate programs.

Do you have thoughts about how, Mr. Posner, we should address this on the long term, in contrast with the short-term need?

Mr. POSNER. I think that's a very good distinction, because the formula really, essentially, grandfathered in the old distribution, which promoted quite large disparities among States, as you know. In terms of per-grant, per-child, it goes from about $700 on average in those 17 to about $1,700 in some of the other States that have traditionally been more willing and able to spend higher amounts of money. So, by freezing in the old distribution, we kind of perpetuated the disparities in the program and the supplemental grants were a small downpayment on trying to kind of edge our way toward a little more uniform allocation.

I think putting that formula on the radar screen for reauthorization is something I know is not easy to do for the Congress, but it is something that probably is the right way to approach that issue.

Mr. DOGGETT. Has any study begun of how that formula might be altered in order to resolve this matter?

Mr. POSNER. We have not done anything on that yet. We have been doing some work on the Medicaid formula, which has similar issues, where you really want to focus more on per person and need indicators and total taxable resources among States and figure out a way to kind of figure in needs, fiscal capacity, and relative costs among States.

We need to develop a formula that—you know, here we have inherited this formula over 60 or 70 years, and it served us well possibly in the early stages of the program, but it is time to reexamine it.

Mr. DOGGETT. Thank you.

Miss Ryan.

Ms. RYAN. May I just add to that by saying one thing that I think does need to be looked at in reauthorization, is that, a year after welfare reform was passed, the TANF supplemental grant formula was applied and determined only 17 States would ever get this supplement, notwithstanding any other changes in poverty or population or anything else. So one thing to look at is whether or not there should be a periodic review of the initial eligibility of States, rather than just freezing that in for six years.

In our Association, and in our bipartisan recommendations, we are concerned about potential formula fights. We don't want to see that occur. We think there is a reason to make adjustments, but future supplements should be funded above the current TANF baseline amount.

Thank you.

Chairman HERGER. Thank you very much, Mr. Doggett.

Mr. DOGGETT. Thank you, Mr. Chairman.

Chairman HERGER. Mr. Holzer, is it true that several of the States receiving supplemental grants, including Mississippi, Montana, Louisiana and Idaho, have some of the largest unobligated TANF balances, and in all, 14 of the 17 States receiving supplemental grants have unspent TANF balances?

Mr. HOLZER. To be honest, I haven't looked carefully at those numbers. It sounds like that might be true.

But on the other hand, remember that California and Florida are two of the States receiving supplemental funds—and not all States are equal in terms of caseload. We know that the eight largest States account for over 60 percent of the overall TANF caseload, and some of the largest States like California have no unobligated balances and relatively small unliquidated balances. So I think the experience there is a real mix across different States. But some of the largest ones have more serious fiscal situations than the States you indicated.

Chairman HERGER. Thank you very much.

The gentleman from Pennsylvania, Mr. English, may inquire.

Mr. ENGLISH. Thank you, Mr. Chairman.

Mr. Posner, in looking over your testimony, I notice you also explore some options that might increase the States' incentives to save. Specifically, you throw out the idea that Congress could either allow States to count rainy day funds toward their maintenance of effort, or that they could allow States to draw down their entire TANF grant and save these funds in their own treasuries.

I wonder if you could explore those two options and give us a sense of the potential fiscal impact and the pros and cons.

Mr. POSNER. Right. Those are important issues.

On the rainy day funds, we saw that some States felt they did not have the incentives to save from their own funds because they couldn't count it as part of the maintenance of effort. The idea that could be explored is permitting States to do that with some safeguards, because there are some potential downsides. You don't want States to draw down their entire TANF funds, replace their State funds, and put it aside for a future purpose, for example.

Mr. ENGLISH. On that point, may I ask, what safeguards do you think would be most appropriate?

Mr. POSNER. Well, you could limit the share of the MOE that's dedicated to a rainy day. You could require States to provide for a "bona fide" rainy day fund. In other words, something like they do with their own rainy day funds, have trigger mechanisms specifying the point when funds would be released, have the legislature pass a statute, have some kind of review process that ensures that the money will truly act as a rainy day fund and be thought about in a more systematic way.

On the other proposal, we heard from State officials—and it has been echoed here, and rightly so—that money that is permanently appropriated to this program, which is available in perpetuity to the States, for all intents and purposes, is potentially at risk, because Congress sees these unspent balances and doesn't really know potentially how much is really needed, how much is not needed.

The idea has been advanced by States that they should draw down that money entirely at the beginning of the year, put it in the State treasuries rather than having it rest in the Federal Treasury. Under the Cash Management Improvement Act, that applies to all the Federal grant programs, States are not allowed to draw down money until they absolutely need it to spend, which means that the outlay is not recorded on the Federal budget books until the States actually pay the money for actual services. By requiring States to outlay that money at the beginning of the year, it would take it off our books and put it on their books.

There's a couple of very important issues. One is our surplus would be lower, at least temporarily, by doing that, and we would lose some interest. You could develop procedures, as currently is done in some States with other grants, to have States reimburse us for those interest costs, because they're going to be gaining in interest earnings when they have those balances in their own bank accounts. So we could have a fiscally neutral exchange, essentially, that moves up the timing of the money, so that States feel like this is in their own bank accounts and can plan with more certainty that that money will actually be there. That's the advantage of it.

We would want to make sure that we maintain transparency if that happens. One of the advantages of the current situation is we see very clearly how much States are spending and how much they're not spending. We would want to make sure that that continued with the other kind of process, should we think about that.

Mr. ENGLISH. Mr. Holzer, looking at these two suggestions, allowing States to count their rainy day funds, perhaps with some important qualifiers, toward their maintenance of effort, and second, considering allowing States to draw down their TANF grant and put it in their own treasury, do you feel comfortable with these two proposals? What sorts of policy restrictions should Congress consider if we get to the discussion stage on these two ideas?

Mr. HOLZER. Both proposals sound quite sensible to me. I guess I would caution us from thinking that that might solve the entire issue. I think one of the hardest things about this business is trying to come up with even broad estimates of how much might be needed in a recession, given how much uncertainty exists about the magnitude of the recession and how States would respond. So I think those are sensible suggestions. I don't think it fully eliminates the need for contingency funds and some additional Federal role.

Mr. ENGLISH. Mr. Potts, looking at this from a State perspective, on either of these two suggestions, are they ideas that would make this even more attractive for Ohio?

Mr. POTTS. Mr. Chairman, Members of the Committee, certainly, the more control we have over the program, I think the better we'll be in a position to make the more immediate decisions.

We talk about recession numbers and inflation and those types of things. Those will all show up eventually, but when we have—for instance, in the City of Cleveland, when they just recently announced a layoff of 2,000 steelworkers, and we know that for every laid off steelworker, it generally results in the loss of five like jobs, we know that that community has an immediate need.

So if we have some way of control where we can move those contingency dollars, if we had control of those within our own situation, as opposed to having to go and meet a formula and go through all the hoops it would take to be able to pull those dollars down, we can probably have a better effect at helping those families that are being impacted by major economic changes.

Obviously, from the State perspective, anything that gives the State more control will ultimately result in better outcomes.

Chairman HERGER. If the witness could sum up. Thank you very much.

Mr. ENGLISH. Thank you, Mr. Chairman.

Chairman HERGER. I thank the gentleman from Pennsylvania.

Now the gentleman from Michigan, Mr. Levin, may inquire.

Mr. LEVIN. This has been an interesting hearing, and I think a very good idea. I wasn't quite sure what the issues were, though, and I think the last few minutes have helped to illuminate what the issues might be.

We are talking about the contingency fund and about rainy day funds in addition to the supplemental. It seems to me that the options are becoming a little more clear. We could leave the contingency fund essentially inoperative, which it is today because of the triggers, and essentially let Federal dollars go into the States to create their own contingency funds, which is what a reserve fund is, in which I think Mr. English's questions elicited some response—and I don't mean these are absolutely black and white situations or alternatives—or we could make the Federal contingency fund operative and use the Federal TANF funds to meet the challenges ahead in welfare reform. I think there is a good argument for the latter, that we not get lost in kind of accounting devices and go back to what are the issues in front of us.

We have been talking about the contingency fund for a number of years, and a number of us have urged that the contingency fund be made real. We can make the triggers more sensitive to the realities; we could also take the cap off the contingency fund—we could have done that years ago—at a small cost. True, if there were a recession, it would have shifted more of the burden to the Federal government.

Also, the use of TANF funds, there is a reason for the maintenance of effort provisions, to try to keep the focus on the purpose of welfare reform, which is to help move people from welfare into work and into work that will lift them out of poverty. I think that's the trouble with the suggestion of simply taking the TANF funds that are unused and putting them into a rainy day fund, because if you take almost any State, and maybe every State, there is a lot of work that is left to be done, both with those who have not moved from welfare to work, who are going to be in many instances harder to place or harder to make that transition—we all know that, right, Mr. Potts—I think you would acknowledge that, by and

large, those who remain in TANF have, by and large, whatever term we should use, have needs that make it more difficult for them to make that transition.

Also, for those who have made the transition, the data are quite clear that the majority, or a substantial number of them—it depends on the States—remain below the poverty level and have needs, whether it's transportation needs to be able to move into a higher paying job, or have training or retraining needs.

So, Mr. Chairman, I think that the hearing has helped to elucidate what these issues are, and I think there is a good case to be made for our taking a look at the contingency fund this year and see why it isn't working, to reauthorize it but perhaps, I would hope, to improve it, and also to look at what we want to be done with the unutilized Federal TANF funds.

I think the vast majority of States, and really all of them, have a lot of unmet challenges to meet, to really make the promise of welfare reform, as we carved it, a reality increasingly, as well as taking a look at the supplemental fund, which we must do.

Mr. Chairman, I would hope the hearing today might accelerate our attention to these issues. I really think any notion of essentially taking unused TANF funds and having them replace what was supposed to be the purpose of a Federal contingency fund is probably not good policy, in terms of making welfare reform the full success that those of us who worked on it, who helped to shape it and eventually voted for it, to make that promise a reality.

Chairman HERGER. I thank the gentleman from Michigan for your comments.

Just in closing, I would like to ask you, Miss Ryan, in general, wouldn't encouraging States to maintain their own State contingency funds, using either their TANF block grants or State funds, relieve some of the pressure on the Federal contingency fund in times of need, and wouldn't that be a smarter way to allocate resources for the Federal fund than to back up State rainy day funds?

Ms. RYAN. Mr. Chairman, we strongly believe that additional flexibility should be afforded to States to send a strong signal from Washington that it is prudent to save in the instances of an economic downturn—that decision Maryland made to create a reserve with their own State dollars, even though it doesn't count toward maintenance of effort to do so, was a prudent course. So we strongly urge attention to giving States more flexibility to be able to reserve State and Federal funds.

Just one other point, if I may. The regulations that apply to the TANF block grant with respect to the drawdown of TANF funds from the Treasury, are unlike any other Federal regulation that applies to any other block grant. You have other block grants in the Federal government that have maintenance of effort requirements, such as substance abuse and mental health block grants, that are treated in a totally different way under Federal regulation than TANF. There have been regulatory disincentives to save that don't exist with respect to other block grants.

I urge you to consider regulatory changes outlined in my testimony. But it seems to me that we should do both, TANF supplemental grants should be extended. A contingency fund in instances

of severe economic downturn, yes, some States may need that extra help. But in the interim, allowing States to create reserve funds, a way to balance prudent investments and saving for economic downturns, is the best formula for success in the future.

Chairman HERGER. Thank you, Miss Ryan.

Mr. Posner, would you like to comment on the same question?

Mr. POSNER. Yes. I don't think that these options are mutually exclusive. They need to be considered. You have a role probably for a contingency fund, you have a role for saving some of TANF's balances for a rainy day, and frankly, you have a role for the States in providing their own money. In fact, that is provided in the contingency fund formula, that States have got to match it up to a certain level. So I think that is the way to go forward.

I would add that the contingency fund has "not worked" not because so much of the triggers. It is because the fiscal limits are so strict. California, for example, would have had to spend $1.9 billion of its own State money increase to get a $247 million State contingency fund grant. That's the challenge. We have set the price. We should have the States participate equally as partners, but that price—the question is, is it self-defeating.

Chairman HERGER. Thank you.

Mr. Potts, in light of Mr. Posner's suggestion, would States be agreeable to paying interest to the Federal government in order to keep unspent TANF balances in the State treasury?

Mr. POTTS. Mr. Chairman, members of the Committee—obviously, not speaking for the other States, but for Ohio, that would be fine. I think having control of the money and having the ability to do those things is very important to us. Right now, we don't have either. So is something better than nothing? Absolutely. I do think it's a responsible way for us all to approach this.

I also think for you to hold the States accountable is critical. Make sure we understand that we are expected to manage our own caseload. You know, we make decisions that will determine how large our caseload will be. In Ohio we have a 3-year time limit instead of a 5-year time limit. Obviously, that makes a difference.

As long as the control and responsibility are combined, I think that's fine.

Mr. CARDIN. Would the chairman yield on that point?

Chairman HERGER. Yes.

Mr. CARDIN. Wouldn't it be more tempting for you to spend the money that you actually have? Wouldn't the legislature give you a little bit more of a difficult time?

Mr. POTTS. Yes, Mr. Chairman, members of the Committee. I worry about that. I mean, I think both things. I think that if it's sitting in the State coffer somewhere, you're going to have the State legislature probably dealing with some of the things that you all had to deal with over the years. If that money is sitting there unspent, especially when you get into tough economic times, they start looking at those.

Yes, in many cases, it's six of one and a half-dozen of the other.

Chairman HERGER. I want to thank each of our witnesses for your testimony this morning. It has been a very informative hearing. I appreciate the work that you have done and the time you have given us today.

With that, this Committee stands adjourned.

[Whereupon, at 11:15 a.m., the hearing was adjourned.]

[Questions submitted from Chairman Herger to the panel, and their responses follow:]

U.S. General Accounting Office, Washington, DC 20548

1. How has the pattern of State saving for rainy days changed over time?

a. For example, are States saving more or less now than before?

b. What factors contribute to this—implementing a new program, signals from Washington about cutting the block grant, uncertainty as TANF heads toward reauthorization?

In our written statement we make a distinction between two types of saving, (1) reserves of unspent TANF balances at the U.S. Treasury and (2) rainy day funds established by the state for welfare programs with state or federal funds. The latter—an established rainy day fund—implies explicit action taken by the state to recognize the need to prepare for future unexpected costs. The former—reserves of unspent TANF funds—provides no information on states' savings plans because it is difficult to ascertain how much of these balances are truly uncommitted and available for future contingencies. While states' reserves of unspent TANF balances probably represent a de facto rainy day fund, there is much "less there than meets the eye" because the data reported by the states are misleading.

As such, if a state is saving Federal funds the distinction between the two types of saving is blurred because all Federal funds a state saves for a rainy day must remain in the Treasury until spent. In our 1998 report we recommended that HHS and the states work together to improve reporting requirements on states' plans for these unspent balances. Without improvements in the data we cannot assess any trends or patterns in the levels of state saving for a rainy day from the data states report on their unspent TANF funds because the data are not reliable enough to make such a determination. Likewise, there is no aggregate information on how much state funds states are saving for a rainy day. States cannot count the funds reserved toward their MOE requirement until they are spent. States are not required to report on these state-only balances to the Federal government.

In our ongoing work for the Subcommittee we have collected data on state savings in ten states. We have seen few changes in the pattern of state saving for a rainy day. We surveyed ten states in 1997 after they enacted their first budgets using TANF funds and found only three states—Colorado, Texas, and Wisconsin—had established rainy day funds of unspent Federal funds left at the U.S. Treasury. One state—Maryland—used state funds to establish a reserve. In 2000 we surveyed the same ten states and found that only one other state—New York—had established a rainy day fund for its welfare program in the interim. New York uses Federal funds for its rainy day fund. However, the balances earmarked for these funds by the states were not determined through a fiscal planning process that reflects budgetary assumptions about projected future needs. State officials said that because their new welfare programs had not been tested during a recession, developing a model that might predict how caseloads and costs would respond to a downturn proved difficult. Instead, these states designate any funds not already appropriated by the state legislature for other purposes as constituting the state's welfare rainy day fund.

Maryland has continued to make deposits into its state-funded rainy day fund. In 1997 it made an initial deposit of $15.7 million and then did not make another deposit until 2000, when it deposited $53 million of state funds in its welfare reserve. However, as we noted in our written statement, Maryland was able to shift the costs of saving state funds to the Federal government by using TANF funds to replace state funds in some programs and depositing the freed-up funds in its reserve account. Again, Maryland has not projected future needs based on alternative economic scenarios, instead a senior state budget official said that they were motivated chiefly by the perceived need to draw down their 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 1998 we reported that the levels of unspent TANF funds were transitional in nature and that a number of factors unrelated to states' savings decisions have influenced the levels of these funds, including cash management practices, timing of the enactment of new state welfare laws, slow-starting programmatic spending, and caseload declines. Concerns similar to those expressed by Maryland budget officials about the future of TANF funding levels have driven other states to spend their

TANF funds more quickly. As a result, the levels of reserves are expected to go down.

2. In your written testimony you note several approaches to encourage States to save more State Funds.

a. Would these changes result in added Federal costs?

b. In fact, depending on what we do with the Federal contingency fund, wouldn't encouraging more State saving tend to reduce Federal costs, as States would need less immediate Federal assistance in a downturn?

In the new block grant environment, the Federal government has an interest in encouraging states to save for future contingencies, but within a framework that recognizes that the size of the reserve will remain largely a state determination made under conditions of inherent uncertainty. While the new fiscal partnership implies a much stronger state role in the safety net, both Federal and state governments have a shared responsibility to ensure that sufficient resources are available for rising TANF costs in a recession.

In our written statement we noted that states could be encouraged to save their own funds by counting a portion of state funds set aside toward their MOE requirement. If a state chose this option it would have to either cut program spending to make up the difference of what it saves, or it could draw down any unspent TANF funds—if available—and use the Federal dollars to make up the difference. If the state chose to draw down TANF funds instead of leaving them in the U.S. Treasury, the rate of outlays recorded in the TANF program would shift forward. Accordingly, the Federal budget surplus would be proportionately lower in the near term.

We also stated that states might be able to save more TANF funds directly for the future if they were able to draw down Federal funds earlier than needed for program spending. Some state officials argued that their incentives to save for the future could be bolstered by allowing states to keep unspent TANF funds in their own accounts rather than the U.S. Treasury. They believe that this might reduce incentives for Congress to rescind unspent balances since the outlays would be recognized earlier at the time of the grant and not when the money is actually spent.

We also suggested that certain changes to the Contingency Fund for State Welfare Programs could make it more effective and thus more likely states would incorporate the fund in its contingency plans which could encourage states to save some of their own funds. The Fund requires states to bring their own spending up to pre-welfare reform levels before they can gain access to additional Federal funds. Simplifying the fund's design and removing some of the restrictive barriers to access could provide incentives to states to save some of their own funds, since they would be more likely to use it in the event of a downturn. Currently, future outlays from the Contingency Fund are recorded at zero. Any change that eases access to the fund could record a faster outlay rate.

It is unclear the degree to which a recession might impact TANF caseloads and state welfare costs. If states have saved enough of their own funds, they may not need to call on the Federal government for emergency funding. But states have not engaged in any rigorous analyses of their future needs. Without better information on the adequacy of their reserves, we cannot assess the impact of these savings on future Federal draws.

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Committee on Ways and Means
U.S. House of Representatives
Washington DC 20515

Dear Rep. Herger:

Thank you for giving me the opportunity to respond to your questions about my testimony on April 26, which raise several important issues.

1. I note your suggestions for changes in the Federal contingency fund, including providing "uncapped" funding for this purpose.

A. Do you have any idea what this would cost?

B. If we enacted your proposals for relaxing eligibility criteria and providing unlimited funds for this purpose, would any States qualify right away? Which ones.

C. How is your proposal any different from the pre-welfare reform approach of providing unlimited Federal funds to States that fail to save or help families leave the rolls and go to work?

1. A. I would prefer to have CBO or OMB cost out this proposal, and I would certainly defer to their estimates. However, my best guess is that the total cost of my proposal to the Federal government would be approximately $2B in a moderate recession and about $6B in a severe one. (My worst-case estimates are about $4B in a moderate downturn and $10B in a severe one respectively.) Details of how I arrive at these estimates are available upon request.

This would be a one-time expenditure, spread over several years. To put it in context, please note that this would be a very small fraction of the total Federal expenditure on TANF block grants over its current 6-year authorization. It is also very small relative to the extra Federal government expenditures in a recession on Emergency Unemployment Insurance benefits ($28B in the previous recession, or about $36B in current dollars) or on food stamps.

B. I don't believe any states would qualify right away (at least not on the basis of the most recent caseload and unemployment rate data), as the triggers I propose would require increases of unemployment (or food stamp caseloads) of at least 20% over their current levels.

C. The proposal differs from the pre-welfare reform approach in a number of ways. For one thing, there would be triggers and state-level MOE requirements that would now limit state access to Federal funds, which was not true in the pre-welfare reform era.

Furthermore, this proposal would be implemented in the context of a welfare reform effort that has already successfully reduced caseloads and dramatically increased work incentives. The time limits and state-level discretion that TANF allows will continue to reduce rolls beyond what was true in the past.

If we pressure the states too much to "save" during good times and finance their own caseloads during bad times, they may forego expenditures on important supports (such as child care) to working families who really need it, or they might decrease other expenditures designed to improve employability among the hardest-to-serve. Alternatively, they may turn away people from the rolls during difficult times who have access to no other safety net.

2. You cite several studies suggesting rising unemployment will send welfare caseloads up by certain percentages.

A. How high would the unemployment rate have to rise for the caseload to return to where it was before the new law was signed in August 1996?

B. How would that rate compare with the unemployment rate in 1996?

C. Do your calculations assume any change in behavior by would-be recipients due to work requirements, time limits, and related factors?

2. A. According to the standard estimates, unemployment rates would have to rise by as much as 10 percentage points or more to return to us to the caseload levels that were in effect in August 1996. It is very unlikely that this will happen, even in a serious recession. (Of course, the "standard estimates" have their limitations, as I note in part C below.)

B. The national unemployment rate averaged 5.4% during 1996, when the welfare reform bill was signed.

C. These estimates are based on statistical models of previous business cycles, but the models do include some measures of state-level policies and behaviors (including enforcement of time limits) in the 1990's that have affected the caseloads. They also capture trends over time that reflect federal work requirements and other recent changes. It is possible that these models do not fully capture the behavioral changes, since we don't really know how states will use their discretion in responding to the increased *need* for assistance by families during recessions. On the other hand, since the huge decrease in the welfare rolls in recent years is completely unprecedented, *it is also possible that our estimates based on the past will understate the response of the caseload to a serious downturn.*

3. Sheldon Danziger of the University of Michigan, summarizing a study by George Wallace and Rebecca Blank, the former Chair of President Clinton's Council of Economic Advisors, writes: "A severe recession that raises the unemployment rate by 3–4 percentage points, to 7.5–8 percent, would leave welfare caseloads well below the levels reached in the early 1990s. They conclude that the 1996 welfare reform seems to have achieved a large reduction in caseloads independent of the state of the economy." Do you agree with this assessment?

3. As my previous answers indicate, I agree with the notion that welfare reform has had an effect on caseloads that is, to some extent, independent of the strength of the economy. The decline in caseloads reflects another factor as well: the growth of the Earned Income Tax Credit and other developments that help "make work pay". But the strong economy has played a very important role as well. Without it, caseload declines would have likely been much smaller, and much more painful to achieve.

Furthermore, while we will not likely see any return to the caseload levels of the mid-1990's during the next downturn, *the need for federal assistance to the states will remain*. Given that states have used their TANF block grants to fund a wide range of laudable activities and work supports, they will not be able to finance significantly higher TANF caseloads out of their current block grants without serious cutbacks in these other supports, which in turn would have unfortunate consequences for working families.

4. What is the "full employment" rate of unemployment? Has this changed over time? You suggest (page 6) that contingency funds be available to States with unemployment rates as low as 5 percent. Should a rainy day fund be available to States that are technically at or near "full employment"?

4. I currently regard the rate of unemployment that we can achieve through fiscal and monetary policy without rising inflation as being about 4%, and most economists would put it somewhere in the range of 4–5%. This is significantly below the rate of 6% or so that most economists believed was the lowest rate achievable in the 1970's, and below the 5–5.5% rate of the 1980's. The decline in this rate can be attributed to a wide range of factors—such as changes in workforce demographics, industrial structure, coverage by unemployment insurance, etc.

Two important caveats to the above statement must be mentioned here. First, *this rate should not necessarily be interpreted as "full employment*." It is simply the lowest rate that we can achieve without setting off inflation. (Most economists refer to this as the "non-accelerating inflation rate of unemployment", or NAIRU, rather than "full employment".) Accordingly, there are probably a fair number of poorly skilled individuals who have difficulty finding work, even in such an environment; and many more people will have such difficulty when unemployment rises above that rate.

Second, *the NAIRU no doubt varies very significantly across states*. Since states differ from one another greatly in terms of the factors that determine these rates (e.g., demographics, industrial structure, coverage by Unemployment Insurance, etc.), they also differ greatly in the rates to which unemployment can fall at any time. Thus, roughly 10 states have recently achieved unemployment rates below 3% (while a few others, such as West Virginia and New Mexico, have had difficulty achieving rates below 6–7%). These 10 states would presumably suffer major cyclical job losses, a lack of job availability for unskilled workers, and seriously rising welfare caseloads, even at 4–5% unemployment; and it would be reasonable for the Federal government to provide assistance in paying for its higher caseloads under those circumstances.

I hope you find these responses useful. Please let me know if I can be of any further assistance.

Sincerely,

HARRY J. HOLZER