Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

WELFARE ADMINISTRATIVE COSTS

JUNE GIBBS BROWN
Inspector General

FEBRUARY 1995
OEI-05-91-01080

OFFICE OF INSPECTOR GENERAL

The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services' (HHS) programs as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by three OIG operating components: the Office of Audit Services, the Office of Investigations, and the Office of Evaluation and Inspections. The OIG also informs the Secretary of HHS of program and management problems and recommends courses to correct them.

OFFICE OF AUDIT SERVICES

The OIG's Office of Audit Services (OAS) provides all auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations in order to reduce waste, abuse, and mismanagement and to promote economy and efficiency throughout the Department.

OFFICE OF INVESTIGATIONS

The OIG's Office of Investigations (OI) conducts criminal, civil, and administrative investigations of allegations of wrongdoing in HHS programs or to HHS beneficiaries and of unjust enrichment by providers. The investigative efforts of OI lead to criminal convictions, administrative sanctions, or civil money penalties. The OI also oversees State Medicaid fraud control units which investigate and prosecute fraud and patient abuse in the Medicaid program.

OFFICE OF EVALUATION AND INSPECTIONS

The OIG's Office of Evaluation and Inspections (OEI) conducts short-term management and program evaluations (called inspections) that focus on issues of concern to the Department, the Congress, and the public. The findings and recommendations contained in these inspection reports generate rapid, accurate, and up-to-date information on the efficiency, vulnerability, and effectiveness of departmental programs.

This report was prepared in the Chicago Regional Office, Region V, under the direction of William C. Moran, Regional Inspector General and Natalie A. Coen, Deputy Regional Inspector General. Project staff: Jennifer Antico and W. Mark Krushat.

For additional copies of this report, please call the Chicago regional office at (312) 353-4124.

EXECUTIVE SUMMARY

PURPOSE

To examine alternative funding arrangements for administrative costs in the Aid to Families with Dependent Children (AFDC), Medicaid and Food Stamp programs.

BACKGROUND

Administrative Costs

Administrative costs are the expenses States incur to administer their programs. In 1993, States charged the Federal Government approximately $5.7 billion to administer three closely linked welfare programs, the AFDC, Medicaid, and Food Stamp programs. The Federal Government pays roughly half of the administrative costs for these programs, and State and local governments pay the remaining share. The payment system is a cost reimbursement system, which means that the States tell the Federal Government how much they have spent and the Federal Government reimburses them for roughly half their costs.

Reimbursement Problems

As we have learned from this study, as well as other studies on this topic, particularly the OIG report, "Reforming the System for the Determination of State and Local Government Administrative/Indirect Costs" (A-12-92-00014), there are two major problems with this cost reimbursement system: accountability and predictability.

The accountability issues are very basic. We are not sure what we are paying for and whether the funds are being spent in a cost-effective manner. The way that the current system operates, it would be too resource intensive to even try to find out the answers. We do know that some States spend double and triple what other States spend per recipient, without any clear relation to outcomes. There are a lot of reasons offered as to why this is the case, but no solid evaluated data to confirm the degree to which these reasons affect administrative costs. We also know that we could find no significant correlation between the costs incurred and the recipients served on an individual State-by-State basis.

The predictability issue means that the Federal Government is in the position of not knowing how much the States are going to charge in future years. While predictions can be made based on historical patterns, there is no assurance that there will not be years where the costs will be higher than predicted. This, in fact, has occurred in the past.

We believe that a lack of accountability and predictability in the current cost-based reimbursement system are a vulnerability for the Federal Government. We believe that the current system should be replaced by one that would provide adequate funding to the States, along with incentives for efficient operations and decreased oversight and monitoring on the part of the Federal Government.

ALTERNATIVE FUNDING OPTIONS FOR ADMINISTRATIVE COSTS

The primary purpose of this report is to examine alternative funding arrangements for the administration of the AFDC, Medicaid, and Food Stamp programs. We offer this as a follow-up to the broader report cited above. Here, in this report, we describe options that provide incentives to promote greater efficiency in the system rather than relying on increased monitoring and oversight activities which, in turn, add to administrative costs.

We present five of many possible options for funding administrative costs. Our intention is to present the general concepts behind these options in order to assess the relative merits of each. We fully expect that if one of these options is implemented, further refinement and adjustment would be required. Regardless of which option is selected for further consideration, it should be evaluated against certain criteria. These criteria are:

1) ***Adequacy:*** Funds should be adequate for the effective and efficient administration of these programs.

2) ***Flexibility and Administrative Relief:*** The States and the Federal Government should have greater flexibility in using their administrative funds, and reduce the administrative burden by cutting back on the need for data collection and intensive monitoring.

3) ***Costs:*** The rate of growth of administrative costs should be controlled.

4) ***Disparity:*** Funding disparity among the States should be reduced.

5) ***Predictability:*** There should be greater predictability in the system as a result of prospective planning and budgeting for administrative costs.

We summarize the five alternative funding options below.

Option 1: Reduce Medicaid Special Match Rates to 50 Percent. This option would reduce special match rates to 50 percent for the Medicaid program, similar to the reduction that has occurred for the AFDC and Food Stamp programs. This option would result in reduced Federal expenditures for administrative costs, but would not reduce the administrative burden or disparity among States. It would not enhance predictability for budgeting purposes.

Option 2: Block Grant. This option would combine the administrative costs of all three programs at a base year level, then provide inflationary increases each succeeding year. This approach would reduce the administrative burden and enhance budgeting predictability. It would reduce Federal costs in so far as the rate of increase under the current system is larger than inflation. It would have no impact on the disparity among States. It is not flexible enough to account for changes in caseload or other special needs that might arise within an individual State.

Option 3: Standard Cost Per Recipient. This option would fund each State for administrative costs based on a standard per recipient allocation amount. Under this option, the disparity among States would be addressed and the administrative burden for the Federal Government and the States would be reduced. This option may or may not generate Federal savings depending on certain factors such as the number of recipients in the program. In years where there is a large increase in the number of recipients, this option could be more costly than the current system. It would not provide for any special needs of one State in comparison to others.

Option 4: Cost Per Recipient Cap. This option imposes a cap on the Federal reimbursement of the cost per recipient. States would be reimbursed for their full recipient cost up to a set, predetermined percentage above the national median cost per recipient. Under this option, there would be reduced disparity between the lowest and highest cost States. It would allow for some differences in costs among the States, but not for excessive differences. Savings would be generated by reducing the amount of Federal administrative funds going to the highest cost States.

Option 5: Flat Percentage. States would be reimbursed for their administrative costs on the basis of their ratios of administrative cost to total program cost. This option reduces the administrative burden but may not reduce the disparity among States. Given the recent high rate of growth in program costs, the Federal Government would actually spend more on administrative costs under this option than it spends currently.

CONCLUSION

The issue of reforming the administrative cost allocation system is very relevant today given the considerable interest in "reinventing" Federal Government operations. If action is not taken, we will continue to have a system that lacks sufficient accountability and predictability, and relies on enhancing our monitoring capabilities.

The alternative funding approaches that we have outlined are meant to serve as examples of what can be done. Furthermore, some combination of options might have a number of advantages. For example, the block grant alternative could be combined with the standard cost per recipient approach.

This report focuses on only three of the many programs for which the Federal Government reimburses States for administrative costs. We focus on AFDC, Medicaid, and Food Stamp administrative costs because they constitute the bulk of administrative costs for Federal public welfare programs. However, we believe that the ultimate objective should be to reexamine the administrative cost allocation systems of all Federal programs.

AGENCY COMMENTS

We received comments on the draft report from the Assistant Secretary for Management and Budget, the Assistant Secretary for Planning and Evaluation, and the Assistant Secretary for Children and Families. They state that we have not necessarily demonstrated a serious problem in this area, expressed concerns about the way we estimated future costs and possible savings, and pointed out that there may be valid reasons for some disparities in costs among the States. The Administration for Children and Families also requested a fuller discussion of the pros and cons of the various funding alternatives. See full text of comments at Appendix B. The Health Care Financing Administration provided informal comments on earlier drafts, but did not provide comments on the latest one.

We recognize the legitimate concerns that have been raised and have considered them carefully. We have revised the report in several places, primarily to focus more succinctly on the need to change the current system and to update our savings projections based on the latest available data. We also are including more detailed responses in Appendix B to the issues raised.

At this point we believe that we have an honest disagreement about the extent of this problem and its appropriate solution. Perhaps this disagreement stems from differences in overall focus.

The agency comments focus on whether total costs within the current system are out of control. There is some evidence offered, such as recent declines in cost per recipient data and a levelling off of the rate of increase in Federal costs, that there is no real problem here. We have reservations about the significance of these indicators and we address them within the report itself. More importantly though, we think that these indicators do not address the most important issue.

We think that the real issue is the current cost reimbursement system itself. The system puts us at risk because we have difficulty knowing what we are paying for, whether it is cost effective, and what we will have to pay out in the future. It provides little incentive to economize, and is itself an inefficient system.

Agency comments also caution that our proposals could harm some States by not taking into account their peculiar needs. We see similar problems of inequity with the current system.

Thus, we continue to believe that the current cost reimbursement system for welfare administrative costs needs to be replaced for the following reasons.

- o Under the current system we are not sure of what we are paying for and whether expenditures are cost-effective. It would require a considerable investment in expanded auditing and monitoring to find out. These costs would be prohibitive especially in an environment of declining resources.

Our Office of Audit Services has reported that the current cost allocation system results in mountainous paperwork, labyrinthine accounting and detailed auditing and negotiation processes.

- We can not predict with any degree of certainty under the current system what the States are going to charge us in the future. This issue becomes very important in thinking about how much the Federal Government wants to pay for administrative costs under welfare reform.

- There is significant cost disparity among the States, without any clear relation to outcomes. While there are reasons offered for some disparity, there is no solid evaluated data that rules out efficiency as a factor in cost disparity. We also could find no significant correlation between administrative costs and numbers of recipients on an individual State-by-State basis.

For these reasons, we believe that the current cost allocation system should be replaced by a system that provides adequate funding for States, incentives for efficient operations, decreased Federal monitoring and oversight, and predictable Federal expenditures. We think that the options presented in this report are a good place to start in developing a new welfare administrative cost system.

We want to caution the reader that the dollar estimates for the various options are illustrative only. In further developing a new administrative cost system, it will be necessary to prepare detailed estimates based on clearly defined assumptions, using the most recent information available.

TABLE OF CONTENTS

PAGE

INTRODUCTION

PURPOSE

To examine alternative funding arrangements for administrative costs in the Aid to Families with Dependent Children (AFDC), Medicaid and Food Stamp programs.

BACKGROUND

The AFDC program (Title IV-A) provides cash assistance to low-income families with children in which one parent is absent or incapacitated, or to families in which the primary earner is unemployed. The Medicaid program provides medical assistance to low-income people who are recipients of Supplemental Security Income, current or recent recipients of AFDC, and certain other low-income people. These programs are administered by the Administration for Children and Families (ACF) and the Health Care Financing Administration within the Department of Health and Human Services (HHS). The Food Stamp program, administered by the Food and Nutrition Service (FNS) in the Department of Agriculture, provides redeemable coupons for food to low-income households to enable them to buy a nutritionally adequate low-cost diet.

In 1993, States charged the Federal Government approximately $5.7 billion to administer the AFDC, Medicaid and Food Stamp programs. The Federal Government pays half of the administrative cost for most types of administrative activities in all three programs and State and local governments pay the remaining share. In general, States have considerable latitude in defining their administrative costs. Costs need only be considered "reasonable and necessary" as outlined in OMB Circular A-87, "Cost Principles for State and Local Governments."[1]

Administrative costs are the expenses States incur to administer their programs. They are not easily defined since States claim and categorize their administrative costs differently. In general, however, administrative costs include such things as computer services, transportation and salaries that are billed directly to an agency or program and allocated costs which are shared with other agencies or programs. The majority of administrative funds pay for staff at the State and local levels to perform a wide variety of tasks. These activities include: the cost of determining eligibility for all applicants, setting the allotments for eligible households, making changes in a recipient's status over time and other administrative tasks. Higher matching rates have been developed for some types of expenses as an incentive for local administrators to engage in particular administrative activities, such as statewide comprehensive systems development, training, and some anti-fraud activities.

In 1986, our Office of Evaluation and Inspections published a report in response to questions raised about rising administrative costs. That report, entitled: "Inspection of

AFDC, Medicaid and Food Stamp Administrative Costs" (OAI-05-86-00008), examined the wide cost variation among States and the overall increase in cost. It suggested an alternative method for funding administrative costs that would reduce costs overall and reduce the variation between States. This proposal, however, was not implemented.

Since 1986, other groups have made the following proposals on this issue:

In 1987, **HHS** authored a legislative proposal to reduce the matching rates for administrative costs in the AFDC, Medicaid and Food Stamp programs. Under the proposal, matching rates were reduced for costs in excess of 125 percent of the median for the AFDC and Food Stamp programs and 135 percent of the median for Medicaid. At that time, HHS also proposed eliminating enhanced matching rates. In addition, the Assistant Secretary for Planning and Evaluation has examined this issue extensively.

The Office of Management and Budget (OMB) proposed creating a fixed grant at the current Federal spending levels. In addition, it is in the process of revising circular A-87, "Cost Principles for State and Local Governments," which establishes the standards for determining administrative costs.

Congress has also shown some interest in this issue. The H.R. 5552, introduced in July 1992, proposed a combined grant to States for administrative costs of AFDC, Medicaid and the Food Stamp programs.

The Congressional Budget Office has also proposed combining funding to States for the cost of administering AFDC, Medicaid and the Food Stamp program into a single indexed grant.[2]

In 1988, the **National Association of State Budget Officers** and the **National Governor's Association** proposed their own reform measure. They proposed development of a combined administrative rate for the AFDC, Medicaid and Food Stamp programs. The rate would be based on the historic ratio of administrative funds to total benefit payments for each State. The goal was to reduce the paperwork burden and create cost savings for State and Federal Governments. They advanced their idea as a demonstration program, but it was not implemented. States were concerned that the proposal would make administrative costs vulnerable to Federal cost cutting measures.

We have also been very involved in this area through our **Office of Audit Services.** We have worked with OMB to revise Circular A-87 and have produced numerous reports on this issue. Most recently we issued a report, "Reforming the System for Determination of State and Local Government Administrative/Indirect Costs"

(A-12-92-00014). We received about 115 comments from 22 Office of Inspectors General and Financial Management Offices representing 13 Federal agencies, and incorporated them into the report. The report describes the current system as, "unnecessarily burdensome to Federal, State and local governments."[3] Furthermore, it suggests that, "a new system can be devised to eliminate or at least minimize, the mountainous paperwork, multiple cognizance arrangements, labyrinthine accounting and detailed auditing and negotiation processes. Such a system would benefit both the States and the Federal Government by reducing administrative burdens and costs."[4] The report offers a range of options, from expanding monitoring efforts and reforming cost allocation guidelines to more far reaching suggestions to "dispense with the current arcane system and establish an equitable level of reimbursement over time."[5] One specific proposal was to award a single administrative cost grant for public assistance programs.

In addition to these past initiatives, the **current Administration** proposed that the Federal reimbursement rate be set at a uniform 50 percent for all administrative costs. That is, they proposed reducing the special matching rates to 50 percent. The first option in this report supported this proposal. Since issuing the working draft of this report, this option was enacted into law for the AFDC and Food Stamp program. Special rates remain, however, in the Medicaid program.

SCOPE

This inspection focuses on possible solutions to concerns specified in our Office of Audit Service's report. We present five different options for funding public assistance administrative costs through a single grant. These represent only some of the many methods that might be used to fund administrative costs. Many have been proposed previously in various forms. We present these options again to help focus the discussion on the issue of administrative costs and to further clarify the costs and benefits to the States as well as to the Federal Government. We believe that there is widespread interest in improving the current system, but there is little consensus on how this should be done.

This report focuses on only three of the many programs for which the Federal Government reimburses States for administrative costs. We focus on the AFDC, Food Stamp and Medicaid programs because they generate most of the administrative costs for federally supported public welfare programs. However, we recognize the risk that States may shift administrative costs to other programs (although there would be some practical limits as to how much cost shifting could occur). Therefore, we believe that the overall objective should be to re-examine the administrative cost of all Federal programs. The ideas presented here for the AFDC, Medicaid, and Food Stamp programs might well be adapted to other programs and could be used in conjunction with an overall reform of the cost allocation system suggested in the Office of Audit Services report.

We do not include funding for Medicaid Fraud Control Units in our analysis, since, by law, they must be administered by State agencies independent of the ones that administer the Medicaid program.

METHODOLOGY

Pre-Inspection Activities

During pre-inspection, we reviewed the following materials: OMB Circular No. A-87, Office of Inspector General (OIG) reports on administrative costs, and other materials provided by the Assistant Secretary for Planning and Evaluation (ASPE). In addition, we spoke with people from the Division of Cost Allocation (regional and headquarters), ASPE, and our Office of Audit Services. We held an entrance conference on September 9, 1992 with representatives from the Administration for Children and Families, ASPE, the Department of Agriculture and other OIG staff.

Inspection Activities

We collected the following data on a State-by-State basis for Fiscal Year (FY) 1982 to FY 1993. Total program and administrative costs for the AFDC program were not available for FYs 1982-1986.

Total Program (AFDC, Food Stamp, Medicaid) Budgets
Total Administrative Costs
Number of Recipients

For the purposes of this study we used State generated data provided to us by ACF, HCFA and FNS. We did not verify the data. We are aware that the States and the agencies define administrative costs and collect their data differently, thus, the data may not be perfectly comparable among States and between programs. Total recipient data, for example, are reported as an annual average number of persons participating in the program for the AFDC and Food Stamp programs. Alternatively, Medicaid collects an annual total recipient count. While the data may not be exactly comparable between programs, it is the best available. We feel confident that it is appropriate for this analysis.

We held an exit conference on March 30, 1993 with representatives from each of the agencies, ASPE, and the Office of Inspector General in the Department of Agriculture.

We received numerous HHS staff comments on our working draft and made many changes based on the advice we received.

This inspection was conducted in accordance with the *Quality Standards for Inspections* issued by the President's Council on Integrity and Efficiency.

PROBLEMS WITH THE CURRENT COST REIMBURSEMENT SYSTEM

One of the primary problems with the current system is that the Federal Government cannot readily determine what is included in the administrative costs claimed by States. Furthermore, the cost to accurately determine what the funds are paying for is prohibitive. This would require increased Federal spending for maintaining the necessary monitoring systems and expanding auditing activities.

Meanwhile, administrative costs vary considerably among States, even among those with similar characteristics. On the face of it, it would seem that some States are being very efficient and others are less efficient. Yet, no one knows for sure what the real cost should be.

In short, the current method for reimbursing States for welfare administrative costs is unwieldy and unpredictable, both for the Federal Government and for the States. We believe that the current system should be replaced with one that would provide adequate funding to States, along with incentives for efficient operations and decreased oversight and monitoring on the part of the Federal Government.

We present five of many possible options for funding administrative costs. Under most of these options the States could realize greater flexibility in using their funds and perhaps increase efficiency in their operations. Under some options States would receive more equitable funding than under the current system. In addition, Federal cost allocation and monitoring processes could be simplified and significant savings achieved.

The remainder of this report is divided into three sections. The first section examines several of the main issues inherent in the current administrative cost system. The second section presents five options for funding administrative costs for these three programs. The options are evaluated according to several criteria. The last section provides some final observations about the five options.

Unexplained Disparity Among States

Significant differences exist among States in their unit cost (i.e., cost per recipient) for administering the three programs. Table 1 lists the States alphabetically and shows the FYs 1989-1993 average combined cost per recipient along with each State's average ranking for the same period. On average, New Jersey and Oregon have been among the highest cost States during our 5 year analysis period, with an average cost per person of $251 and $232, respectively. This is a significant contrast to States like Texas and Illinois which operated at $107 and $124 per person, respectively.

A multitude of anecdotal explanations have been offered as to why such disparities exist: cost-of-living differences, complexity of caseloads, stringency of eligibility requirements, schedule of automated systems development, differences in the delivery of program services, and cost allocation methodologies. In addition, some States may be operating

>>>TABLE 1<<<

AVERAGE STATE ADMINISTRATIVE COST PER RECIPIENT (CPR) AND AVERAGE RANKING
FY 1989 - FY 1993

	Combined Average CPR	Average Rank
Alabama	$100.14	48
Alaska	323.39	1
Arizona	213.36	9
Arkansas	111.66	43
California	163.84	25
Colorado	142.69	32
Connecticut	194.93	15
Delaware	222.04	7
Dist. of Col.	285.70	2
Florida	124.30	38
Georgia	144.97	31
Guam	237.54	5
Hawaii	169.79	22
Idaho	209.23	10
Illinois	123.54	39
Indiana	111.22	44
Iowa	121.81	40
Kansas	135.79	34
Kentucky	100.57	47
Louisiana	74.45	51
Maine	135.19	35
Maryland	186.18	19
Massachusetts	166.32	24
Michigan	151.68	29
Minnesota	215.23	8
Mississippi	65.58	52
Missouri	97.15	49
Montana	190.04	17
Nebraska	152.97	28
Nevada	188.56	18
New Hampshire	206.47	11
New Jersey	250.79	3
New Mexico	113.70	42
New York	247.55	4
North Carolina	130.10	37
North Dakota	180.33	21
Ohio	104.77	46
Oklahoma	198.24	14
Oregon	231.82	6
Pennsylvania	154.65	27
Puerto Rico	19.65	54
Rhode Island	114.10	41
South Carolina	141.16	33
South Dakota	131.30	36
Tennessee	91.25	50
Texas	106.87	45
Utah	198.67	13
Vermont	205.61	12
Virgin Islands	168.85	23
Virginia	160.06	26
Washington	181.87	20
West Virginia	62.26	53
Wisconsin	148.96	30
Wyoming	193.14	16
AVERAGE	$159.30	

NOTE: Federal Share Only

much more efficiently than others. Thus, some variation between States should be expected due to the many differences between States. However, there is no consensus on how much variation should exist or the extent to which each of these factors influences variation.

Burden of Accountability and Oversight

In order to accept the contention that increased program responsibilities are leading to increased administrative costs, there must be data that will assure that the cost increases are justified. But verification through audits and other monitoring activities is extremely costly. In fact, our Office of Audit Services points out that efforts to verify State administrative costs may not be feasible. They emphasize that, "The auditing of costs ... require an enormous amount of resources, is very difficult, time consuming and labor intensive with little relative payoff. Even after unallowable costs are identified a reasonable estimate or extraordinary costing effort has to be made as to the dollar impact on all Federal programs at the State."[6]

In addition to verifying State plans, the current lack of accountability is itself a problem. Because of limited staff resources and significant time constraints, HHS is not able to make detailed reviews of all the plans. Instead, HHS must rely on State audits. There is concern about whether these cost allocation plans are adequately screened for unallowable costs being improperly charged to Federal programs.

Questions about Costs and Workload

Total administrative costs have risen significantly over the past 5 years, however, each of the three programs has grown at different rates. Between FY 1989-1993, total administrative costs increased 37 percent overall. This is roughly 18 percent above the growth due to inflation. During this period, administrative costs in the Medicaid program increased by 39 percent after inflation and the Food Stamp program grew by 13 percent. The AFDC administrative costs actually decreased by 4 percent after taking inflation into account (See Appendix A, Table 1).

The number of recipients increased much more rapidly than usual during this time period. In the AFDC program, the number of recipients increased by 29 percent, the Medicaid programs by 42 percent and the Food Stamp program by 44 percent (See Appendix A, Table 2).

One obvious conclusion from this data might be that the growth in the number of recipients increased administrative activities in States, thus resulting in increased administrative costs. In fact, the cost of administering these programs has actually decreased as measured by the unit cost (cost per recipient). For example in FY 1989, the AFDC cost per recipient was $145 per recipient; in FY 1993 that cost had decreased to $107 per recipient. The Medicaid and Food Stamp programs also experienced similar decreases (See Appendix A, Table 3).

A more detailed analysis of the data show this to be an incomplete interpretation. It is important to note that the data yield different results depending on what years are chosen for analysis. Had we begun our analysis in FY 1987 instead of FY 1989, we would see that costs per recipient increased rapidly and peaked in 1989 then began to decrease to more typically historic levels in the Medicaid and Food Stamp programs (cost data was not available for the AFDC program, 1982-1986). In addition, there have been dramatic fluctuations in the rate of growth of recipients within the last 5 years. Growth rates range from 14.4 percent to 5.9 percent.

Furthermore, a State-by-State analysis of the linkage between costs and workload on an annual basis demonstrates a disconnect between the amount of money being spent and the number of recipients. During some years, both the number of recipients and administrative costs increase together, however, they increase at varying rates. In other years administrative costs increase and recipients decrease, and there are other instances where recipients increase and administrative costs go down.

The following two States are typical examples of the disconnect between administrative cost and recipient increases. In New Jersey for example, annual changes in administrative costs between 1989 and 1993 were: 13.5 percent, -5.6 percent, 19.8 percent, 7.8 percent and -3.0 percent respectively. In comparison, the annual changes in the estimated unduplicated count of recipients were: -1.6 percent, 6.2 percent, 10.6 percent, 11.0 percent and 8.4 percent, respectively. Similarly, in Utah, the increase in administrative costs were: 9.8 percent, -5.7 percent, 19.5 percent, 21.2 percent and 2.3 percent. Correspondingly, increases in the number of recipients were: 5.9 percent, 8.6 percent, 13.7 percent, 8.6 percent, and 6.7 percent.

These are not isolated examples. We calculated correlation coefficients to determine whether the annual changes in administrative costs are related to the changes in the number of recipients for each State and territory. The correlation coefficients fail to show any significant correlation between these two factors (see Appendix A, Table 4). These results cause us to further question the nature and magnitude of the relationship between administrative costs and recipients.

Thus, there must be factors other than number of recipients that are influencing the increased administrative costs. We believe that this disconnect is another indication of the unpredictable and somewhat unknown nature of the current administrative cost system.

Projected Administrative Costs FY 1995 - FY 1999

It is extremely difficult to estimate future costs. So much depends on underlying assumptions and on future events which are inherently unpredictable.

As noted in the previous section, we were unable to correlate programmatic factors such as workload with administrative costs. We believe that historical cost patterns are the best predictors of future spending. Therefore, to estimate the level of administrative costs under the current system to FY 1999, we took each State's administrative cost in FY 1993 as the baseline amount. We then increased that baseline amount by the State's average annual rate of growth in administrative costs from FYs 1989-1993 (see Table 2).

For example, Alabama's administrative costs grew an average of 7.4 percent annually from FY 1989-FY 1993. Therefore, to project Alabama's administrative costs, we increased the FY 1993 amount by 7.4 percent each year until FY 1999.

On average, administrative costs increased by about 8.7 percent for all States annually. We project that the total Federal share of administrative costs will be $9.5 billion in FY 1999 (this figure is adjusted for savings achieved by the reduction in special match rates for the AFDC and Food Stamp programs) if the current system remains unchanged. This would be a 64.9 percent increase over the FY 1993 amount of $5.7 billion.

Other factors, such as workload and inflation, will affect actual State expenditures in ways that we cannot easily foretell. As a result, actual expenditures under current law and savings under the various options we describe could be more or less than we project.

We continue to be concerned that an open-ended cost reimbursement system, especially one with poorly defined cost elements, does not provide sufficient incentives for an efficient and effective administrative cost system for public assistance programs. In addition, we believe that with renewed focus on major changes in the current welfare system, there will be increased pressure on administrative costs to expand.

>>> TABLE 2 <<<

ADMINISTRATIVE COST PROJECTION
($ in thousands)

	FY89-93 Avg Inc	1995	1996	1997	1998	1999
	------	-----	-----	-----	-----	-----
Alabama	7.4%	$71,078	$76,329	$81,968	$88,024	$94,527
Alaska	14.1%	31,456	35,884	40,934	46,695	53,267
Arizona	16.2%	125,179	145,485	169,087	196,517	228,396
Arkansas	8.3%	48,968	53,011	57,388	62,126	67,256
California	11.1%	1,135,574	1,261,276	1,400,891	1,555,961	1,728,197
Colorado	5.7%	49,817	52,660	55,666	58,843	62,202
Connecticut	3.6%	67,241	69,637	72,118	74,688	77,350
Delaware	14.5%	20,929	23,972	27,458	31,451	36,024
Dist. of Col.	5.7%	41,035	43,354	45,805	48,394	51,129
Florida	10.2%	250,760	276,249	304,330	335,265	369,345
Georgia	8.0%	161,838	174,742	188,676	203,720	219,963
Hawaii	4.4%	24,798	25,895	27,040	28,236	29,484
Idaho	12.2%	26,473	29,696	33,312	37,368	41,918
Illinois	7.1%	258,668	276,958	296,540	317,508	339,957
Indiana	9.2%	84,405	92,184	100,680	109,959	120,094
Iowa	5.3%	43,992	46,329	48,791	51,383	54,113
Kansas	7.6%	44,646	48,050	51,713	55,656	59,900
Kentucky	9.1%	96,062	104,849	114,441	124,911	136,338
Louisiana	9.1%	95,074	103,757	113,232	123,573	134,858
Maine	7.2%	29,204	31,303	33,554	35,966	38,551
Maryland	12.0%	141,346	158,309	177,308	198,586	222,418
Massachusetts	-0.4%	122,600	122,072	121,546	121,023	120,501
Michigan	6.6%	287,273	306,271	326,525	348,119	371,141
Minnesota	13.1%	151,146	170,874	193,177	218,391	246,895
Mississippi	5.2%	47,117	49,559	52,128	54,829	57,671
Missouri	8.1%	87,991	95,119	102,825	111,155	120,160
Montana	8.8%	20,695	22,525	24,517	26,684	29,044
Nebraska	7.7%	30,617	32,976	35,516	38,253	41,200
Nevada	15.2%	25,755	29,660	34,158	39,337	45,302
New Hampshire	8.3%	18,342	19,863	21,510	23,294	25,226
New Jersey	6.5%	228,234	243,065	258,859	275,681	293,595
New Mexico	5.9%	34,367	36,377	38,506	40,759	43,143
New York	4.3%	802,607	836,891	872,639	909,915	948,782
North Carolina	9.1%	135,230	147,498	160,878	175,473	191,391
North Dakota	4.4%	13,468	14,065	14,688	15,339	16,019
Ohio	11.2%	256,455	285,094	316,931	352,323	391,668
Oklahoma	9.3%	102,953	112,551	123,044	134,515	147,056
Oregon	8.5%	99,285	107,752	116,941	126,913	137,736
Pennsylvania	7.2%	292,963	313,914	336,363	360,417	386,192
Rhode Island	3.9%	19,920	20,703	21,517	22,363	23,242
South Carolina	5.4%	75,643	79,717	84,010	88,534	93,302
South Dakota	8.5%	11,962	12,979	14,083	15,281	16,581
Tennessee	10.1%	111,870	123,207	135,694	149,447	164,593
Texas	11.8%	401,196	448,519	501,424	560,569	626,691
Utah	9.4%	42,989	47,050	51,494	56,358	61,682
Vermont	11.0%	22,496	24,973	27,723	30,776	34,165
Virginia	8.6%	126,428	137,318	149,147	161,994	175,948
Washington	16.1%	192,836	223,921	260,017	301,932	350,603
West Virginia	9.5%	33,917	37,133	40,652	44,506	48,725
Wisconsin	8.3%	99,213	107,482	116,441	126,147	136,661
Wyoming	13.3%	12,595	14,268	16,163	18,309	20,741
Guam	20.9%	4,050	4,898	5,924	7,165	8,665
Puerto Rico	-4.6%	11,469	10,938	10,431	9,948	9,487
Virgin Islands	9.1%	4,309	4,702	5,132	5,600	6,112
TOTAL	8.7%	$6,776,532	$7,373,865	$8,031,535	$8,756,178	$9,555,207
Sp Match Savings		($80,000)	($90,000)	($90,000)	($90,000)	($90,000)
ADJ TOTAL		$6,696,532	$7,283,865	$7,941,535	$8,666,178	$9,465,207

ALTERNATIVE FUNDING OPTIONS

This report is an initial step in assessing the viability of various funding options. We recognize that there are numerous ways of constructing options. Our intention is to present the general concepts behind these options in order to assess the relative merits of each. We fully expect that if one or more of these options is implemented, further refinement and adjustment would be necessary. Regardless of which option is selected for further consideration, it should be evaluated against certain criteria. These criteria are:

1) ***Adequacy:*** Funds should be adequate for the effective and efficient administration of these programs.

2) ***Flexibility and Administrative Relief:*** The States and the Federal Government should have greater flexibility in using their administrative funds, and reduce the administrative burden by cutting back on the need for data collection and intensive monitoring.

3) ***Costs:*** The rate of growth of administrative costs should be controlled.

4) ***Disparity:*** Funding disparity among the States should be reduced.

5) ***Predictability:*** There should be greater predictability in the system as a result of prospective planning and budgeting for administrative costs.

The five options are:

Reduce Medicaid Special Match Rates to 50 Percent. This option would reduce special match rates to 50 percent for the Medicaid program, similar to the reduction that has occurred for the AFDC and Food Stamp programs.

Block Grant. This option would combine the administrative costs of all three programs at a base year level, then provide inflationary increases each succeeding year.

Standard Cost Per Recipient. This option would fund each State for administrative costs based on a standard per recipient allocation amount.

Cost Per Recipient Cap. This option imposes a cap on the Federal reimbursement of the cost per recipient. States would be reimbursed for their full recipient cost up to a set, predetermined percentage above the national median cost per recipient.

Flat Percentage. States would be reimbursed for their administrative costs on the basis of their ratio of administrative cost to total program cost.

Our purpose in presenting these options is to illustrate the various methods that could be used to distribute Federal funds to the States and to estimate the potential financial impact of each approach. We caution that the level of estimated savings are a direct result of the assumptions made under each option. To underscore this point we demonstrate the sensitivity of the options by testing how various assumptions under Option 3 would affect the results (see Option 3). Policy makers wishing to either increase or decrease grants to States for administrative costs could use these methodologies. The important goal in our mind is to control the amount spent, to relate it to programmatic goals, and to eliminate administrative costs and burdens in dispensing the Federal funds.

In the following analysis we describe each of the five options, provide State level examples of the financial impact, and assess the strengths and weaknesses of each option according to the five criteria listed above:

OPTION 1: REDUCE MEDICAID SPECIAL MATCH TO 50 PERCENT

Since the development of this option, the special match rates for the AFDC and Food Stamp programs has been reduced to 50 percent. This affects all five options equally by reducing the amount of savings still achievable by about $80 million in FY 1995 and $90 million in each subsequent year.[7] We adjusted for these savings in all our option calculations.

Special matching rates have been provided to States to encourage specific administrative activities. In the AFDC program, for example, the Family Assistance Management Information System was reimbursed at 90 percent, the Systematic Alien Verification for Entitlement at 100 percent, and control of fraud and abuse at 75 percent. The Medicaid program has similar types of special matching provisions. (NOTE: Funding for Medicaid Fraud Control Units matched at 90 percent start-up and 75 percent operating costs is not included in our analysis since by law this program is operated independently of the State agency that administers the Medicaid program.)

One alternative for funding administrative costs is to reduce the special matching rates that exist for some activities in the Medicaid program to 50 percent. For example, the development and operation of management information systems is currently funded anywhere from 75 to 90 percent for Medicaid. Option 1 considers reducing these special matching rates to a uniform 50 percent (see Table 3).

To calculate administrative costs under this option, we first determined the proportion of administrative costs eligible for the special match rates for each State. Then we reduced the Federal reimbursement rate to 50 percent.

Impact

Adequacy: There would be impact on a portion of Medicaid administrative costs. Costs reimbursed at the special matching rates accounted for 27.9 percent of all Medicaid administrative funds in FY 1993; 72.1 percent would remain unaffected. Of the three programs, Medicaid administrative costs would be affected more than the other two programs since it has the largest proportion of special matching rates.

The impact on special matching rate activities is unclear. Special match rates were provided to encourage States to initiate cost saving activities. Since many of these cost saving activities (e.g. development of MIS systems) are largely in place, these special rates may no longer be necessary. However, eliminating the special match rates may reduce State investment in cost saving activities.

Flexibility and Administrative Relief: This option would have virtually no impact on Federal and State administrative burdens. The cost allocation system would remain the same except that all administrative costs would be reimbursed at 50 percent. States would gain no additional flexibility since reimbursement and reporting requirements would not change.

Costs: Based on historical data through FY 1993, we project this option would reduce the Federal share of administrative costs by approximately $2.3 billion from FYs 1995-1999. The savings could increase or decrease depending on the total amount which States choose to spend in categories affected by the higher rates.

Disparity: The funding gap among States would not be affected for the majority of administrative costs. States funding levels would decrease proportionate to the amount spent on activities matched at the higher rates.

Predictability: This option would not introduce any additional predictability into the cost allocation system since it would remain essentially unchanged.

>>> Table 3 <<<

REDUCE MEDICAID SPECIAL MATCH RATES
($ in millions)

	FY 1995	FY 1996	FY 1997	FY 1998	FY 1999
Total Medicaid Administrative Costs (Projected)	$3,502	$4,022	$4,632	$5,350	$6,200
Amount Provided at Special Match Rates	$ 977	$1,122	$1,292	$1,493	$1,730
Special Match Rates Reduced to 50 Percent	$ 644	$ 739	$ 851	$ 983	$1,139
Savings	$ 333	$ 383	$ 441	$ 510	$ 591

OPTION 2: BLOCK GRANT

Under Option 2, the Federal Government would provide a block grant to each State to cover administrative expenses for all three programs. For illustrative purposes, we used an approach that combines the administrative costs for the three programs at their FY 1993 levels, then provides an allowance for inflation in subsequent years (see Table 4).

To calculate the Federal share of administrative expenditures under a block grant approach, we combined administrative costs at the FY 1993 levels. Then we increased the block grant for inflation. We adjusted for savings already realized by the AFDC and Food Stamp programs by the reduction in special matching rates by subtracting the estimated savings amount from total administrative costs.

<u>**Impact**</u>

Adequacy: The block grant option does not reduce the baseline amount that States are currently receiving. It holds the rate of increase to the rate of inflation. Policy and program officials should select the base year and growth rate that will ensure adequate funding for States. This approach might need some mechanism to occasionally adjust funding for overall program changes. For example, if States generally experience a significant increase in recipients, the block grant might be increased to cover larger administrative costs. Even with such an overall adjustment, the block grant approach does not automatically adjust funding levels to States based on State specific cost

>>> TABLE 4 <<<

BLOCK GRANT
($ in thousands)

	FY95 Adm	FY96 Adm	FY97 Adm	FY98 Adm	FY99 Adm
Alabama	$65,325	$67,480	$69,707	$72,077	$74,528
Alaska	25,595	26,389	27,260	28,159	29,117
Arizona	98,125	101,167	104,506	107,954	111,625
Arkansas	44,241	45,613	47,118	48,673	50,328
California	974,669	1,004,884	1,038,045	1,072,300	1,108,759
Colorado	47,205	48,669	50,275	51,934	53,700
Connecticut	66,382	68,440	70,698	73,031	75,515
Delaware	16,891	17,414	17,989	18,583	19,214
Dist. of Col.	38,924	40,131	41,455	42,823	44,279
Florida	218,776	225,559	233,002	240,691	248,875
Georgia	146,986	151,543	156,544	161,710	167,208
Hawaii	24,081	24,827	25,647	26,493	27,394
Idaho	22,276	22,967	23,725	24,508	25,341
Illinois	238,909	246,315	254,444	262,840	271,777
Indiana	74,924	77,247	79,796	82,429	85,232
Iowa	42,000	43,301	44,730	46,207	47,778
Kansas	40,812	42,077	43,466	44,900	46,427
Kentucky	85,378	88,025	90,930	93,930	97,124
Louisiana	84,525	87,146	90,021	92,992	96,154
Maine	26,914	27,748	28,664	29,610	30,616
Maryland	119,309	123,007	127,066	131,260	135,722
Massachusetts	130,940	134,999	139,454	144,056	148,954
Michigan	267,611	275,907	285,012	294,417	304,427
Minnesota	125,219	129,100	133,361	137,761	142,445
Mississippi	45,094	46,492	48,026	49,611	51,298
Missouri	79,728	82,199	84,912	87,714	90,696
Montana	18,497	19,071	19,700	20,350	21,042
Nebraska	27,946	28,813	29,764	30,746	31,791
Nevada	20,562	21,199	21,899	22,622	23,391
New Hampshire	16,561	17,074	17,638	18,220	18,839
New Jersey	213,071	219,677	226,926	234,415	242,385
New Mexico	32,477	33,484	34,589	35,730	36,945
New York	781,631	805,861	832,455	859,926	889,163
North Carolina	120,360	124,091	128,186	132,416	136,918
North Dakota	13,076	13,481	13,926	14,386	14,875
Ohio	219,729	226,541	234,017	241,739	249,958
Oklahoma	91,211	94,039	97,142	100,347	103,759
Oregon	89,255	92,022	95,058	98,195	101,534
Pennsylvania	270,177	278,553	287,745	297,241	307,347
Rhode Island	19,527	20,132	20,797	21,483	22,213
South Carolina	72,117	74,352	76,806	79,340	82,038
South Dakota	10,758	11,091	11,457	11,835	12,238
Tennessee	97,655	100,682	104,004	107,437	111,089
Texas	339,890	350,427	361,991	373,936	386,650
Utah	38,001	39,179	40,472	41,807	43,229
Vermont	19,328	19,927	20,585	21,264	21,987
Virginia	113,476	116,993	120,854	124,842	129,087
Washington	151,427	156,122	161,274	166,596	172,260
West Virginia	29,963	30,892	31,911	32,964	34,085
Wisconsin	89,507	92,282	95,327	98,473	101,821
Wyoming	10,392	10,715	11,068	11,433	11,822
Guam	2,932	3,023	3,123	3,226	3,335
Puerto Rico	13,352	13,766	14,220	14,690	15,189
Virgin Islands	3,830	3,949	4,079	4,214	4,357
TOTAL	$6,077,547	$6,266,081	$6,472,862	$6,686,536	$6,913,878
Sp Match Saving	($80,000)	($90,000)	($90,000)	($90,000)	($90,000)
ADJ TOTAL	$5,997,547	$6,176,081	$6,382,862	$6,596,536	$6,823,878

problems. For example if one State experienced a significant cost increase for ADP equipment its share of the block grant would not increase automatically.

Flexibility and Administrative Relief: States' administrative burden would be significantly reduced. States would have less reporting requirements to the Federal Government since they would have the responsibility for, and control the use of, funds for administrative activities. This, in turn, would reduce the cost and administrative burden of oversight and monitoring by the Federal Government.

Costs: Based on historical data through FY 1993 and using FY 1993 as the base year for calculating inflationary adjustments, we project Federal savings of $8.1 billion by FY 1999. This alternative produces the greatest savings of all the options. Savings are generated by reducing the rate of growth in administrative costs to the level of inflation. This is significantly lower than the estimated 9 percent annual rate of increase under the current system (see Table 2). As noted earlier, this estimate of savings is very sensitive to assumptions regarding inflation and State fiscal policies, both of which are difficult to predict. They are also sensitive to the discretionary features of the block grant mechanism itself. For example, savings could be greatly decreased or increased by choosing a higher or lower base amount for the start-up year. Or, some factor other than inflation could be used to annually increase the appropriation. In fact, those factors could be used to increase the amount available to States for administrative costs. The key here is that the block grant mechanism allows policy makers to decide how much they want to spend for administration and to efficiently distribute the funds to the States.

Disparity: This option does not address any funding disparities that may currently exist among the States since it freezes their administrative funding at the FY 1993 level. Some low cost States may be operating programs below desired staffing levels because of current budget constraints, but plan to hire more staff to better administer their programs. Alternatively, this approach does nothing to limit Federal reimbursement to States that may be operating excessively costly programs, in essence, rewarding them by locking in higher levels of funding.

Predictability: A block grant option would greatly enhance predictability since the annual increase would grow at the rate of inflation.

OPTION 3: STANDARD COST PER RECIPIENT

Option 3 funds each State's administrative costs on the basis of a standardized cost per recipient (CPR). Though there are numerous ways to calculate a standard cost per recipient, ours is based on the average cost per recipient for FY 1989-FY 1993 (see Table 5).

Specifically, we calculated the overall State average of the cost per recipient for each year from FYs 1989-1993. This average cost per recipient served as the standard cost per recipient for the baseline year of FY 1993. It was increased by inflation in subsequent years. It was also adjusted to compensate for differences in labor costs

>>> TABLE 5 <<<

STANDARDIZED COST PER RECIPIENT

	1995			1996			1997			1998			1999		
	Ver 1	Ver 2	Ver 3	Ver 1	Ver 2	Ver 3	Ver 1	Ver 2	Ver 3	Ver 1	Ver 2	Ver 3	Ver 1	Ver 2	Ver 3
Standard Cost Per Recipient	$168.35	$168.35	$168.35	$173.73	$173.73	$173.73	$179.29	$179.29	$179.29	$185.03	$185.03	$185.03	$190.95	$190.95	$190.95
Recipients (in millions)	46.3	42.7	39.5	50.3	44.5	39.5	54.8	46.3	39.5	59.9	48.3	39.5	65.7	50.5	39.5
Estimated Savings ($ in millions)	($943)	($339)	$171	($1,269)	($259)	$557	($1,671)	($166)	$996	($2,166)	($56)	$1,496	($2,779)	$72	$2,063

NOTES:
Version 1 uses estimates of recipients based on the increase over the past 5 years
Version 2 uses estimates of recipients based on the increase over the past 11 years.
Version 3 holds the number of recipients constant at the FY 1993 level.

between states. We used the Bureau of Labor Statistic's listing of State wage levels for government employees to adjust the standard cost per recipient for these differences.

Our cost per recipient figure uses an estimated, unduplicated count of the number of recipients for all three programs. Unfortunately, none of the three agencies currently collects unduplicated recipient information. Therefore we estimated it using information from the Survey of Income and Program Participation, which is administered by the Bureau of the Census.[8] If adopted, this option would require that States report their unduplicated count of recipients. As a result, current data systems may need to be improved. However, other per recipient approaches may not require an unduplicated count.

To illustrate the sensitivity of these calculations, we varied our method for projecting future numbers of recipients. As shown on Table 5, we calculated three different recipient projections; one was based on the historical increase over the past 5 years, another was based on the historical increase from the past 11 years, and the third holds recipients constant at the 1993 level. The cost per recipient remained constant in each version of this option.

We adjusted for savings already realized by the AFDC and Food Stamp programs by the reduction in special matching rates by subtracting the estimated savings amount from total administrative costs.

Impact

Adequacy: States that have a cost per recipient level higher than the standard amount will experience a reduction in Federal funding compared to their current baseline amount. This could be a real disadvantage if their current higher funding is the result of unique cost problems not experienced by other States who spend less per recipient. Though we used a historical baseline, policy makers could select a standard amount and growth rates based on many different factors to ensure adequate funding for States. One advantage is that policy makers can be very explicit about the types of activities they are including in the rate and the level of funding that will be provided for these activities. In addition, a standard rate may generate incentives for greater efficiency among the States.

Flexibility and Administrative Relief: Like the block grant option, a standard cost per recipient approach gives States the responsibility for, and control of, their administrative funds. A standard cost per recipient approach would relieve much of the administrative burden on States since they would no longer have to maintain their cost allocation processes for these three programs. This approach has an advantage over the block grant (Option 2) since it automatically adjusts according to the number of recipients.

Costs: Based on the number of recipients, this options would either cost or save Federal funds. The three versions of this option produced dramatically different results in terms of estimated savings. Version 1 uses recipient estimates based on the recipient increase over the past 5 years, it results in an increased cost to the Federal Government of $8.8

billion between FY 1995 and FY 1999. Version 2 uses recipient estimates based on the recipient increase over the past 11 years, it results in an increased cost to the Federal Government of $748 million between FY 1995 and FY 1999. Version 3 holds the number of recipients constant at the FY 1993 level and results in a savings to the Federal Government of $5.1 billion between FY 1995 and FY 1999. It is clear from these figures that it is critical to consider the sensitivity of the data to the underlying assumptions when assessing each of the options.

Disparity: This option directly addresses the funding disparity among States because all States receive the same amount of funding per recipient. For example, the actual cost for New Jersey in FY 1993 was $227 per recipient, versus $99 for Florida. Under a standard cost per recipient approach, New Jersey and Florida would receive the same, standard per recipient amount with adjustments for differences in labor costs.

Predictability: Like the block grant option, this approach would greatly enhance the ability to plan and budget for administrative costs prospectively.

OPTION 4: CAP

Option 4 imposes a cap on the Federal reimbursement of the cost per recipient. Each year, States would be reimbursed up to a percentage above the median cost per recipient for all States (see Tables 6 and 7).

Based on our analysis of administrative growth under the current system, we first determined the annual cost per recipient for each State. Then we determined the annual median cost per recipient to calculate the cap amount. Next, the cap was applied to individual State costs per recipient. To illustrate the impact that different cap levels might have on States, we considered two cap levels: 150 percent of the national median, and 125 percent of the national median. Under this approach, States that have administrative costs in excess of the cap would receive only the cap amount. States that have a cost per recipient below the cap would receive their actual cost.

We adjusted for savings already realized by the AFDC and Food Stamp programs by the reduction in special matching rates by subtracting the estimated savings amount from total administrative costs.

Impact

Adequacy: This funding approach would impact the highest cost States since their administrative costs would not be fully covered. With a 150 percent cap, we estimate that 7 States would be affected in FY 1999. With a 125 percent cap, 21 States would be affected in FY 1999. The number of States affected by a cap vary in any given year. Compared to the previous option, this one offers more of a compromise between the need to reduce disparity of funding among the States while still allowing for legitimate differences. It allows for some variation but not for extensive differences.

>>> TABLE 6 <<<

150% COST PER RECIPIENT CAP
(CPR in dollars, Adm in thousands)

	1995 CPR	150% CPR CAP	1995 Adm	1996 CPR	150% CPR CAP	1996 Adm	1997 CPR	150% CPR CAP	1997 Adm	1998 CPR	150% CPR CAP	1998 Adm	1999 CPR	150% CPR CAP	1999 Adm
Alabama	95.94	$95.94	$71,078	96.30	$96.30	$76,329	96.66	$96.66	$81,968	97.03	$97.03	$88,024	97.39	$97.39	$94,527
Alaska	323.01	218.25	21,254	326.85	216.04	23,718	330.74	219.98	27,226	334.67	227.45	31,735	338.65	230.54	36,262
Arizona	126.73	126.73	125,179	112.61	112.61	145,485	100.05	100.05	169,087	88.90	88.90	196,517	78.99	78.99	228,396
Arkansas	118.26	118.26	48,968	120.93	120.93	53,011	123.67	123.67	57,388	126.48	126.48	62,126	129.34	129.34	67,256
California	181.67	181.67	1,135,574	187.30	187.30	1,261,276	193.10	193.10	1,400,891	199.08	199.08	1,555,961	205.25	205.25	1,728,197
Colorado	120.78	120.78	49,817	119.05	119.05	52,660	117.33	117.33	55,666	115.64	115.64	58,843	113.98	113.98	62,202
Connecticut	145.50	145.50	67,241	136.03	136.03	69,637	127.18	127.18	72,118	118.90	118.90	74,688	111.16	111.16	77,350
Delaware	201.10	201.10	20,929	204.32	204.32	23,972	207.59	207.59	27,458	210.91	210.91	31,451	214.29	214.29	36,024
Dist. of Col.	251.57	218.25	35,600	250.56	216.04	37,381	249.55	219.98	40,377	248.55	227.45	44,286	247.55	230.54	47,617
Florida	85.41	85.41	250,760	79.35	79.35	276,249	73.72	73.72	304,330	68.49	68.49	335,265	63.62	63.62	369,345
Georgia	113.57	113.57	161,838	109.93	109.93	174,742	106.41	106.41	188,676	103.00	103.00	203,720	99.70	99.70	219,963
Hawaii	157.63	157.63	24,798	156.63	156.63	25,895	155.65	155.65	27,040	154.66	154.66	28,236	153.69	153.69	29,484
Idaho	206.19	206.19	26,473	210.21	210.21	29,696	214.30	214.30	33,312	218.47	218.47	37,368	222.73	222.73	41,918
Illinois	139.33	139.33	258,668	144.00	144.00	276,958	148.84	148.84	296,540	153.83	153.83	317,508	158.99	158.99	339,957
Indiana	101.06	101.06	84,405	99.18	99.18	92,184	97.33	97.33	100,680	95.52	95.52	109,959	93.74	93.74	120,094
Iowa	133.79	133.79	43,992	136.98	136.98	46,329	140.25	140.25	48,791	143.60	143.60	51,383	147.02	147.02	54,113
Kansas	140.07	140.07	44,646	140.08	140.08	48,050	140.10	140.10	51,713	140.11	140.11	55,656	140.12	140.12	59,900
Kentucky	117.89	117.89	96,062	121.61	121.61	104,849	125.44	125.44	114,441	129.39	129.39	124,911	133.47	133.47	136,338
Louisiana	91.43	91.43	95,074	95.38	95.38	103,757	99.49	99.49	113,232	103.79	103.79	123,573	108.27	108.27	134,858
Maine	126.01	126.01	29,204	125.04	125.04	31,303	124.08	124.08	33,554	123.13	123.13	35,966	122.18	122.18	38,551
Maryland	223.12	218.25	138,261	233.14	216.04	146,696	243.61	219.98	160,106	254.56	227.45	177,439	265.99	230.54	192,773
Massachusetts	131.63	131.63	122,600	122.41	122.41	122,072	113.84	113.84	121,546	105.87	105.87	121,023	98.46	98.46	120,501
Michigan	181.08	181.08	287,273	189.42	189.42	306,271	198.15	198.15	326,525	207.28	207.28	348,119	216.84	216.84	371,141
Minnesota	277.05	218.25	119,069	298.33	216.04	123,739	321.26	219.98	132,277	345.94	227.45	143,588	372.52	230.54	152,795
Mississippi	68.90	68.90	47,117	70.27	70.27	49,559	71.66	71.66	52,128	73.09	73.09	54,829	74.54	74.54	57,671
Missouri	96.45	96.45	87,991	96.07	96.07	95,119	95.69	95.69	102,825	95.31	95.31	111,155	94.93	94.93	120,160
Montana	187.44	187.44	20,695	196.85	196.85	22,525	206.74	206.74	24,517	217.12	217.12	26,684	228.02	228.02	29,044
Nebraska	157.44	157.44	30,617	159.90	159.90	32,976	162.40	162.40	35,516	164.94	164.94	38,253	167.52	167.52	41,200
Nevada	157.34	157.34	25,755	151.90	151.90	29,660	146.65	146.65	34,158	141.58	141.58	39,337	136.69	136.69	45,302
New Hampshire	136.29	136.29	18,342	120.47	120.47	19,863	106.49	106.49	21,510	94.13	94.13	23,294	83.20	83.20	25,226
New Jersey	225.04	218.25	221,344	224.13	216.04	234,287	223.23	219.98	255,093	222.33	222.33	275,681	221.43	221.43	293,595
New Mexico	87.19	87.19	34,367	81.49	81.49	36,377	76.16	76.16	38,506	71.18	71.18	40,759	66.52	66.52	43,143
New York	230.81	218.25	758,923	229.85	216.04	786,614	228.89	219.98	838,676	227.93	227.45	907,990	226.98	226.98	948,782
North Carolina	106.49	106.49	135,230	102.34	102.34	147,498	98.35	98.35	160,878	94.52	94.52	175,473	90.83	90.83	191,391
North Dakota	175.02	175.02	13,468	172.23	172.23	14,065	169.49	169.49	14,688	166.80	166.80	15,339	164.15	164.15	16,019
Ohio	127.97	127.97	256,455	136.46	136.46	285,094	145.51	145.51	316,931	155.16	155.16	352,323	165.46	165.46	391,668
Oklahoma	187.54	187.54	102,953	190.56	190.56	112,551	193.64	193.64	123,044	196.77	196.77	134,515	199.94	199.94	147,056
Oregon	219.10	218.25	98,897	219.09	216.04	106,250	219.08	219.08	116,941	219.07	219.07	126,913	219.06	219.06	137,736
Pennsylvania	171.47	171.47	292,963	177.74	177.74	313,914	184.24	184.24	336,363	190.99	190.99	360,417	197.97	197.97	386,192
Rhode Island	85.98	85.98	19,920	79.40	79.40	20,703	73.32	73.32	21,517	67.71	67.71	22,363	62.53	62.53	23,242
South Carolina	117.73	117.73	75,643	113.32	113.32	79,717	109.07	109.07	84,010	104.98	104.98	88,534	101.05	101.05	93,302
South Dakota	139.28	139.28	11,962	143.28	143.28	12,979	147.40	147.40	14,083	151.63	151.63	15,281	155.98	155.98	16,581
Tennessee	85.11	85.11	111,870	84.05	84.05	123,207	82.99	82.99	135,694	81.95	81.95	149,447	80.93	80.93	164,593
Texas	102.72	102.72	401,196	101.41	101.41	448,519	100.13	100.13	501,424	98.85	98.85	560,569	97.59	97.59	626,691
Utah	205.97	205.97	42,989	207.38	207.38	47,050	208.80	208.80	51,494	210.23	210.23	56,358	211.67	211.67	61,682
Vermont	210.62	210.62	22,496	212.90	212.90	24,973	215.20	215.20	27,723	217.52	217.52	30,776	219.87	219.87	34,165
Virginia	149.70	149.70	126,428	147.15	147.15	137,318	144.63	144.63	149,147	142.16	142.16	161,994	139.74	139.74	175,948
Washington	222.30	218.25	189,322	237.37	216.04	203,803	253.45	219.98	225,678	270.63	227.45	253,758	288.97	230.54	279,711
West Virginia	72.39	72.39	33,917	74.84	74.84	37,133	77.38	77.38	40,652	80.00	80.00	44,506	82.72	82.72	48,725
Wisconsin	174.71	174.71	99,213	186.95	186.95	107,482	200.05	200.05	116,441	214.06	214.06	126,147	229.05	229.05	136,661
Wyoming	197.13	197.13	12,595	202.09	202.09	14,268	207.17	207.17	16,163	212.38	212.38	18,309	217.73	217.73	20,741
Guam	397.78	218.25	2,222	466.53	216.04	2,268	547.16	219.98	2,382	641.73	227.45	2,539	752.65	230.54	2,654
Puerto Rico	26.75	26.75	11,469	27.61	27.61	10,938	28.50	28.50	10,431	29.41	29.41	9,948	30.36	30.36	9,487
Virgin Islands	258.81	218.25	3,633	286.13	216.04	3,550	316.34	219.98	3,569	349.74	227.45	3,642	386.66	230.54	3,644
TOTAL	$158.73	$150.47	$6,668,757	$161.40	$150.07	$7,212,524	$164.60	$151.00	$7,857,125	$168.36	$152.55	$8,584,479	$172.75	$153.51	$9,331,573
Special Match Savings			(80,000)			(90,000)			(90,000)			(90,000)			(90,000)
ADJ TOTAL			$6,588,757			$7,122,524			$7,767,125			$8,494,479			$9,241,573

>>> TABLE 7 <<<

125% COST PER RECIPIENT CAP
(CPR in dollars, Adm in thousands)

	1995 CPR	125% CPR CAP	1995 Adm	1996 CPR	125% CPR CAP	1996 Adm	1997 CPR	125% CPR CAP	1997 Adm	1998 CPR	125% CPR CAP	1998 Adm	1999 CPR	125% CPR CAP	1999 Adm
Alabama	95.94	$95.94	$71,078	96.30	$96.30	$76,329	96.66	$96.66	$81,968	97.03	$97.03	$88,024	97.39	$97.39	$94,527
Alaska	323.01	181.88	17,713	326.85	180.00	19,762	330.74	183.31	22,688	334.67	189.54	26,446	338.65	192.11	30,217
Arizona	126.73	126.73	125,179	112.61	112.61	145,485	100.05	100.05	169,087	88.90	88.90	196,517	78.99	78.99	228,396
Arkansas	118.26	118.26	48,968	120.93	120.93	53,011	123.67	123.67	57,388	126.48	126.48	62,126	129.34	129.34	67,256
California	181.67	181.67	1,135,574	187.30	180.00	1,212,143	193.10	183.31	1,329,865	199.08	189.54	1,481,366	205.25	192.11	1,617,526
Colorado	120.78	120.78	49,817	119.05	119.05	52,660	117.33	117.33	55,666	115.64	115.64	58,843	113.98	113.98	62,202
Connecticut	145.50	145.50	67,241	136.03	136.03	69,637	127.18	127.18	72,118	118.90	118.90	74,688	111.16	111.16	77,350
Delaware	201.10	181.88	18,928	204.32	180.00	21,119	207.59	183.31	24,246	210.91	189.54	28,264	214.29	192.11	32,296
Dist. of Col.	251.57	181.88	29,667	250.56	180.00	31,145	249.55	183.31	33,646	248.55	189.54	36,905	247.55	192.11	39,679
Florida	85.41	85.41	250,760	79.35	79.35	276,249	73.72	73.72	304,330	68.49	68.49	335,265	63.62	63.62	369,345
Georgia	113.57	113.57	161,838	109.93	109.93	174,742	106.41	106.41	188,676	103.00	103.00	203,720	99.70	99.70	219,963
Hawaii	157.63	157.63	24,798	156.63	156.63	25,895	155.65	155.65	27,040	154.66	154.66	28,236	153.69	153.69	29,484
Idaho	206.19	181.88	23,352	210.21	180.00	25,429	214.30	183.31	28,495	218.47	189.54	32,419	222.73	192.11	36,156
Illinois	139.33	139.33	258,668	144.00	144.00	276,958	148.84	148.84	296,540	153.83	153.83	317,508	158.99	158.99	339,957
Indiana	101.06	101.06	84,405	99.18	99.18	92,184	97.33	97.33	100,680	95.52	95.52	109,959	93.74	93.74	120,094
Iowa	133.79	133.79	43,992	136.98	136.98	46,329	140.25	140.25	48,791	143.60	143.60	51,383	147.02	147.02	54,113
Kansas	140.07	140.07	44,646	140.08	140.08	48,050	140.10	140.10	51,713	140.11	140.11	55,656	140.12	140.12	59,900
Kentucky	117.89	117.89	96,062	121.61	121.61	104,849	125.44	125.44	114,441	129.39	129.39	124,911	133.47	133.47	136,338
Louisiana	91.43	91.43	95,074	95.38	95.38	103,757	99.49	99.49	113,232	103.79	103.79	123,573	108.27	108.27	134,858
Maine	126.01	126.01	29,204	125.04	125.04	31,303	124.08	124.08	33,554	123.13	123.13	35,966	122.18	122.18	38,551
Maryland	223.12	181.88	115,221	233.14	180.00	122,224	243.61	183.31	133,417	254.56	189.54	147,864	265.99	192.11	160,639
Massachusetts	131.63	131.63	122,600	122.41	122.41	122,072	113.84	113.84	121,546	105.87	105.87	121,023	98.46	98.46	120,501
Michigan	181.08	181.08	287,273	189.42	180.00	291,037	198.15	183.31	302,069	207.28	189.54	318,321	216.84	192.11	328,821
Minnesota	277.05	181.88	99,227	298.33	180.00	103,097	321.26	183.31	110,227	345.94	189.54	119,656	372.52	192.11	127,324
Mississippi	68.90	68.90	47,117	70.27	70.27	49,559	71.66	71.66	52,128	73.09	73.09	54,829	74.54	74.54	57,671
Missouri	96.45	96.45	87,991	96.07	96.07	95,119	95.69	95.69	102,825	95.31	95.31	111,155	94.93	94.93	120,160
Montana	187.44	181.88	20,082	196.85	180.00	20,597	206.74	183.31	21,738	217.12	189.54	23,295	228.02	192.11	24,469
Nebraska	157.44	157.44	30,617	159.90	159.90	32,976	162.40	162.40	35,516	164.94	164.94	38,253	167.52	167.52	41,200
Nevada	157.34	157.34	25,755	151.90	151.90	29,660	146.65	146.65	34,158	141.58	141.58	39,337	136.69	136.69	45,302
New Hampshire	136.29	136.29	18,342	120.47	120.47	19,863	106.49	106.49	21,510	94.13	94.13	23,294	83.20	83.20	25,226
New Jersey	225.04	181.88	184,459	224.13	180.00	195,203	223.23	183.31	212,570	222.33	189.54	235,026	221.43	192.11	254,722
New Mexico	87.19	87.19	34,367	81.49	81.49	36,377	76.16	76.16	38,506	71.18	71.18	40,759	66.52	66.52	43,143
New York	230.81	181.88	632,453	229.85	180.00	655,390	228.89	183.31	698,872	227.93	189.54	756,652	226.98	192.11	803,025
North Carolina	106.49	106.49	135,230	102.34	102.34	147,498	98.35	98.35	160,878	94.52	94.52	175,473	90.83	90.83	191,391
North Dakota	175.02	175.02	13,468	172.23	172.23	14,065	169.49	169.49	14,688	166.80	166.80	15,339	164.15	164.15	16,019
Ohio	127.97	127.97	256,455	136.46	136.46	285,094	145.51	145.51	316,931	155.16	155.16	352,323	165.46	165.46	391,668
Oklahoma	187.54	181.88	99,848	190.56	180.00	106,312	193.64	183.31	116,480	196.77	189.54	129,576	199.94	192.11	141,296
Oregon	219.10	181.88	82,417	219.09	180.00	88,526	219.08	183.31	97,847	219.07	189.54	109,807	219.06	192.11	120,793
Pennsylvania	171.47	171.47	292,963	177.74	177.74	313,914	184.24	183.31	334,657	190.99	189.54	357,689	197.97	192.11	374,754
Rhode Island	85.98	85.98	19,920	79.40	79.40	20,703	73.32	73.32	21,517	67.71	67.71	22,363	62.53	62.53	23,242
South Carolina	117.73	117.73	75,643	113.32	113.32	79,717	109.07	109.07	84,010	104.98	104.98	88,534	101.05	101.05	93,302
South Dakota	139.28	139.28	11,962	143.28	143.28	12,979	147.40	147.40	14,083	151.63	151.63	15,281	155.98	155.98	16,581
Tennessee	85.11	85.11	111,870	84.05	84.05	123,207	82.99	82.99	135,694	81.95	81.95	149,447	80.93	80.93	164,593
Texas	102.72	102.72	401,196	101.41	101.41	448,519	100.13	100.13	501,424	98.85	98.85	560,569	97.59	97.59	626,691
Utah	205.97	181.88	37,961	207.38	180.00	40,838	208.80	183.31	45,208	210.23	189.54	50,813	211.67	192.11	55,983
Vermont	210.62	181.88	19,426	212.90	180.00	21,114	215.20	183.31	23,615	217.52	189.54	26,817	219.87	192.11	29,852
Virginia	149.70	149.70	126,428	147.15	147.15	137,318	144.63	144.63	149,147	142.16	142.16	161,994	139.74	139.74	175,948
Washington	222.30	181.88	157,773	237.37	180.00	169,805	253.45	183.31	188,058	270.63	189.54	211,463	288.97	192.11	233,084
West Virginia	72.39	72.39	33,917	74.84	74.84	37,133	77.38	77.38	40,652	80.00	80.00	44,506	82.72	82.72	48,725
Wisconsin	174.71	174.71	99,213	186.95	180.00	103,486	200.05	183.31	106,699	214.06	189.54	111,697	229.05	192.11	114,619
Wyoming	197.13	181.88	11,621	202.09	180.00	12,708	207.17	183.31	14,301	212.38	189.54	16,340	217.73	192.11	18,301
Guam	397.78	181.88	1,852	466.53	180.00	1,890	547.16	183.31	1,985	641.73	189.54	2,116	752.65	192.11	2,212
Puerto Rico	26.75	26.75	11,469	27.61	27.61	10,938	28.50	28.50	10,431	29.41	29.41	9,948	30.36	30.36	9,487
Virgin Islands	258.81	181.88	3,028	286.13	180.00	2,958	316.34	183.31	2,974	349.74	189.54	3,035	386.66	192.11	3,037
TOTAL	$158.73	$141.46	$6,386,125	$161.40	$139.92	$6,838,934	$164.60	$140.28	$7,420,527	$168.36	$141.89	$8,116,367	$172.75	$142.21	$8,791,989
Special Match Savings			(80,000)			(90,000)			(90,000)			(90,000)			(90,000)
ADJ TOTAL			$6,306,125			$6,748,934			$7,330,527			$8,026,367			$8,701,989

Flexibility and Administrative Relief: Unlike the other options, this alternative would not reduce the administrative burden currently experienced by States and the Federal Government. Though they would not have to allocate costs between the AFDC, Food Stamp and Medicaid programs, States would continue to meet current reporting requirements.

Costs: Based on historical data through FY 1993, we project that a cap on reimbursement at 150 percent of the national median would reduce the Federal share of administrative funding by $839 million from FYs 1995-1999. Using the 125 percent cap, the Federal share of administrative funding would be reduced by $2.9 billion from FYs 1995-1999. A cap approach only controls the growth at the margin based on those States that exceed the cap. As States continue to report increases in administrative costs, the national median and therefore, the Federal cap would increase correspondingly.

Disparity: This option would reduce some of the funding disparity that exists between States. States with the highest cost would see their cost per recipient levels reduced, closing the funding gap somewhat.

Predictability: This option would not improve predictability in the system. The system would still be dependent on the cost allocation plans submitted by the States.

OPTION 5: FLAT PERCENT

The final option reimburses each State on the basis of its ratio of administrative cost to total program cost (see Table 8).

Specifically, we calculated the FY 1993 ratio of administrative cost to total program cost for each State. We then applied that ratio (or percentage) to an estimated benefit payment in subsequent years. (AFDC, Medicaid and Food Stamp benefit payments combined increased by 17.8 percent annually.) For example, Alabama's ratio of administrative cost to total program cost is 3.6 percent in FY 1993. The estimated total benefit payment for Alabama is $2.5 billion in FY 1995. To calculate Alabama's FY 1995 Federal share of administrative costs, we applied the 3.6 percent to benefit payments. This resulted in an expenditure of $91.6 million in administrative costs for the Federal Government to Alabama.

We adjusted for savings already realized by the AFDC and Food Stamp programs by the reduction in special matching rates by subtracting the estimated savings amount from total administrative costs.

>>> TABLE 8 <<<

FLAT PERCENTAGE
($ in thousands)

	FY 1993 Adm/Tot	FY 1994 Adm	FY 1995 Adm	FY 1996 Adm	FY 1997 Adm	FY 1998 Adm	FY 1999 Adm
Alabama	3.6%	$75,141	$91,608	$111,683	$136,157	$165,994	$202,370
Alaska	9.3%	28,796	34,303	40,863	48,678	57,988	69,078
Arizona	6.2%	125,910	171,069	232,425	315,787	429,047	582,929
Arkansas	4.1%	48,626	56,591	65,859	76,646	89,200	103,809
California	7.7%	1,074,635	1,254,571	1,464,635	1,709,872	1,996,171	2,330,408
Colorado	4.4%	53,339	63,815	76,349	91,345	109,287	130,753
Connecticut	4.4%	75,250	90,322	108,412	130,126	156,189	187,472
Delaware	8.2%	19,009	22,651	26,991	32,162	38,325	45,668
Dist. of Col.	7.7%	42,080	48,169	55,139	63,117	72,249	82,703
Florida	4.6%	260,454	328,316	413,859	521,692	657,620	828,964
Georgia	5.2%	164,246	194,331	229,928	272,045	321,876	380,835
Hawaii	5.7%	26,077	29,900	34,283	39,310	45,073	51,680
Idaho	7.4%	24,553	28,655	33,443	39,030	45,550	53,160
Illinois	5.7%	258,188	295,440	338,067	386,844	442,659	506,527
Indiana	3.1%	84,761	101,531	121,620	145,683	174,506	209,033
Iowa	4.7%	44,279	49,430	55,180	61,598	68,763	76,762
Kansas	4.6%	47,301	58,049	71,238	87,423	107,287	131,663
Kentucky	4.3%	93,683	108,844	126,459	146,924	170,701	198,327
Louisiana	2.2%	100,024	125,330	157,038	196,768	246,550	308,926
Maine	3.7%	29,818	34,978	41,033	48,134	56,466	66,239
Maryland	7.6%	129,669	149,221	171,722	197,615	227,412	261,703
Massachusetts	4.5%	141,831	162,667	186,565	213,973	245,407	281,460
Michigan	6.4%	281,616	313,791	349,642	389,590	434,102	483,699
Minnesota	7.3%	132,215	147,817	165,260	184,761	206,563	230,938
Mississippi	3.0%	48,742	55,785	63,845	73,070	83,628	95,712
Missouri	3.8%	92,344	113,250	138,889	170,332	208,894	256,186
Montana	5.4%	19,953	22,789	26,028	29,727	33,952	38,778
Nebraska	5.6%	30,606	35,492	41,158	47,727	55,346	64,181
Nevada	6.2%	25,584	33,706	44,405	58,502	77,073	101,540
New Hampshire	5.5%	21,933	30,758	43,134	60,489	84,827	118,958
New Jersey	6.3%	241,409	289,610	347,434	416,804	500,024	599,860
New Mexico	4.3%	36,573	43,608	51,997	62,000	73,927	88,148
New York	5.4%	850,164	979,117	1,127,628	1,298,666	1,495,647	1,722,506
North Carolina	4.3%	137,614	166,600	201,690	244,173	295,603	357,865
North Dakota	5.0%	13,886	15,615	17,558	19,744	22,201	24,964
Ohio	4.3%	234,633	265,290	299,953	339,144	383,456	433,559
Oklahoma	7.3%	98,365	112,321	128,258	146,456	167,236	190,965
Oregon	8.8%	98,359	114,771	133,920	156,264	182,337	212,760
Pennsylvania	5.1%	297,308	346,414	403,630	470,297	547,975	638,482
Rhode Island	3.2%	21,751	25,654	30,258	35,687	42,091	49,644
South Carolina	4.4%	83,752	102,989	126,643	155,731	191,499	235,482
South Dakota	4.1%	11,483	12,978	14,668	16,578	18,737	21,176
Tennessee	3.6%	109,662	130,392	155,041	184,349	219,197	260,633
Texas	4.5%	403,683	507,660	638,419	802,857	1,009,650	1,269,707
Utah	7.0%	41,862	48,829	56,955	66,434	77,490	90,386
Vermont	7.8%	21,070	24,320	28,071	32,402	37,400	43,169
Virginia	7.4%	125,098	146,026	170,455	198,970	232,256	271,110
Washington	7.3%	168,135	197,670	232,393	273,216	321,211	377,636
West Virginia	2.2%	34,524	42,121	51,388	62,695	76,490	93,320
Wisconsin	4.8%	92,555	101,337	110,953	121,481	133,009	145,630
Wyoming	7.2%	11,839	14,281	17,226	20,778	25,063	30,232
Guam	10.3%	3,057	3,375	3,726	4,114	4,542	5,015
Puerto Rico	9.6%	12,919	13,235	13,559	13,891	14,231	14,580
Virgin Islands	15.1%	3,832	4,059	4,300	4,555	4,826	5,112
TOTAL	5.8%	$6,754,198	$7,961,449	$9,401,275	$11,122,414	$13,184,803	$15,662,402
Sp Match Savings		($90,000)	($90,000)	($90,000)	($90,000)	($90,000)	($90,000)
ADJ TOTAL		$6,664,198	$7,871,449	$9,311,275	$11,032,414	$13,094,803	$15,572,402

Impact

Adequacy: States would have little incentive to reduce administrative costs under this option, since administrative reimbursement would be tied to benefit payments rather than the actual cost of administering these programs. States most at risk under this option are those with a relatively low ratio of administrative costs to benefit payments. States with a lower percent would be held to this level. This outcome is similar to the block grant option which freezes States at their FY 1993 funding levels, then increases in subsequent years for inflation only.

Flexibility and Administrative Relief: Like many of the other options, this option would simplify the system for funding administrative costs for the States and the Federal Government. States could eliminate or modify their burdensome cost allocation system and increase their flexibility in the use of these funds.

Costs: This option illustrates that not all options necessarily result in cost savings. In fact, based on our assumptions, there would be virtually no cost control under this option. Based on historical data through FY 1993, we project that by FY 1999, the Federal share would be $16.8 billion more than it would be under the current system. By basing administrative funding as a percentage of benefit costs, it allows the benefit levels to drive the allowable level of administrative costs. This method even fails to recognize the fact that in recent years, as a percent of total program costs, administrative costs have been shrinking.

Disparity: There would continue to be disparity among the States since future administrative funding will be based on the current ratio of administrative costs to total program costs.

Predictability: Budgeting for administrative costs under this approach would continue to be done retrospectively since it will be based on annual program costs.

CONCLUSION

The issue of reforming the administrative cost allocation system is very relevant today given the considerable interest in "reinventing" Federal Government operations. If action is not taken, this cost allocation system will remain burdensome to both the States and the Federal Government. It will also be costly and difficult to audit. Therefore, we believe that opting to reform the system is preferable to an approach which maintains the status quo with enhanced monitoring capabilities. We also believe that reform should be implemented concurrently with enhanced efforts to insure quality in the delivery of services.

This study illustrates several of many possible alternatives that seek to address the fundamental problems in the current cost allocation system. We recognize that as a result of implementing one of these options, States may not receive as much Federal funding as they might under the current system. However, significant benefits will accrue to both the States and the Federal Government by simplifying the administrative cost funding system. These benefits include: increased flexibility, reduced growth in cost, minimized funding disparity among States, and greater predictability for Federal budgeting and planning.

These alternative funding approaches are meant to serve as examples of what can be done. Any of the options could be modified to moderate their impact on State budgets or to achieve greater savings. They could even be adapted to increase Federal financing of administrative costs should policy makers wish to do so. The options would then provide more control and flexibility in spending.

We also believe that some combination of the options might have a number of advantages. For example, the block grant alternative could be combined with the standard cost per recipient approach. Under this combined alternative, States would receive their block grant amount as described under Option 2 and an additional standard amount (see Option 3) for the increase in the number of recipients for each year. By combining these two options, States would not have to absorb the increased cost of additional recipients since they would receive reimbursement for them. In addition, States would gain greater discretion over the use of their administrative funds. This alternative would also decrease States' administrative burden since they could eliminate or modify their cost allocation methodologies and reporting requirements for these three programs. Federal accountability and monitoring concerns would also be addressed.

Finally, programs other than the three discussed in this report could be considered as could different combinations. For example, administrative costs for Child Support Enforcement programs could have been substituted for Medicaid to illustrate other possibilities. Our bottom line is that the system for reimbursing administrative costs should be simplified and made more controllable, predictable and efficient.

APPENDIX A

Administrative Costs and Recipients, 1989-1993

TABLE 1

ADMINISTRATIVE COSTS
1989-1993
(constant dollars = 1993 dollars)

	1989	1990	1991	1992	1993	% Change
AFDC						
Current $	$1,359	$1,308	$1,405	$1,492	$1,517	11.6%
Constant $	1,583	1,445	1,491	1,537	1,517	-4.2%
Medicaid						
Current $	1,654	2,005	2,155	2,365	2,682	62.2%
Constant $	1,927	2,216	2,286	2,436	2,682	39.2%
Food Stamps						
Current $	1,172	1,247	1,349	1,465	1,540	31.4%
Constant $	1,365	1,378	1,431	1,509	1,540	12.8%

TABLE 2

TOTAL RECIPIENTS
1989-1993
(in thousands)

	1989	1990	1991	1992	1993	% Change
AFDC	10,934	11,466	12,596	13,625	14,143	29.3%
Medicaid	23,511	25,255	28,280	31,150	33,432	42.2%
Food Stamps	18,764	19,931	22,625	25,403	26,982	43.8%

TABLE 3

ADMINISTRATIVE COST PER RECIPIENT
1987-1993
(constant dollars = 1993 dollars)

	1987	1988	1989	1990	1991	1992	1993
AFDC Constant Dollars	$122	$143	$145	$126	$118	$113	$107
Medicaid Constant Dollars	73	80	82	88	81	78	80
Food Stamps Constant Dollars	69	73	73	69	63	59	57

TABLE 4

Correlation of Percent Change in Administrative Costs
and Percent Change in Recipients

	Correlation Coefficient
1987-1988	.0427
1988-1989	.1532
1989-1990	.2166
1990-1991	.0656
1991-1992	.1742
1992-1993	.2214

Note: The Correlation Coefficient (r) is a measure of the association between two variables, X and Y. A perfect correlation of +1 indicates that all possible values of X and Y lie on a straight line with a positive slope. A perfect negative correlation, -1, indicates that all possible values of X and Y lie on a straight line with a negative slope. A correlation of 0 means the variables are uncorrelated.

The calculation is based on annual data from all States and territories. The independent variable (X) is the percent change in the number of recipients in each State or territory and the dependent variable (Y) is the corresponding change in administrative cost.

APPENDIX B

Agency Comments and OIG Response

RESPONSE TO AGENCY COMMENTS

We received comments on the draft report from the Assistant Secretary for Management and Budget, the Assistant Secretary for Planning and Evaluation, and the Assistant Secretary for Children and Families. They state that we have not necessarily demonstrated a serious problem in this area, expressed concerns about the way we estimated future costs and possible savings, and pointed out that there may be valid reasons for some disparities in costs among the States. The ACF also requested a fuller discussion of the pros and cons of the various funding alternatives. The Health Care Financing Administration provided informal comments on early drafts, but did not provide comments on the latest one.

We recognize the legitimate concerns that have been raised and have considered them carefully. We have revised the report in several places, primarily to focus more succinctly on the need to change the current system and to update our savings projections based on the latest available data.

At this point we believe that we have an honest disagreement about the nature of this problem and its appropriate solution. Perhaps this disagreement stems from differences in overall focus.

The agency comments focus on whether total costs within the current system are out of control. There is some evidence offered, such as recent declines in cost per recipient data and a levelling off of the rate of increase in Federal costs, that there is no real problem here. We have reservations about the significance of these indicators and we address them within the report itself. More importantly though, we think that these indicators do not address the most important issue.

We think that the real issue is the current cost reimbursement system itself. The system puts us at risk because we have difficulty knowing what we are paying for, whether it is cost effective, and what we will have to pay out in the future. It provides little incentive to economize, and is itself an inefficient system.

Agency comments also caution that our proposals could harm some States by not taking into account their peculiar needs. We see similar problems of inequity with the current system.

Thus, we continue to believe that the current cost reimbursement system for welfare administrative costs needs to be replaced for the following reasons.

- Under the current system we are not sure of what we are paying for and whether expenditures are cost-effective. It would require a considerable investment in expanded auditing and monitoring to find out. These costs would be prohibitive especially in an environment of declining resources. Our Office of Audit Services has reported that the current cost allocation system results in mountainous paperwork, labyrinthine accounting and detailed auditing and negotiation processes.

- We can not predict with any degree of certainty under the current system what the States are going to charge us in the future. This issue becomes very important in thinking about how much the Federal Government wants to pay for administrative costs under welfare reform.

- There is significant cost disparity among the States, without any clear relation to outcomes. While there are reasons offered for some disparity, there is no solid evaluated data that rules out efficiency as a factor in cost disparity. We also could find no significant correlation between administrative costs and numbers of recipients on an individual State-by-State basis.

For these reasons, we believe that the current cost allocation system should be replaced by a system that provides adequate funding for States, incentives for efficient operations, decreased Federal monitoring and oversight, and predictable Federal expenditures. We think that the options presented in this report are a good place to start in developing a new welfare administrative cost system.

We want to caution the reader that the dollar estimates for the various options are illustrative only. In further developing a new administrative cost system, it will be necessary to prepare detailed estimates based on clearly defined assumptions, using the most recent information available.

The following are our responses to each of the offices that we received comments from.

Assistant Secretary for Management and Budget

Outyear estimates are different than Mid-Session Estimates
There are, of course, numerous methods that could be used to estimate future administrative expenditures. We recognize that our estimates are higher. We felt that the best predictor of the future was actual past experience over a number of years, so we used a 5 year average, actual cost by State, to predict future costs. We have now updated these projections in this final report using a 5 year period of FY 1989 - FY 1993, the most recent years for which reliable State data is available.

Difference between administrative cost growth in the AFDC and Food Stamp programs, and in the Medicaid program.
We realize that there have been differences among the three programs in their rates of administrative cost growth. However, we believe that administrative cost issues could be addressed more effectively by looking at a more global perspective rather than a narrow perspective of individual programs. We know that at the State and local level many of the administrative functions and personnel are overlapping among these three programs.

We believe that a prospective administrative cost system that includes all three would provide the greatest flexibility and the most incentives for an efficient operation.

Relationship between growth in administrative costs and caseload growth.
We could find no significant correlation between costs and workload on a State-by-State basis in the current cost reimbursed system. There are a variety of factors that contribute to administrative costs. It is difficult to ascribe to any one factor precisely how much it affects the growth.

Disparity among States
While there are many reasons given for the disparity, we found no solid programmatic or evaluative data that explained what those reasons are and whether they are good influences on administrative costs. We also could find no solid data that would suggest that some States should be spending more than twice what other States spend per capita on administrative costs.

Simplification of Cost Allocation Systems
We agree that the long range goal should include even more programs and that the current cost allocation system needs to be replaced. We believe that the three programs we analyze in this report provide a good example of how funding for many programs could be combined.

Assistant Secretary for Planning and Evaluation

Failure to emphasize the declines in administrative costs per case for welfare
When we began this study, we believed that a common indicator, such as cost per recipient would be useful in looking at the rate of growth of administrative costs over time. In fact, we used it in early working drafts. However, as we conducted further analysis, we could find no significant correlation between costs and recipients on a State-by-State basis, and thus do not believe that it is a reliable indicator of the efficient use of administrative funds over a given period of time. For example, we do not believe that the recent decrease in cost per recipient for the three programs is necessarily indicative of more efficient State operations. It seems to us to be much more the result of recent dramatic increases in caseload with States unable to increase administrative resources proportionately.

In regard to the selection of the years for our analysis, we only had complete data up through 1992 when we prepared the official draft report. We agree that more current data would be better. We now have available the 1993 data and have included it in this final report. We used this more recent data instead of the earlier data to update all of our estimates. With regard to unit costs, the report does, as did the draft, indicate that the time period used could affect the trend in unit costs.

__The report's estimates of potential savings are overstated__
We agree that the most current data should be used in making any estimates regarding expenditures or savings. We also know that the savings are very sensitive to assumptions. For that reason, it is probably useful to look at savings using different assumptions and think about a range of numbers rather than an absolute amount. However, as noted in the previous paragraph, we did update our estimates based on more recent data. Savings estimates have been reduced as a result, although they remain significant for most options.

__State variation is not bad, per se__
We agree that State variation in costs is not bad per se. However before financing such variations it would be useful to know what we are paying for and why there is variation. Because of the complexities in the accounting systems used, we do not believe in the case of administrative costs that it is practical for us to be able to know what we are paying for, what constitutes the variation, and what the outcomes are of that variation.

Assistant Secretary for Children and Families

__The report does not establish that there is a major problem with funding of administrative costs__
We believe that the two biggest problems with the current system are a lack of accountability and a lack of cost predictability. Under the current system, we are not sure of what we are paying for and whether expenditures are cost-effective. We also can not predict with any degree of certainty how much we are going to pay in the future, since States decide how much they are going to charge the Federal Government. We also know that the current cost allocation system results in tremendous paperwork and requires significant administrative oversight. We believe that there are other ways to adequately reimburse States for administrative costs that will result in more efficient operations at both the State and Federal level, and will provide predictable future Federal costs.

__The report does not adequately explore the reasons for the disparities among the States for each of the three programs__
We noted the disparity among the States to indicate that some States require more dollar inputs, per person, in their system than other States. We found a lot of anecdotal evidence for this difference in inputs, but could find no solid programmatic or evaluative data to explain the need for the difference in inputs. We also have questions about whether these differences in inputs are related to differences in outcomes. We believe that to try to accurately measure all the factors that influence costs and to relate those inputs to outcomes would be extremely difficult and very costly. We fully acknowledge that the needs of States may vary. We are not at all certain that the current system responds better than any of the options we present.

__The report does not fully address the pros and cons of the various funding options__
This report was meant to suggest logical options to the current cost reimbursement system for administrative costs. These options have been discussed and debated at

different times over the past ten years by various administrations. However, we did add language is several places to remind the reader that some options might not address specific problems encountered by each State. We point out that this is also a problem with the current system. We also agree that once a general approach is decided upon, more detailed analysis can be performed. We had already stated this explicitly in the report.

DEPARTMENT OF HEALTH & HUMAN SERVICES

ADMINISTRATION FOR CHILDREN AND FAM
Office of the Assistant Secretary, Suite 600
370 L'Enfant Promenade, S.W.
Washington, D.C. 20447

DATE: December 16, 1994

TO: June Gibbs Brown
Inspector General

FROM: Mary Jo Bane
Assistant Secretary MJ Bane
for Children and Families

SUBJECT: Comments - OIG Draft Report: "Welfare Administrative Costs," OEI-05-91-01080

As requested, we have reviewed the subject Draft Report and find it unchanged from the previous draft submitted to us for comments in March 1993. While minor modifications have been made to the current draft, a few of the comments we provided to the OIG earlier this year have been incorporated. The substance of the material in the "Background" and the five "Alternate Funding Options" sections is the same as the 1993 Draft.

We have serious concerns about the present Draft. We believe previously provided comments, along with those of HCFA and FNS, should be incorporated. As the report now stands, a distorted picture of administrative costs is given when the three programs are combined. There are considerable differences in the policies and procedures of the respective programs which are not taken into account.

Furthermore, we believe that the report should make clear that the present administration of these programs is not out of control. We appreciate the concerns about the administrative costs of these three programs, but the report does not provide sufficient analysis to accurately portray the complexities of the issues, and it does not sufficiently discuss the advantages and disadvantages of the options available. Each of the listed options could cause serious problems, and could adversely affect specific States in different ways. We believe the discussion of options should be expanded to fully discuss the consequences and potential problems associated with each option. As it stands, the options might be perceived as simple solutions to a very complex issue.

In summary, the report does not:

(1) Establish that there is a major problem with funding of administrative costs.

(2) Adequately explore the reasons for the disparities among the States for each of the three programs.

(3) Fully address the pros and cons of the various funding options.

We continue to believe that the administrative cost for the three programs needs to be examined in greater detail before any conclusions or alternative options are developed.

DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of the Secretary

Washington, D.C. 20201

DEC 20 1994

TO: June Gibbs Brown
Inspector General

FROM: Assistant Secretary for
Planning and Evaluation

SUBJECT: OIG Draft Report: "Welfare Administrative Costs"
OEI-05-91-01080

This responds to your request for comments on the draft OIG report entitled, "Welfare Administrative Costs." We are glad the Office of the Inspector General addressed many of the concerns raised regarding an earlier draft of this report. This is a significantly improved report. However, several conceptual problems remain.

- Failure to emphasize the declines in administrative costs per case for welfare. According to data in the report, the rate of increase in administrative costs for both AFDC and food stamps is lower than the rate of increase in the number of clients in those two programs. Only for Medicaid do administrative costs increase faster than the increase in clients, suggesting that much of the problem is the rapid pace of health care inflation.

  While the draft report analyzes State administrative expenditure data from 1987 to 1992, more recent data for 1993 and 1994 show a lower rate of increase. In fact, per client administrative costs have actually been declining recently, even in Medicaid. In addition, the report should discuss the reasons for its choice of starting and ending years, 1987 to 1992.

- The report's estimates of potential savings are overstated. The report's projections for administrative costs for AFDC, food stamps, and Medicaid are between $3.5 and $5.6 billion higher than the Administration's Mid-Session Review estimates for 1995-1999. Since the report's baseline projections are too high, the estimates of potential savings are also too high.

- State variation is not bad, per se. The report sees disparities in per capita administrative costs and in rates of increase or decrease among States as inherently bad and in need of correction. But the report does not explain why disparity is bad and it should at least discuss the reasons why reducing disparity would lead to desirable outcomes.

Disparities among States are to be expected, however, and many things could explain such variation. For example, Texas is cited as a State with low administrative costs per client, yet it is atypical. Texas has much lower Medicaid administrative costs than other States because it pays an insurance provider a per capita amount to finance most Medicaid services. Since the insurance provider handles all the administrative details, the State has minimal Medicaid administrative costs.

David T. Ellwood

DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of the Secretary

Washington, D.C. 20201

NOV 21 1994

MEMORANDUM TO THE INSPECTOR GENERAL

From : Kenneth S. Apfel
Assistant Secretary for Management and Budget

Subject: OIG Draft Report: "Welfare Administrative Costs," OEI-05-91-01080

This responds to your request for comments on the draft OIG report entitled, "Welfare Administrative Costs." We applaud the Office of the Inspector General for its efforts to identify a range of options for policymakers to consider in thinking about administrative costs and offer the following comments.

- Outyear estimates are different than Mid-Session Estimates. The OIG's projected administrative costs for the AFDC, Food Stamps and Medicaid programs, for FY 1995-FY 1999, are higher than current estimates contained in the Administration's Mid-Session Review for 1995-1999.

  We recognize that there are many reasons for variance in long range estimates. Key among these is the time period used for the "basis" of the estimate. Beginning in 1989, and continuing through 1991, all three of these programs experienced explosive caseload growth, accompanied by substantial increases in benefits and administrative costs. However, in the last several years (1993 and 1994) caseload and costs have grown at substantially lower levels, and these lower growth rates are reflected in the Administration's Mid-Session estimates.
  My staff will provide you with these estimates. I would note that there are many valid reasons for varying projections, especially in programs experiencing such fundamental changes.

- Difference between administrative cost growth in AFDC and Food Stamps, and in Medicaid. In recent years, AFDC and Food Stamps administrative costs have been relatively stable, with moderate growth of less than ten percent annually. Expenditures have been relatively close to Administration estimates. On the other hand, Medicaid administrative costs have been more volatile and less accurately projected. In considering future options, this variance in administrative cost growth needs to recognize that approaches and solutions may be different for each of these programs.

- Relationship between growth in administrative costs and caseload growth. A variety of factors contribute to administrative costs, one of which is caseload. Other factors which influence administrative cost growth include policy changes such as waiver demonstrations and/or welfare reform, State FTE constraints, automated systems development costs, political and timing issues, economic issues and family composition.

- Disparity among States. The report recognizes that there are disparities across States in administrative costs/recipient. In many cases this disparity is the result of variation in services provided by States, the comprehensiveness of their programs, and the extent to which they have sought to make clients more self sufficient by lowering caseload ratios.

- Simplification of Cost Allocation Systems. An anticipated outcome of implementing the proposed options is that cost allocation systems and Federal monitoring could be simplified. To achieve such simplification may also necessitate inclusion of a broader spectrum of programs, including Foster Care, Child Support or related programs under the new funding mechanism.

My staff has several other editorial recommendations that will be provided separately to your staff.

APPENDIX C

Endnotes

1. OMB Circular A-87, "Cost Principles for State and Local Governments." Attachment A, p. 6.

2. Congressional Budget Office, "Reducing the Deficit." February 1992, p. 232.

3. Department of Health and Human Services, Office of the Inspector General, Office of Audit Services. Draft report # A-12-92-00014, Reforming the System for Determination of State and Local Government Administrative/Indirect Costs. May 21, 1991, p.i.

4. Ibid, pp. iii.

5. Ibid, p. 25.

6. Ibid, p. i.

7. Savings estimates from the reduction of special match rates in the AFDC program come from the Agency for Children and Families. They estimate $40 million in savings in FY 95 and $50 million in each succeeding year. The Food and Nutrition Service in the Department of Agriculture estimated savings at $40 million in FY 95 and each succeeding year. For ease of calculation, we use a figure of $90 million in savings for each year from FY 95-FY 99.

8. The Census Bureau percentages used are published in: "Overview of Entitlement Programs," FY 1992 Green Book. Committee on Ways and Means, U.S. House of Representatives. p.1384.