1995 Budget

THE SECRETARY OF HEALTH AND HUMAN SERVICES
WASHINGTON, D.C. 20201

FEB 13 1995

The Honorable E. Clay Shaw
Chairman, Subcommittee on Human Resources
Committee on Ways and Means
U.S. House of Representatives
Washington D.C. 20515

Dear Mr. Chairman:

This letter expresses the Administration's views on the Chairman's mark for welfare reform legislation under consideration by the House Ways and Means Subcommittee on Human Resources.

The Administration shares the commitment of the Congress and the American people to real welfare reform that emphasizes work, parental responsibility, state flexibility, and the protection of children. Last year, the President submitted a bold welfare reform bill, the Work and Responsibility Act of 1994, which embodied these values. It imposed tough work requirements while providing opportunities for education, training, child care and supports to working people. It included a stringent set of child support enforcement provisions. It required each teen mother to live at home, stay in school and identify her baby's father. It increased state flexibility without sacrificing accountability. And it maintained a basic structure of protections for children.

The Administration looks forward to working cooperatively with the Congress in a bipartisan way to pass bold welfare reform legislation this year. The Administration has, however, serious concerns about a number of features of the Chairman's mark that appear to undermine the values to which we are all committed. The Administration seeks to end welfare as we know it by promoting work, family and responsibility, not by punishing poor children for their parents' mistakes. Welfare reform will succeed only if it successfully moves people from welfare to work.

Work

For years, Republicans and Democrats alike have agreed that the central goal of welfare reform must be work. That is still our goal: People who can work ought to go to work and earn a paycheck not a welfare check. The Administration believes that no adult who is able to work should receive welfare for an unlimited time without working. The Administration believes that from the first day someone comes onto welfare, he or she should be required to participate in job search, job placement, education, or training needed to move off welfare and into a job quickly. It is government's responsibility to help ensure that the critical job placement, training, and child care services are provided. Individuals who are willing to work should have the opportunity to work and not be arbitrarily cut off assistance.

The Administration therefore has serious concerns about the Chairman's mark before you:

- It eliminates requirements that recipients participate in job search, education, work or training as a condition of receiving welfare, and ends any responsibility of state welfare systems to provide education, training and placement services to move recipients from welfare to work. The proposed legislation effectively repeals the bipartisan Family Support Act signed by President Ronald Reagan in 1988.

- The proposed legislation includes only minimal and unenforceable requirements that recipients work. The bill requires only that persons on the rolls for more than 2 years engage in "work activities" loosely defined by the state welfare bureaucracy, rather than a real work requirement. The proposed participation standards are very low. In many ways, the work requirements are even weaker than those in current law.

- The proposed legislation provides no assurance of child care to recipients who work or are preparing to work--even if a state requires them to participate. It offers no promise of child care for those who leave welfare for work or for those who could avoid falling onto welfare if they had some help with child care. While it repeals provisions of existing law that provide funding for child care, this bill is silent on whether any additional funds will be available for subsidized child care for low income working families.

- The proposed legislation repeals the current rule that anyone who leaves welfare for work can receive Medicaid for an additional year to ease the transition. This would further reduce health care coverage and make it harder for people to move from welfare to work.

- The proposed legislation would deny all cash assistance to families that have received assistance for more than five years, even if the adult in the family is unable to find a job or prevented from holding a job because of illness or the need to care for a disabled family member. Children would be seriously jeopardized even if their parents cannot find any work.

The Administration supports an alternative approach that would genuinely transform the welfare system into a transitional system focused on work. It would have strict requirements for recipients to participate in and clear responsibilities for states to provide education, training and placement assistance; it would have serious time limits after which work would be required; it would ensure that children would not be left alone when parents were working by providing assistance for child care; it would put parents to work, not just cut them off; and it would ensure that children can expect support from two parents.

Parental Responsibility

The Administration believes that welfare reform should recognize the responsibility and encourage the involvement of both parents in their children's lives. The Administration considers child support enforcement to be an integral part of welfare reform, particularly because it sends a strong message to young people about the responsibility of both parents to support their children. The Administration was pleased that you had agreed to add child support enforcement to your welfare reform bill, and sorry that your proposals are not yet part of the bill now under consideration. The Administration looks forward to working closely with you on this issue in the coming weeks.

- o The only child support provision included in the Chairman's mark is one that allows states to reduce payments to children for the first 6 months if paternity has not been legally established. This provision seems ineffectual and unfair. Even if a mother fully cooperates by giving detailed information identifying the father and his possible location, and even if the state is diligent in pursuing the father, it can easily take 6 months to get paternity legally established. There is no reason why the child should be punished during this period.

The Administration believes that it makes far more sense to deny benefits entirely to any parent who refuses to identify the father or to cooperate in locating him. However, once the mother has done all she can, the family should qualify for aid, and then the state should establish paternity within one year.

The Administration believes that the welfare system should encourage the formation and support of two-parent families. The Administration is therefore concerned about an important omission in the proposed legislation:

- o The proposed legislation would encourage the break-up of families by repealing the requirement that states provide cash assistance to two-parent families in which a parent is unemployed or unable to work. It allows states to discriminate against married, two-parent families by treating single-parent families better than two-parent families.

The Administration supports an approach that both encourages the formation of two-parent families and makes sure that both parents take responsibility for children in all cases.

Teen Pregnancy

The Administration and the American people agree that the best reform of welfare would be to ensure that people do not need it in the first place. Welfare reform must send a very strong message to young people that they should not get pregnant or father a child until they are ready and able to care for that child, and that if they do have children, they will not be able to escape the obligations and responsibilities of parenthood. We must be especially concerned about the well-being of the children who are born to young mothers, since they are very likely to grow up poor.

The Administration therefore has serious concerns about the bill before you:

- o The proposed legislation would deny all federal cash benefits for eighteen years to any child born to an unmarried mother under 18, as well as to the parent. This provision appears to punish children for their entire childhood--18 years--for the mistakes of their parents.

- o The proposed legislation does not require that teen mothers live at home, stay in school, and identify the child's father. It weakens requirements in current law, and may make the prospects for mother and child even worse.

- o The proposed legislation establishes only minimal expectations for states to provide services to unmarried parents, and provides no additional funds to support them.

The Administration supports an alternative approach that would require minor mothers to live at home, stay in school, make progress toward self-sufficiency, and identify the father of the child. The Administration also supports a national campaign to prevent teen pregnancy. It is time to enlist parents and civic, religious, and business leaders in a community based strategy to send a clear message about abstinence and responsible parenting. The Administration also supports a state option not to increase benefits for children born to mothers on welfare. This decision should be made by the state, not the federal government.

State Flexibility with Accountability

The Administration embraces the creativity and responsiveness of states, and the opportunities for real reform when states have the flexibility to design and administer welfare programs tailored to their unique circumstances and needs. Already this Administration has granted waivers to nearly half the states for welfare reform demonstrations. National welfare reform should embody the values of work and responsibility in a way that assures taxpayers that federal money is being spent prudently and appropriately. For reform to succeed, the funding mechanisms for welfare should not put children or states at risk in times of recession, population increase or unpredictable growth in demand.

In this context, the Administration has serious concerns about the proposed legislation:

- o The spending cap in the proposed legislation makes no allowances for potential growth in the need for cash assistance because of economic downturn, population growth, or unpredictable emergencies. It could result in states running out of money before the end of the year. and thus having to turn away working families who hit a "bump in the road" and apply for short-term assistance. It could preclude states from investing in job placement, in work programs, in education and training, and in supports for working families.

- The proposed legislation removes the requirement that states match federal funds with their own state funds. With none of their own money at risk, states will have many fewer incentives to spend the funds efficiently and effectively to improve performance and increase self-sufficiency.

- The proposed legislation provides virtually no accountability. There are no incentives for good performance and virtually no penalties for failure. There is no provision for the recovery of monies paid out fraudulently or in error. There are no mechanisms for ensuring that states are actually spending the money on needy children rather than on state bureaucracies, or for monitoring whether federal money is being used to help parents gain self-sufficiency, require work, and enforce parental responsibility. Indeed, the federal government is forbidden from taking any meaningful steps to ensure program performance and accountability.

The Administration supports proposals that significantly increase state flexibility but also ensure accountability for achieving national goals. The Administration supports a funding mechanism that will not put children and states at risk down the road, and that enables states to succeed in moving people from welfare to work and in supporting working families. The Administration has significant doubts about the ability of a pure block grant funding mechanism to adequately protect both children and states.

Protection of Children

The Administration recognizes that the protection of children is the primary goal both of cash assistance programs and of child welfare and child protective services. Cash assistance programs assist families to care for children in their own homes. Child protection services help those children who are abused or neglected or at risk of abuse by their parents and who need special in-home services or out of home placements to assure their safety. Strengthening families, and where appropriate, preventing removal of children from their homes also are, key goals of child protection services. There are problems in a number of areas.

<u>Denial of Benefits to Children on AFDC</u>

The legislative proposals that would reform cash assistance have a number of provisions that would put vulnerable children at greater risk.

- As noted above, the legislation would deny cash assistance to children of unmarried minor mothers for their entire childhood, to children born while the parent was on welfare, and to children whose parent had received welfare for more than five years, whether or not a job was available or the parent was unable to work. The funding caps could have the effect of denying cash assistance to children when states used up their allocated funds, for whatever reasons. Children in low income working families, who may be forced onto cash assistance in times of economic downturn, could be most affected.

<u>Child Protection Services</u>

Some of these children could well come into a system of child protection services that is already seriously overburdened and that is failing to provide the most essential services. Reported child maltreatment and out-of-home placements have both been increasing sharply. Many state systems are in such distress that they have been placed under judicial oversight. The proposed legislation responds to these increasingly serious problems by consolidating existing programs that protect children into a block grant with nominal federal oversight. The Administration has serious concerns about this approach.

- The proposed legislation caps spending for child protection programs at a level considerably lower than baseline projections. This could lead to uninvestigated maltreatment reports, and to children being left in unsafe homes with minimal services. It could also seriously hamper states' efforts to improve their child abuse prevention and child protection systems.

- The proposed legislation eliminates the adoption assistance programs, and leaves it up to states whether they will significantly sustain the subsidies that enable many special needs children to find permanent homes, and whether they will honor commitments to those adoptive families that now receive subsidies.

- The proposed legislation virtually eliminates federal monitoring and accountability mechanisms. It makes it impossible for the federal government to ensure the protection of children.

- The proposed legislation is silent on the formula for allocating funds to the states. Because of serious imbalances among the states in spending on child protection, it is hard to imagine a formula that would not disadvantage either states that have been heavy spenders, or states that are only beginning to improve their systems.

Substantial improvements need to be made in the child protection system and in the federal role in overseeing that system. The Administration supports a careful and thoughtful review of the programs before actions are taken that might seriously harm millions of vulnerable children.

Denial of Benefits to Disabled Children on SSI

The Administration is deeply troubled by the changes proposed in the program designed to help disabled children--SSI.

- o The proposed legislation essentially eliminates SSI benefits for children, with the exception of a small group of children currently receiving benefits. Within 6 months, over one hundred thousand disabled children would lose eligibility for SSI benefits--some would lose medical protection as well. And in the future, no child, no matter how disabled, will be eligible for any cash benefits for SSI, except if cash benefits prevent them from having to be institutionalized. These proposals appear to penalize parents who are determined to care for their child no matter what the economic consequences for the family. SSI recipients are among the neediest and most vulnerable children, in the poorest families.

- o Some of the money saved is put into a new block grant for services to disabled children, which would require the creation of a new state bureaucracy to decide on appropriate services. This idea is untested, and no one knows what impact it will have on the most vulnerable of children and the parents who care for them. The 5-year cut off in AFDC for all persons along with the elimination of SSI cash for disabled children may leave these children extremely vulnerable.

The Administration sees the need for careful reform in this area, with its potential for serious harm to extremely vulnerable children. Last year the Congress established a Commission on Childhood Disability to look into these issues in consultation with experts from the National Academy of Sciences. The Commission will provide its report to the Congress later this year. The Administration believes prudence dictates waiting for this short time until this bipartisan commission, following a thorough review of all aspects of this important program, has an opportunity to make recommendations.

Benefits to Legal Immigrants

The Administration strongly believes that illegal aliens should not be eligible for government welfare support. But the blanket prohibition of all benefits to legal immigrants who are not yet citizens is too broad, and would shift substantial burdens to state and local taxpayers. These legal immigrants are required to pay taxes. Many serve in the armed forces, and contribute to their communities. The Administration strongly favors a more focused approach of holding sponsors accountable for those they bring into this country and making the sponsors' commitment of support a legally binding contract.

In summary, the Chairman's mark espouses goals for the reform of welfare--work, parental responsibility, prevention of teen pregnancy and state flexibility--that the Administration and the American people share. But the translation of general goals into specific legislation misses the mark in fundamental ways. The proposed legislation does not represent serious work-based reform. It does nothing to move people from welfare to work, and it does not require everyone who can work go to work. It neither holds state bureaucracies accountable nor cushions state taxpayers against recession. It puts millions of children at risk of serious harm. There are alternative approaches to reform that achieve our mutual goals in far more constructive and accountable ways.

The Administration reiterates its commitment to real welfare reform and its desire to work cooperatively with Congress to achieve it.

The Office of Management and Budget advises that there is no objection to the transmittal of this report to Congress.

A similar letter was sent to Representative Harold E. Ford.

Sincerely,

Donna E. Shalala

cc: Members of the Subcommittee on Human Resources

DRAFT

Summary of the Shaw Welfare Proposal (February 10)

TITLE I: BLOCK GRANT TEMPORARY ASSISTANCE FOR NEEDY FAMILIES

- **Block Granting of AFDC:** Eliminates all existing statutory language on the purposes, administration and requirements of the AFDC, JOBS and EA programs and replaces them with a block grant to states. Eliminated, for example, are provisions on individual entitlements, fair hearings, state financial participation, consistent standards of need, who in the family is eligible, and statewide program availability. Separately, states would be required to operate, child support, child protection,and foster care and adoption programs.

- **Funding:** The block grant would be $15.355 billion for each year from 1996 through 2000. Administration estimates show that this would save approximately $13 billion over 5 years.

- **State Allotment:** The block grant money would be a capped entitlement to states. Each state would be allotted an amount equal to their average proportion of AFDC spending for 1991 through 1993.

- **Rainy Day Funds:** States may put unspent amounts of block grant funds into a rainy day account for years when more money is needed. Amounts above 120% of their annual allocation may be transferred into the state's general revenue fund. There would also be a national rainy day account of $1 billion that states may borrow from and must pay back within 3 years.

- **Work requirements:** All recipients on the rolls for 24 months (including recipients currently on AFDC) would be required to be in a work activity, unless under age 20 and enrolled in school. For most states, this implies a participation rate of 40% or more. By statute a state's total work participation rate would be set at 2% in 1996 and would rise to 20% by 2003. Educational and training services would be allowed but not required. No definitions for standards for work activity are provided. Child care would not be guaranteed.

- **State Flexibility:** States would determine all rules relating to benefit levels and eligibility criteria. States may pay benefits to interstate immigrants at the level of their original state for up to 12 months. States would be allowed to transfer up to 20% -- or 30% -- of the funds to other block grants.

- **State Requirements:** Benefits must be used to serve families with a minor child. States are required to submit annual data on several measures and must submit to a bi-annual audit. Additionally, under provisions from title III of this act, state social service agencies would be required to provide the name and address of illegal aliens with children to the INS.

- **Prohibitions on States:** States cannot use federal block grant funds to provide benefits to:
  (1) families who have been on the rolls for 5 cumulative years;
  (2) Individuals that are receiving SSI or OAA (current law);
  (3) non-citizens (except refugees and/or aged non-citizens who have resided in the U.S. more than 5 years);
  (4) minor mothers with children born out-of-wedlock;
  (5) children born while on AFDC (*i.e., family cap*); and
  (6) families not cooperating with the state child enforcement agency or who have not assigned to the state the child's claim rights against non-custodial parents (current law).
  (7) Additionally, beginning 1 year following the enactment of the bill, states must pay a

- **Penalties:** If an audit determines that funds were spent inappropriate to the legislation, the misspent amounts can be withheld from future payments to the state. Failure to provide required performance data would be a 3% reduction state annual grant. Failure to participate in Income Eligibility Verification System results in a penalty of 1% of state annual grant.

- **Time Limits:** AFDC would no longer be an entitlement to individuals. States would be prohibited from using federal block grant dollars to provide benefits to a family that has been on the rolls 5 years. Since states determine all rules relating to benefit levels and eligibility, they could establish any time limit.

- **Medicaid:** Transitional Medicaid for recipients who leave due to employment would be eliminated. Recipients of assistance would be eligible for Medicaid. Current recipients that become ineligible for aid would retain Medicaid eligibility.

TITLE II: CHILD PROTECTION BLOCK GRANT

- **Block Grant for Child Protection Services:** The current open-ended entitlement program for IV-E Foster Care and Adoption Assistance Program and the IV-B Child Welfare Services program and Family Preservation and Support program, along with a number of discretionary programs related to child abuse and neglect, would be consolidated into a block grant to states.

- **Funding:** The funding would be $4.145 billion in FY 1996, $4.308 billion in FY 1997, $4.471 billion in FY 1998, $4.631 billion in FY 1999, and $4.789 billion in FY 2000. Administration estimates show that resulting savings would be $5.7 billion over 5 years.

- **State Allotment:** The block grant would be a five year capped entitlement to the states using (not yet specified in bill).

- **State Eligibility for Funds:** States must provide HHS with information on how they intend to use the funds and provide a series of certifications ensuring that procedures are in place on reporting of abuse and neglect and acting on those reports, removal of children and their placement in safe and nurturing settings, and for achieving permanent placement. A declaration of a state's quantifiable goals and their progress is also required.

- **Purpose and Use of Funds:** States may use funds in any manner they so choose to accomplish the purposes specified in the law. The purposes are identifying and assisting families at risk of abusing or neglecting their children; operating a system of receiving reports on abuse or neglect; investigating families reported; assisting troubled families in providing proper protection and nurturing their children; providing foster care; making timely decisions about permanent living arrangements; and continuing evaluation and improvement of child protection laws, regulations and services. Twenty percent of the funds can be transferred to the block grant under Title 1, the Social Services Block Grant, the food and nutrition block grant, and the Child Care and Development Block Grant.

- **Penalties:** If a required audit finds that states have used funds not consistent with the law, funds are to be withheld the following year. However, not more than 25 percent of a quarterly payment can be withheld. Also, the annual grant will be reduced by 3 percent if states fail to submit within 6 months the required data report.

- **Child Protection Goals:** States are required to protect children, investigate reports of abuse and neglect promptly, have permanency planning in place for children removed from their homes and dispositional hearings within 3 months of a fact-finding hearing, and out-of-home placements reviewed every 6 months unless the child is already in a long term placement.

- **Citizen Review Panels:** States are required to establish citizen review panels for each metropolitan region that is broadly representative of the community and meets at least quarterly. The panel is to review specific cases to determine state compliance and make a report available to the public.

- **Data Collection and Reporting:** Annual state data reports are required to be submitted to HHS that includes basic aggregate data on the numbers of children abused and neglected, in foster care, that received services, and other similar information. States must also provide data measuring their progress towards the goals in the law and a summary response to the citizen review panels findings and recommendations. The Secretary of HHS issues an annual report of this data and provides it to the public.

- **Limitation on Federal Authority:** Other than what's specified in the law, the Secretary cannot regulate the conduct of states or enforce any provision of the law.

<u>TITLE III: RESTRICTING WELFARE FOR ALIENS</u>

- **NonCitizens Ineligible for Assistance:** Under these provisions, except for the exceptions noted below, noncitizens would be ineligible for most federal assistance programs. However, adults and children would remain eligible for emergency medical services and immunizations, and several educational and training programs. States would be allowed to use state resources to provide other benefits to noncitizens at state option.

- **Exceptions:** Noncitizens over 75 (who have resided in the U.S. at least 5 years) are eligible for benefits. Refugees are eligible for benefits for up to five years after the date of their arrival. Other noncitizens currently living in the U.S. would become ineligible 1 year after the enactment of the provisions and would receive notification of their ineligibility.

- **Sponsorship:** Sponsorship documents would become legally binding until the noncitizen attained citizenship.

<u>TITLE IV: SUPPLEMENTAL SECURITY INCOME REFORMS</u>

- **Denial of Benefits to Addicts:** Individuals diagnosed with drug or alcohol addiction would no longer be eligible for SSI or Medicaid.

- **SSI Restrictions to Disabled Children and Medical Services Block Grant:** Cash benefits would be restricted. Children would only receive cash benefits or new medical services based only on the medical listing criteria, not the individual functional assessment. Current SSI children receiving cash benefits because of a disability under the medical listing would continue to be eligible for cash, but children not already under SSI will only receive cash payments if they are institutionalized or would be in an institution if the cash payment did not exist. Children considered disabled but not eligible for cash benefits will be eligible for additional medical services under a block grant. This block grant would be an entitlement to states for authorized medical and non-medical services to those children who qualify (those children eligible for SSI cash benefit or who are not eligible for cash but are disabled due to a condition in the medical listing).

Welfare Reform Daily Talking Points
Monday, February 13, 1995

WELFARE REFORM MUST BE STRONG ON WORK, NOT CRUEL TO CHILDREN

Today, Clay Shaw's House Subcommittee on Human Resources begins marking up the Personal Responsibility Act, the welfare reform plan contained in the *Contract with America*. Over the past week, Democrats have united against the Republican proposal, which is tough on children and low-income families, but weak on requiring work. As House Democratic Leader Richard Gephardt said on Friday, "for the Republicans, welfare reform is just a way of passing the buck, kicking people off the welfare rolls, and leaving innocent children out in the street."

- **In fact, the work requirements in the Personal Responsibility Act would be weaker than those under current law.** In 1996, under current law, 11.5 percent of welfare recipients (595,000 people) would be working -- either in part-time private sector jobs or in mandatory work programs. In contrast, under the Republican plan, only two percent of welfare recipients (105,000 people) would be required to participate in "work activities" in 1996.

- **President Clinton's principles for welfare reform will not change.** As he said in his State of the Union address: "We have to help those on welfare move to work as quickly as possible, to provide child care and teach them skills if that's what they need for up to two years. And after that, there ought to be a simple hard rule: anyone who can work must go to work."

This Administration believes that:

- **Welfare reform must be about a paycheck, not a welfare check.** We won't have ended welfare as we know it until the central focus of the program is to move people off welfare and into a private sector job so that they can support themselves and their families.

- **Our goal must be to lift people up from dependence to independence, not to punish them because they happen to be poor, young, or unmarried.** We intend to work with Congress on a bipartisan basis, but we continue to oppose any plan to deny assistance to young mothers, break up families, punish children for their parents' past mistakes, or put children in orphanages.

- **Tough child support enforcement must be a centerpiece of welfare reform.** We're pleased that House Republicans intend to adopt our proposals for child support enforcement, which was a key agreement reached at the Working Session on Welfare Reform. If we're going to end welfare as we know it, we must make sure that all parents -- fathers and mothers alike -- take responsibility for the children they bring into this world.

CENTER ON BUDGET AND POLICY PRIORITIES

THE KASSEBAUM FEDERALISM PROPOSAL: IS IT A GOOD IDEA?

Overview

Senator Nancy Kassebaum has proposed a major restructuring of the social welfare system, under which the federal government would take over full financial responsibility for Medicaid and devolve the food stamp, AFDC, and WIC programs. During a five-year transition period, a maintenance-of-effort requirement would bar states from reducing overall expenditures on cash and food assistance to the poor. States would continue to bear some share of Medicaid costs during the transition. After the transition period, the federal government would take over full responsibility for Medicaid, and states would neither receive federal funds for food stamps, AFDC or WIC nor be subject to any requirement to maintain cash or food benefits.

The idea of "sorting out" federal and state responsibilities — increasing the federal role in some areas and devolving other areas to states — has considerable merit. So does the notion of giving states more flexibility in designing their AFDC programs. Senator Kassebaum's intention clearly is to improve the welfare system and help poor families. Nevertheless, the Kassebaum proposal is seriously flawed; it devolves the wrong set of programs to the states. As explained in this paper, devolving means-tested income security programs such as food stamps is likely to lead over time to incalculable damage to the safety net and to generate substantial increases in poverty, especially among children. Under the Kassebaum plan, devolution would come in precisely the areas where state performance has been most inadequate and where proponents of realigning federal and state roles have traditionally called for a stronger rather than a weaker federal role. The proposal runs counter to the recommendations issued by a distinguished bipartisan Commission that studied these issues carefully in the 1980s, the Committee on Federalism and National Purpose, on which Daniel Evans, Charles Robb, Leon Panetta, Alice Rivlin, Barber Conable, David Durenberger, Richard Gephardt, and Richard Williamson (who handled federalism issues for the Reagan White House during the first Reagan term) served, among others.

The plan also is ill-advised from a macroeconomic standpoint. It would weaken the "automatic stabilizers" the federal government employs to lessen the depth of recessions. In addition, it would cause the federal deficit to swell significantly after the transition period ends.

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Iris J. Lav and Isaac Shapiro, Acting Co-Directors

The timing of the proposal would exacerbate its problems. The plan would be implemented at the same time that federal grants-in-aid to state governments are likely to be sustaining cuts of unprecedented depth, as a result of constitutional and statutory requirements likely to be put in place in the next year or two to balance the federal budget without raising taxes or touching Social Security or defense. In such an atmosphere, the prospects that states would maintain cash and food assistance for the poor after the transition period ends would dim further. These issues are discussed below.

I. Devolving Food Stamps and AFDC

The Committee on Federalism and National Purpose, chaired by then-Senator Daniel Evans (R) and then-Governor Charles Robb (D), called in 1985 for a major realignment of federal and state roles. The Committee proposed a much larger federal role in financing and setting national standards for Medicaid and AFDC, accompanied by the devolution of scores of federal programs to the states. In issuing its recommendations, the Committee affirmed a principle that has undergirded most thoughtful examinations of federalism issues — income security for the poor should largely be a federal responsibility. The Committee wrote:

> "Wherever it occurs, poverty is a blight on our whole society, and Americans in similar circumstances should be treated alike. Children whose early years are damaged by the effects of poverty in one state may later become voters, employees, and possibly welfare recipients in other states."
>
> "Safety net programs also should furnish benefits that can be expected to provide for basic necessities. Welfare programs in many states fall far short of this mark. Even when combined with the cash value of food stamps, AFDC benefits were at or below 60 percent of poverty-level income in 10 states in 1984, and the median level of benefits was 73 percent of the poverty line. [These levels are lower today.]
>
> "Only the federal government can effectively bring about greater uniformity and adequacy of welfare services. This is because it is the only source of nationwide political authority and because it is the only level of government that commands the necessary resources."[1]

Trends in welfare programs since 1970 support the Committee's conclusion. Even though the federal government matches every state AFDC benefit dollar with between $1 and $3.65 in federal funds (depending on the state), AFDC benefits in the median state have fallen 47 percent in real terms since 1970. AFDC benefits have tumbled so far that the average combined AFDC and food stamp benefit for a family with no other income is

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[1] Daniel J. Evans and Charles S. Robb, Chairmen, *To Form a More Perfect Union: The Report of the Committee on Federalism and National Purpose*, December 1985, pp. 13-14.

now back to the level of AFDC benefits alone in 1960, before the food stamp program was created.

It may be argued that the decline in AFDC benefits largely reflects public antipathy to non-working, unmarried mothers rather than the role of states in setting these benefit levels. But the evidence suggests otherwise. State SSI benefit supplements for the elderly poor, a much more sympathetic group than AFDC families, have declined even more; since the SSI program started in 1974, state SSI benefits for poor elderly people living alone have dropped 63 percent in the median state that pays these benefits. State SSI benefits for elderly couples have dropped 75 percent.[2]

The Historical Pattern

In fact, when one examines benefit trends, a distinct pattern emerges. In the two programs where benefits are 100 percent federally funded and national benefit standards exist — the food stamp program and the federal SSI program — there has been no benefit erosion over the past 20 or 25 years. By contrast, in AFDC, where states set the benefit levels and pay part of the costs, benefits have fallen sharply. In the state component of SSI, where states set benefit levels and pay 100 percent of the cost, benefits have fallen even more steeply. (See Table I.) And the cuts have been most severe in state general assistance programs that receive no federal financial support and provide cash aid to poor people who aren't elderly, aren't sufficiently disabled to get SSI, and don't qualify for AFDC because they either don't care for children or live in two-parent families that don't meet the restrictive AFDC eligibility criteria that apply to such families. Most states that formerly operated general assistance programs have eliminated them or limited benefits to a fixed number of months out of the year. These deep GA cutbacks have increased the ranks of the homeless population, according to some studies.

This background is essential for assessing the Kassebaum proposal. Once the five-year transition period ends, the Kassebaum plan would place AFDC, food stamps, and WIC under a structure similar to that used for general assistance (and to a lesser extent, for state SSI benefits). States would decide whether to provide benefits, which categories of the poor to cover, and where to set benefit levels. Benefits would be paid entirely with state funds. *If states reduced AFDC benefits 47 percent in real terms over the past 24 years when the federal government paid 50 percent to 80 percent of the benefit costs, what would happen to food stamp and AFDC benefits when the federal government paid none of the costs?* The history of state general assistance programs in recent years is a chilling example of what could occur in some areas.

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[2] When federal and state SSI benefits are examined together, the combined benefit package shows a decline because of the large drop in state SSI benefits. In the median state that provides state SSI benefits, combined federal and state benefits have fallen about 10 percent in real terms since 1975. This translates into sizeable benefit declines. Combined federal and state SSI benefits for elderly couples are now about $100 a month — or $1,200 a year — lower than in 1975 in the typical state that provides SSI benefits. This is a large loss for people living below the poverty line.

Table I

Trends in Maximum Benefit Levels Over the Past Quarter Century
(Percentage changes reflect changes in real dollars)

State-Prescribed Benefit Levels	
AFDC (1970-1994)	-47%
SSI State Supplements (1975-1994)	
elderly individuals	-63%
elderly couples	-75%
Federally Prescribed Benefit Levels	
Food stamps (1971-1994)	+3%
SSI federal benefits (1974-1994)	+6%

Advocates of the Kassebaum proposal may respond that states would reap substantial savings from being relieved of fiscal responsibilities for Medicaid and the pressures of rising Medicaid costs — and hence could provide adequate cash and food assistance. Such a response, however, would miss several key points.

First, constitutional and statutory provisions are likely to be put in place soon that require a balanced federal budget in seven years while "walling off" defense and Social Security and requiring a three-fifths vote to raise taxes on the House floor. If this series of developments unfolds, federal grants-in-aid to state and local governments — including grants for many services benefitting the middle class — will have to absorb very large hits. And if federal funds for education, infrastructure, mass transit, economic development and similar tasks are substantially reduced, there will be intense pressure in statehouses to accord higher priority to dedicating state resources to these areas than to using scarce funds to avert reductions in cash and food aid for the poor.

That, after all, has been the broad pattern in states for the past two decades. In addition, in recent years, most states have not appropriated sufficient state funds to draw down the full amount of federal matching funds available to the state for the JOBS program, which provides training and work experience — and enforces work requirements — on AFDC recipients. Despite the broad interest in welfare reform at the state level, most AFDC recipients remain outside the JOBS program today in no small part because state legislatures, faced with competing priorities, have placed state resources elsewhere.

That under the Kassebaum proposal the funds states provide for food and cash assistance would not be matched by any federal dollars is likely to add to the difficulty of securing adequate funds for such assistance when states must make tough decisions on fiscal priorities, especially when these decisions involve competing interest groups that wield more clout than poor families and children. Furthermore, some of the programs with which cash and food aid for poor families would have to compete have their own federal matching provisions; in competing with such programs, cash and food aid for the poor would be at a further disadvantage. Adding to these problems is the fact that states compete with each other in other areas such as higher education systems and tax burdens, but not over which state provides more adequate assistance to poor households.

Another problem with the argument that states will perform satisfactorily in providing resources for cash and food assistance is that it fails to address the problems states would face during recessions. Under the current benefit structure, the amount of federal food stamp benefits provided in a state automatically rises when the state economy turns down and unemployment and poverty mount. State-funded programs for the poor, by contrast, tend to be *cut* during recessions, because state revenues contract during economic slumps. If AFDC and food stamps are devolved, states will be forced to choose between absorbing the additional benefit costs during recessions (which in most states would require cutting other programs or raising taxes), reducing benefits across the board, denying benefits to categories of needy families, and putting new applicants on waiting lists. History provides a strong indication of the likely outcome — most states will not be able to increase the resources available for these programs during recessions when state budgets experience strain and tax collections fall. It is more likely that funding for these programs will be cut than increased during hard times; indeed, general assistance benefits and SSI supplements were cut in numerous states during the recession of the early 1990s (and were not restored during the subsequent economic recovery).

Not only would state inability to boost funding during recessions result in greater hardship, but it also could weaken the national and state economies. The food stamp program is the federal government's most important "automatic stabilizer" after unemployment insurance; under the Kassebaum plan, it would no longer play that role. Neither would AFDC. As Alice Rivlin wrote in 1992, over the past several decades "social insurance and welfare programs not only provided income to individuals and families facing economic disaster, they also made economic disaster less likely. If economic activity dropped off sharply, the downward spiral would be cushioned, since individuals drawing social insurance benefits and welfare would be able to buy necessities and pay their rent or mortgages. This increased purchasing power would bolster the income of producers and prevent layoffs of workers and forced sales of homes. Thus, both welfare programs and social insurance would act as automatic stabilizers for the economy."[3]

Still another issue is that some of the poorest states in the nation would lose heavily under the proposal. For example, because of its relative poverty compared to other states, Mississippi receives a high federal matching rate for AFDC and Medicaid. The federal government pays about 79 percent of AFDC and Medicaid costs in the state, along with 100 percent of food stamp benefits. If Mississippi were relieved of paying Medicaid costs but received no food stamp, AFDC, or WIC funds, the state — and its poor

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[3] Alice M. Rivlin, *Reviving the American Dream, the Economy, the States, and the Federal Government*, The Brookings Institution, 1992, pp. 90-91.

families — would be hit hard. Mississippi would have to absorb the 79 percent of AFDC costs and the 100 percent of food stamp and WIC costs the federal government now pays, while being relieved of just the 21 percent of Medicaid costs it now bears. In fiscal year 1994, the federal government paid $574 million in AFDC, food stamp, and WIC costs in Mississippi, while the state paid $278 million in Medicaid costs, less than half as much. The state thus would suffer a large loss under the swap. Mississippi already pays the lowest AFDC benefits in the nation; they equal just 12 percent of the poverty line. When food stamps are added in, they bring a family to only about two-fifths of the poverty line. Under the proposal, Mississippi would be unable to afford even this meager level of benefits. In short, poverty would be likely to become grimmer in some very poor parts of the country.

Finally, if Medicaid is federalized and the federal government pays 100 percent of Medicaid costs, the wide variations that now exist among states in the categories of households eligible for Medicaid and in the health services covered could not be justified — and would likely be eliminated. To limit its fiscal exposure, the federal government could be expected to set national Medicaid eligibility and service levels no higher than those provided in the average state. If states with more extensive eligibility rules or service coverage wished to maintain their coverage in order to avoid increasing the ranks of the uninsured or dropping particular medical services, they would have to do so entirely with state funds. In a number of states, some of the savings that the state secured from no longer paying a portion of Medicaid costs would likely be used to maintain some of the Medicaid coverage and services that would otherwise be lost.

Some defenders of the Kassebaum proposal may say that if these concerns are borne out and state aid is reduced significantly after the maintenance-of-effort period ends, parts of the AFDC, food stamp, and WIC programs could be refederalized or the maintenance-of-effort requirement could be extended or reimposed. This seems unrealistic, however. The federal government is likely to face a constitutional requirement for a balanced budget starting in fiscal year 2002 and be struggling mightily to meet it. It will be in no position to refederalize cash and food assistance, as that would carry a hefty cost that would have to be borne on top of the costs of a fully federalized Medicaid program. And with the federal government cutting grants to states substantially to help achieve budget balance, it will be in no position to reimpose or extend a maintenance-of-effort requirement. Moreover, doing so would likely run afoul of unfunded mandate legislation that Congress is likely to pass in the next few months.

A Closer Look at the Role of the Food Stamp Program

When the role of the food stamp program is examined, the problems posed by the Kassebaum plan deepen. The food stamp program has unique features, a factor that has led Senator Robert Dole on more than one occasion to call food stamps the most important social program since Social Security.

The food stamp program provides the only national benefit floor in the United States under poor children. If the national benefit structure is scrapped and federal funding for the program ends, benefits for poor children are likely to decline over time.

As noted, over the past quarter century, food stamp benefits have kept pace with need and escaped the sharp reductions in purchasing power that have marked AFDC, SSI state supplements, and general assistance. This is due in no small part to the program's national benefit structure under which the federal government fully funds food stamp benefits, the benefit levels are indexed to food costs, and the benefits are available on an entitlement basis so the program can respond automatically to increased need during recessions or when wages for low-paid jobs erode. The program's strength also is partly attributable to an apparent public preference for in-kind benefits over cash aid, especially for the non-elderly poor.

The program's political strength and durability stem in part from one other critical program feature as well — the food stamp program is the only major low-income benefit program that serves all categories of the poor *under a single benefit structure*, the one program in which the same benefit formula that applies to low-income elderly people also is used for poor mothers and children. As a result, a reduction in benefits hits the elderly poor along with poor children; this makes the program less vulnerable and more resistant to cutbacks. Various proposals to cut food stamp benefits advanced in the early 1980s by President Reagan or then-Agriculture Committee chairman Jesse Helms were turned aside primarily because of their impact on the elderly. Some of these proposals would probably have passed if they had affected only the non-elderly poor.

Another key feature of the food stamp program is its role in helping moderate what otherwise would be huge differences between states in the benefits they provide to poor children. In states that pay low AFDC benefits, food stamp benefits are large, since a family's food stamp allotment depends on its income level. This is of particular importance for poorer states with limited fiscal capacity — such as a number of states in the South — and for the poor children who live in these states. The federal food stamp program mitigates disparities among states and places a floor under children in the poorest jurisdictions.

For example, the State of Connecticut provides a family of three that has no other income with an AFDC benefit of $680 per month, about two-thirds of the poverty line. Mississippi, by contrast, pays a family of three only about one-sixth as much — $120 a month, which is less than 12 percent of the poverty line. When food stamps are added in, the benefit package in Mississippi climbs from about one-sixth of the size of the Connecticut package to half of it. The combined AFDC and food stamp benefit package pays a little more than 41 percent of the poverty line in Mississippi and a little less than 83 percent in Connecticut. Similarly, the disparity between welfare benefits in two of the largest states — California and Texas — is cut in half when food stamps are added to the package. (See Table II.)

Table II

The Impact of Food Stamps on State Variations in Benefit Levels

State	**Maximum Monthly AFDC Benefit***	**Monthly AFDC and Food Stamps Benefits****	**Maximum AFDC as % of Poverty**	**AFDC and Food Stamps as % of Poverty**
California	$607	$805	59.12%	78.43%
Texas	$184	$488	17.92%	47.48%
Connecticut	$680	$850	66.23%	82.74%
Mississippi	$120	$424	11.69%	41.25%

* January 1994 AFDC grant levels for a family of three with no other income, as reported by the Congressional Research Service.

** Assumes average shelter costs for food stamp households in respective states as reported in USDA's report on the characteristics of food stamp households in summer 1992 (expressed in 1994 dollars).

Under the Kassebaum plan, these unique features of the food stamp program would all be lost:

- There would be no national benefit structure or floor under poor children. In addition, in some states, various categories of the poor that now qualify for no other aid except food stamps — such as poor non-elderly single individuals — might receive no assistance at all.

- There would be no automatic increase in food benefits if food prices climbed. Nor would the number of people receiving benefits automatically rise if poverty and unemployment mounted.

- The already-wide differences among states in benefit levels would be likely to increase substantially, a particular problem for poor families living in Southern states. This also could lead to pressures on states with well-above average benefits to cut benefits in order to lessen risks of welfare in-migration (i.e., the increased gaps among states in benefit packages would increase political pressures on "high-payment" states to moderate their benefit payments).

- Moreover, the concept of a single benefit structure covering poor children and poor elderly people alike would be abandoned by many, if not most, states. Many states would probably end most uses of food stamps and instead raise the AFDC cash benefit level for AFDC recipients and the SSI state supplement for recipients of that program. Over time, these cash benefits would likely erode in purchasing power, just as state AFDC and SSI benefits have in the past.

It should be noted that the food stamp program lacked a national benefit structure in its early years. The national structure was instituted under President Richard Nixon, with bipartisan support, when large state-by-state disparities in state food stamp benefit structures emerged and studies found hunger to be a serious problem in many areas. Prior to this action by the Nixon Administration and Congress, some states were denying food stamps to families with incomes as low as half the poverty line — as some states still do today in AFDC — even though food stamps were federally funded.

II. Devolving the WIC Program

Devolving WIC also would be unwise. A 1992 GAO review of the cost-effectiveness of an array of children's programs found the data on WIC's effectiveness to be stronger than the data on any other such program. Indeed, WIC's documented impact on birth outcomes is nothing short of spectacular.

Rigorous studies have demonstrated that WIC markedly reduces infant deaths, low birthweight, prematurity, and other problems. It also is associated with higher immunization rates and increased use of prenatal and pediatric care. Evidence also suggests that WIC reduces child anemia, and there are indications it improves cognitive functioning among children. In short, WIC works. A panel of Fortune 100 CEO's noted when testifying before the House Budget Committee in 1991 that WIC is "the health-care equivalent of a triple-A rated investment" and called for the program to be fully funded in five years.

Documented successes of this nature are rare among social programs, and WIC may be the most successful low-income program the federal government operates. Given its track record, devolving it — which would likely lead to changes in the program that would lessen its effectiveness — does not represent sound policy.

There are two reasons why devolving WIC is likely to compromise its effectiveness. First, funding for it would probably decline over time. In no year under Ronald Reagan's tenure — or that of any other President — has federal WIC funding been reduced. Reagan's efforts to cut WIC were decisively rejected by the Republican Senate in 1981 and 1982, at a time when most other cuts in low-income programs proposed by the Reagan Administration were being approved. Federal WIC funding has increased nearly every year. In the late 1980s and early 1990s, George Bush sought major increases in WIC funding, as Bill Clinton is now doing.

But the story is different at the state level. Even though state appropriations for WIC generally qualify a state for a larger federal WIC allocation, those states that provide funds for WIC have been reducing them in recent years. In the past two years, state funding for WIC has fallen 33 percent in real terms.

Second — and most important — devolving WIC would change its character in ways that would almost certainly lessen its effectiveness. WIC features what may be the most effective set of cost-containment measures of any federally-supported health program. Federal law requires every state to use competitive bidding to purchase infant formula for WIC. These competitive bidding procedures typically result in price reductions of 60 percent to 80 percent and saved $920 million in FY 1994, according to USDA data. The savings were used to provide WIC foods to an additional 1.5 million pregnant women, infants, and children each month. Today, nearly one of every four WIC participants is served with savings from WIC infant formula cost containment systems.

In a number of states, these systems probably would be weakened if WIC were devolved. In many states, the two largest infant formula manufacturers — which control nearly 90 percent of the domestic infant formula market between them — have considerable clout with state health departments and medical associations. Prior to passage of the 1989 federal law requiring use of competitive bidding to purchase infant formula for the WIC program, fewer than half of the states had instituted this practice.

In addition, more than half of the states have now joined in multi-state contracts for the purchase of infant formula for WIC. This increases savings; the infant formula companies offer larger price reductions when a greater volume of sales is at stake under a WIC contract. If WIC is devolved and the programs that replace it vary significantly from state to state, the extent of multi-state contracting is likely to decrease — and savings are like to fall as a consequence.

Still another problem is that if WIC is devolved, agricultural commodity interests that are potent in particular states are likely to push hard to have their commodities added to the WIC food package in these states. There is a strong likelihood that such efforts will succeed in a number of places. By contrast, at the federal level, Republican and Democratic administrations alike have stood firm against such encroachments and succeeded in making decisions on the food package entirely on scientific merit. If items are added to the food package largely due to political muscle, more nutritionally valuable foods will have to be dropped or the benefit package will grow more costly, with the result that fewer women and children are served.

In short, devolution of WIC would weaken one of the most successful and effective of all federal poverty programs. It should be noted that there has been no call from states for devolving WIC or block-granting it. As with most other programs, WIC is not problem-free, but the federal-state partnership works quite well here.

III. Swelling the Deficit

Another problem posed by the Kassebaum plan is that it would swell the federal deficit substantially once the five-year transition period ended. The state share of Medicaid costs — which would be transferred to the federal government — greatly exceeds the federal AFDC, food stamp, and WIC costs that would shift to states. In addition, Medicaid costs are rising more rapidly than costs in the three cash and food aid programs. (The proposal is likely to appeal to governors for this reason.)

CBO projections indicate that the state portion of Medicaid costs will significantly exceed $100 billion in fiscal year 1999. Federal AFDC, food stamp, and WIC costs will be less than $55 billion that year. While the federal government may be able to save some money in Medicaid through certain administrative efficiencies that it can more readily implement if it takes over full financial responsibility for the program, this would not yield savings of anything close to $50 billion a year.

The federal government also could eventually bear other costs if states shifted into the foster care system some AFDC cases in which the custodian is not the child's parent. States would have an incentive to do so, since the federal government provides matching funds for state foster care costs but would no longer do so for AFDC costs. Shifting cases to the foster care system would financially benefit both the state and the families in question, but increase the drain on the federal treasury.

Complications During the Transition Period

A shorter-range problem is that the Kassebaum plan would be difficult to administer accurately and equitably during the five-year transition period. State maintenance-of-effort requirements, as well as federal payments to states during this period, would be determined by a formula under which HHS and USDA estimated how much AFDC, food stamp, and WIC caseloads would have risen in each state in each calender quarter during the transition if the current programs had remained intact. Such estimates would be extremely difficult to make accurately. Disputes and extensive litigation would be likely.

IV. Conclusion

Realignment of federal and state roles is an important issue, and there are strong advantages to greater federal participation in Medicaid. A "swap" that devolves various federal programs in return for increased federal Medicaid funding may be worth exploring.

But this does not mean any federal program is an appropriate candidate for devolution. Various community and economic development, infrastructure, education, and services programs may be candidates. But income security programs for the poor — especially basic safety net entitlements for poor children — are not.

Senator Kassebaum is neither a welfare-basher nor someone seeking to harm poor children. Nevertheless, her proposal would likely have severe effects. As a *New York Times* editorial noted on November 25, "States may be the right place to locate many programs Washington houses, but welfare is not one of them. States have a huge financial incentive to skimp on benefits — to drive poor residents out and persuade the poor from other states never to enter. Note that states eviscerated welfare benefits during the 1970s and 1980s while Washington kept federal benefits whole."

Devolving food stamps, AFDC, and WIC — especially at a time when the federal government is likely to cut sharply into other federal grants to state and local governments — is likely to lead to increases in poverty, hunger, and even homelessness in the decades ahead. As a result, it would risk making our society more deeply divided.

Devolution and increased state flexibility are not synonymous. Proposals can be designed to accord states substantially increased flexibility in designing and operating their AFDC programs without terminating federal support for cash and food assistance for poor families.

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CENTER ON BUDGET AND POLICY PRIORITIES

THE *CONTRACT WITH AMERICA* PROPOSAL: ASSESSING THE LONG-TERM IMPACT

By Iris Lav, Cindy Mann, and Pauline Abernathy

Overview

On September 27, 1994, a number of federal tax and budget changes were proposed in a *Contract with America* released by a group including House Republican Members of Congress. Among other proposals, the Contract calls for changes that would reduce revenues by approximately $190 billion over the next five years.[1] The revenue proposals include a new tax credit for children, a new type of Individual Retirement Account, reductions in the rate of taxation of capital gains income, a reduction in taxes for businesses that invest in buildings, machinery, and equipment, and a reduction in the extent to which Social Security income is taxable for higher-income taxpayers. In addition, the proposal calls for a constitutional amendment requiring a balanced budget by the year 2002.

There are four key issues with respect to the long-term impact of the Contract.

- **The revenue loss under the plan would rise dramatically after five years**. The plan is presented as losing $190 billion in revenue over the next five years, itself a substantial amount. But the IRA, capital gains, and business depreciation provisions are designed so they lose smaller amounts or even *raise* revenue over the next five years — and then lose much larger amounts of revenue after the five-year period ends. For example, the IRA proposal is said to raise $5 billion over the next five years, but past analyses show that it could eventually lose $50 billion over subsequent five-year-periods. The overall eventual revenue loss from the

> Since 1984, the Center on Budget and Policy Priorities has been analyzing the effects of various tax and budget proposals on low-income families. Over the years, the Center has issued more than 20 analyses of tax plans, including analyses of the Clinton, Bush, Gingrich, Bentsen, and Rostenkowski tax proposals. This analysis of the "Contract with America" is the latest in this series.

[1] House Budget Committee minority staff cost estimates for Contract with America, September 22, 1994. No further estimates were released with the Contract. The staff estimate showed a total cost of $147.9 billion, which was comprised of $192.9 billion in net revenue reductions offset by $45 billion in spending cuts in welfare, nutrition, and crime bill programs.

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Contract for subsequent five-year periods thus greatly exceeds $190 billion.

- **The revenue proposals would likely cause either a worsening of the deficit or unusually large reductions in major benefit programs.** The deficit has been halved as a share of the Gross Domestic Product since 1992, but the proposals in the Contract would put further progress in question. Over the next five years, large potential budget savings would have to be devoted to paying for tax cuts rather than continuing to make progress on deficit reduction. After five years, when the revenue losses would escalate, much larger cuts would be needed to keep the deficit from growing larger. If, in addition, the budget had to be balanced — as the Contract calls for — cuts of unusual depth would likely have to be made in many of the big-ticket items in the budget. This suggests that major benefit programs such as Medicare, Medicaid, veterans programs, and Social Security could be subject to substantial reductions.

- **High-income households would be the only clear winners.** Several of the major revenue proposals — including the changes in IRAs, capital gains taxation, and the taxation of Social Security income — would primarily benefit those at higher income levels. Past analyses indicate, for example, that about 95 percent of the benefits from the IRA proposal would accrue to the top fifth of the population, while about half of the benefits from the capital gains provisions would go to the top one percent. Middle-income families would benefit significantly from the $500 per child tax credit, but whether middle-income families are better off in the long-run would depend on how the costs of the various tax cuts are financed. This is especially true in years after the five-year budget period ends, when the costs of the tax cuts primarily benefitting upper-income households and corporations begin to mushroom. If financing the tax cuts required sharp cuts in programs from which middle-income families derive substantial benefits, significant numbers of middle-income families might find their disposable incomes reduced as a result of the offsetting actions.

  Low-income households are the clear losers. They would gain little from the tax proposals but bear most of the burden from the budget cuts identified in the Contract. They would likely also be affected by other cuts that would ultimately have to be made.

- **Future Medicare benefit reductions or tax increases would be required.** The Medicare hospital insurance trust fund is out of long-term balance. The Medicare actuaries project that without changes to reduce Medicare costs or increase the revenues flowing into the trust fund, the Medicare hospital insurance trust fund will be insolvent by 2001. The Contract would reduce the taxes of higher-income Social Security beneficiaries by lowering the proportion of their Social Security benefits that is subject to taxation; the taxes that would be cut are now deposited in the Medicare hospital insurance fund. By withdrawing these revenues, the Contract would push Medicare further out of balance and require larger Medicare reductions or tax increases to avert insolvency.

Escalating Costs in Future Years

In issuing the Contract, its authors have provided estimates of its costs over the next five years. The costs of the proposed new Individual Retirement Accounts, capital gains taxation, and business depreciation allowances, however, are likely to increase rapidly in years after that. Each of these proposals has been structured to have costs that are relatively small in the initial years after enactment but increase over time.

Individual Retirement Accounts

The plan creates a new type of IRA from which anyone, regardless of income or pension coverage, could benefit. This would restore full eligibility for Individual Retirement Account tax benefits to the highest-earning 30 percent of taxpayers, who lost eligibility for these tax benefits as a result of the Tax Reform Act of 1986. It also would index the $2,000 maximum permitted contribution for inflation in future years and allow non-working spouses to make full contributions. The Contract shows the IRA proposal as *raising* $5 billion over the next five years. Yet in 1991, the Joint Tax Committee estimated that simply restoring eligibility to tax filers who lost it in 1986 — a less generous provision than that in the Contract — would be expected to *lose* $30 billion to $40 billion over five years.

The IRA provision in the Contract raises revenue in the near term because it changes the timing of revenue gains and losses. Under conventional IRAs, taxpayers pay taxes on withdrawals of principal and interest after they retire. By contrast, the new IRAs proposed in the Contract are "backloaded;" taxpayers do not receive an up-front deduction for deposits, but all interest earned in the account is permanently tax exempt. Over the long term, backloaded IRAs cost the federal government about the same as regular IRAs, but the timing of the revenue losses differ. Backloaded IRAs have very small up-front costs and larger costs in subsequent years. Over time, the costs mount because, as additional funds are deposited each year in backloaded IRAs, the interest earned on an increasing share of personal savings in the United States becomes exempt from taxation.

In addition, the proposal would encourage "rollovers" of existing IRAs into the new, "backloaded" IRAs. Rollover provisions also help turn the IRA proposal from a revenue loser to a revenue gainer over the next five years. The rollover provision would give taxpayers with existing IRA accounts a one-time only option to pay taxes now on the funds in their IRA accounts and transfer the funds into new "backloaded" IRAs. Funds so deposited in the new IRAs could be withdrawn in the future without any further tax payments; in other words, all future interest earned on these amounts would be tax-free. Because the rollover provision would be attractive to existing IRA account-holders, many would make use of it. As taxpayers convert their existing IRAs to new IRAs and pay taxes on the funds in their existing accounts, billions of dollars in revenue collections that would normally occur years into the future are shifted into the next few years instead.

Thus, the combined effect of the backloaded and rollover provisions is simultaneously to push most of the revenue losses caused by the new IRA benefit outside the five-year budget window, while accelerating into the five-year period some billions of dollars in revenue collections that normally would occur later. The effect is to take an expensive tax cut and make it appear as though it saves money.

The backloaded and rollover devices were not invented by the authors of the Contract. They were developed by both Democratic and Republican members of Congress in the early 1990s as a way to facilitate consideration of IRA tax cuts without having to pay for them under the "pay-as-you-go" budget rules. Past Congressional Research Service analyses of similar proposals suggest that the IRA provisions in the Contract could cost $50 billion or more over subsequent five-year periods, after the rollover period ends and the amount of exempt interest in the IRA accounts grows.[2]

Taxation of Capital Gains

The Contract would cut the capital gains tax — the tax on profits from the sale of assets such as stocks, bonds, art, and rare coins — in two ways. The capital gains proposal in the Contract would allow taxpayers to exclude half of their capital gains profits from taxation. In addition, it would allow taxpayers to adjust the purchase price of an asset for inflation that occurs after the effective date of the law in computing the amount of their capital gain.

This proposal goes well beyond most capital gains proposals advanced over the last several years, including those proposed by the Bush administration. Although the maximum tax rate on other types of income is now 39.6 percent, under the Contract, capital gains income would be taxed at a maximum rate of 19.8 percent, and at lesser rates after adjustment for inflation. At no time during the last 40 years has the maximum effective tax rate on capital gains income been so low. The plan's sponsors estimate the capital gains provisions will cost $56 billion over the next five years. But this estimate, as well, likely understates future costs.

[2] Statement of Jane G. Gravelle, Congressional Research Service, before the House Committee on the Budget, February 11, 1992.

For a short period of time, a capital gains tax cut can increase revenues as investors decide to sell assets sooner than they otherwise might to take advantage of the new provision excluding 50 percent of capital gains profits from taxation. Once the sale of assets stabilizes, however, the cost of the lower tax rate on profits will increase rapidly — both because some of the sales that would have produced future revenues will have already occurred and because the tax per transaction will be cut by more than half as a result of the 50 percent exclusion and indexing. A past Joint Committee on Taxation analysis of President Bush's 1992 proposal for a 45 percent capital gains exclusion found an accelerating revenue loss; by the end of the first six-year period, the annual revenue loss was double the average annual loss for the period as a whole. The provision to apply indexing to assets after the effective date of the new law also is likely to have a rapidly escalating cost. An analysis of a 1991 indexing proposal put forward by Representative Gingrich showed a relatively small cost — a total of $700 million — in the first three years, but a much larger cost — $2.6 billion — by the fifth year. The eventual five-year cost of indexing alone, without the 50 percent capital gains exclusion, could be as high as $40 billion.[3]

Depreciation Deductions

The Contract also proposes some complex changes in depreciation allowances, which are the way that businesses account for the use of capital investments such as buildings, machinery, and equipment in the production of business income. For financial accounting purposes, the cost of such an investment is deducted in equal amounts over the investment's expected useful life. Current tax law allows some acceleration of these deductions into the early years of ownership, with smaller deductions in subsequent years; total deductions are limited to the value of the initial investment.

The "neutral cost recovery system" (NCRS) proposed in the Contract would reverse current law. Deductions in the early years of ownership would be *smaller* than those allowed under current law, but deductions in later years would be much *larger*. In addition, total deductions would *not* be limited to the initial investment. For example, a business that purchased a $100,000 building or piece of equipment expected to last 20 years might deduct $300,000 or $400,000 under NCRS, while the total deduction would be limited to $100,000 under current law. The Contract says the depreciation changes would *raise* $20 billion over the next five years. A proposal that was similar in design except that it did not reduce initial deductions was estimated in the past by the Joint Tax Committee to cost $58 billion over its first five years. Once a

[3] Jane Gravelle estimates that the cost of capital gains indexing in the fifth year represents about 30 percent of the annual cost that can be expected when losses stabilize. Applying Gravelle's calculations to the Joint Committee estimate of the Gingrich indexing proposal suggests the eventual cost of indexing could be at least $40 billion. Jane G. Gravelle, *Estimating Long-Run Revenue Effects of Tax Law Changes,* Eastern Economic Journal, Vol. 19, No. 4, Fall 1993.

substantial portion of new investment is being depreciated under the new method, the Contract proposal would likely be at least as expensive .

Impact on Deficit Reduction

The revenue reductions in the Contract are estimated by its sponsors to cost $190 billion over the first five years. As discussed above, the cost in subsequent years is likely to be much greater. The sponsors do not indicate how the majority of these cuts will be financed, but they call for a constitutional amendment requiring a balanced budget by the year 2002.

According to the Congressional Budget Office, balancing the budget gradually over a five-year period would require spending cuts or tax increases totalling approximately $750 billion. These measures would be in addition to those needed to pay for the revenue reductions proposed in the Contract.

Substantial progress has been made in recent years in reducing the federal budget deficit. In its most recent analysis, the Congressional Budget Office projected that the 1995 deficit will be a smaller share of GDP — 2.3 percent — than in any year since 1979. This is a sharp drop from its 1992 level of 4.9 percent. The recent progress in reducing the deficit has required difficult tax increases and painful budget cuts. In addition, under current forecasts, further deficit reduction action is required to keep health care costs from driving the deficit higher by the end of the decade. The Contract calls further progress into question. Over the next five years, large, potential budget savings would be devoted to paying for tax cuts, rather than continuing progress on deficit reduction. And outside the five-year budget period, the deficit likely would increase sharply unless very large cuts in domestic spending programs were made to offset the mounting revenue reductions.

Impact on the MedicareTrust Fund

The Contract includes a provision that would lower the taxes of the highest-income 13 percent of Social Security beneficiaries, reversing changes made in the 1993 budget reconciliation act. Since funds from those taxes are deposited directly to the Hospital Insurance (Medicare) Trust Fund, this provision would weaken the trust fund's financial condition.

The most recent report of the Social Security actuaries says that the Medicare Trust Fund is out of long-term balance. Without changes to reduce Medicare costs or increase the revenue flowing into the trust fund, the Medicare Trust Fund will be insolvent by 2001. The loss of the additional tax revenue would push Medicare further out of balance. Offsetting actions, such as reductions in benefits or tax increases, would be required to avert insolvency.

Distribution of Costs and Benefits

Low- and middle-income households will receive little benefit from the proposed IRA and capital gains changes. It is likely, however, that a number of federal programs benefitting such households would ultimately have to be cut to compensate for the cost of the tax cuts, particularly beyond the five-year budget period.

Although all taxpayers would be eligible to use the new IRAs, the benefits of the change would accrue primarily to higher-income taxpayers. Most middle- and lower-income taxpayers — an estimated 70 percent in 1995 — are already eligible for up-front IRA tax deductions. In addition, the higher a taxpayer's income level, the more likely the taxpayer is to have money to save and thus to use for IRA deductions. In 1986, the last year that IRA deductions were available to all taxpayers, 66 percent of the tax filers in the top four percent of the income scale made IRA contributions, but only 13 percent of those in the middle third of the income scale did. Finally, the higher an individual's tax bracket, the greater the tax benefit derived from an IRA deduction.

Joint Tax Committee estimates of earlier IRA proposals indicated that the top one-fifth of taxpayers would receive approximately 95 percent of the tax benefits. The wealthiest five percent of taxpayers — those with incomes of at least $100,000 — would collect nearly one-third of the tax benefits.

The benefit of excluding a portion of capital gains income from taxation would be even more tilted toward upper-income taxpayers, as indicated by analyses of previous capital gains proposals similar to those in the Contract. In analyzing President Bush's 1992 proposal to exclude 45 percent of capital gains from taxation, the Joint Committee on Taxation estimated that 70 percent of the benefit would go to taxpayers with incomes of at least $100,000. The top one percent of taxpayers — those with incomes of at least $200,000 — would capture more than half of the total tax benefits from a capital gains exclusion. Similarly, the Joint Tax Committee estimated that about half the benefits from indexing would accrue to the wealthiest one percent of taxpayers.

Since wealthy individuals and families receive the least assistance relative to their incomes from government programs that would have to be cut to compensate for the revenue losses, they would be the clear winners under the Contract.

The $500 per child tax credit included in the Contract at a cost of $107 billion over five years would immediately benefit many middle-income families. Whether middle-income families are better off in the long-term, however, would depend on how the costs of the tax cuts are financed, especially in future years when the costs of the tax cuts that primarily benefit upper-income households and corporations would grow rapidly.

If the budget gaps that resulted from the need to pay for the new tax cuts and balance the budget in years after 2002 had to be closed without raising taxes, cutting defense, or significantly cutting Social Security, the reductions in the rest of the budget would have to be massive. The benefits provided to middle-class Americans under programs such as Medicare, veterans benefits, farm programs, student loans, and retirement benefits for current civilian and military employees would likely face reductions of unprecedented severity. If financing the tax cuts ultimately requires sharp reductions in programs from which middle-income families also benefit, significant numbers of middle-income families might find their incomes reduced or their expenses increased as a result of such offsetting actions.

Low-income households are the clear losers. They would gain very little from the tax proposals, and would bear a disproportionate share of the burden of the resulting cuts in federal programs. The principal spending cuts specified in the Contract are $40 billion over five years from reductions in AFDC, Supplemental Security Income, public housing, and nutrition programs.

The proposals in the Contract thus would likely exacerbate recent trends in income disparities. From 1977 to 1990, the average after-tax income of the richest one percent of American households *doubled*, after adjusting for inflation, while the income of the average American household in the middle fifth of the income distribution rose by a scant 3 percent, and the income of the lowest-income fifth of American households dropped by 12 percent.[4] The benefits of key tax proposals in the Contract, such as the new IRA and the capital gains taxation changes, would accrue to the groups that have fared the best in income growth over the last decade.

A more comprehensive version of this report will be available in the near future.

September 29, 1994

[4] Congressional Budget Office. 1990 is the most recent year for which this data is available.

November 15, 1994

MEMORANDUM TO LEON PANETTA AND BOB RUBIN

From: Gene Sperling

Subject: Budget Strategy

It is vital that everyone considering overall strategy for the next two years as well as the next two months, consider the strategic dynamics of the budget, how we can play them to our advantage, and how they interact with other Presidential goals.

No one should underestimate what is at stake: while other political trends could shift back and forth with other events, the combination of a balanced budget, severe but vague caps on both the entitlement and discretionary side, and little political will for anyone to deliver on the financing that the Republicans have promised, could put the nation on a path that will make progressive government as we know it largely unsustainable for years to come.

1981: Republican Budget Strategy -- Round I: In 1981, the Republicans came in with a strategy to reduce existing revenues through tax cuts to the most well-off Americans and to build up defense. As David Stockman's book describes, some knew that this supply-side theory would not pay for itself, but that the debt accumulated by Republican irresponsibility would create a fiscal environment that would prevent Democrats and progressive Republicans from using the federal government as a positive force in the lives of working America and poor children for years to come. It worked! Not only has the Republican irresponsibility of the past made progressive government more difficult, but the tough choices made by a Democratic President to clean up the mess are precisely some of the tough choices that Republicans have criticized to regain power in the Congress. Democrats share blame for many of the reasons people do not like Washington, but one of those reasons should not be that they took the political hits for cleaning up an escalating deficit that was fueled by a reckless Republican philosophy.

1994: Republican Budget Strategy -- Round II: This is the second major opportunity -- Round II -- for Republicans to use the federal budget to lock in an agenda long after the politics of the moment change that the American people have not fully bought into. We should understand that the path they seek to put the nation on is more severe [illegible] likely to be more mean-spirited than anything we have seen before. Bob Greenstein of [illegible] is doing a specific memo on what we know about their specific budget strategy; but [illegible] can anticipate -- and must anticipate -- the fundamental dynamics. The Republicans have nowhere near the political mandate or the political will to inflict the type of severe cuts that would be required to pay for their agenda and balance the budget.

If Republicans are serious, even at the beginning, about taking taxes, defense and -- for the short-term -- Social Security and possibly Medicare -- off the table, there is little left other than scoring and budget gimmicks and "one-time savings," means-tested entitlements for the poor and international and domestic discretionary spending. Consider the following math: as we stated during the critique of the Contract, you need to cut 43% of the all programs by 2002 if defense, taxes, Social Security and Medicare are off the table. Therefore, they will rely on the following seven-part strategy:

SEVEN-PART REPUBLICAN BUDGET STRATEGY:

1) Rosy Scenario Part II: As many have already started to report, the Republicans will clearly seek to rely on "dynamic scoring" not only to pay for their capital gains and business tax cuts, but to gain additional revenue to pay for the middle class tax cut. But it is worth noting that this will provide only a fraction of what they would need to balance the budget and pay for everything they are offering. The main thing that could provide serious revenue increases are inflated growth scenarios -- the rosy scenarios -- which they will link to the new environment they will claim they are creating. They may also give the impression of larger deficit reduction by offering so called budget "one-shots" -- sales of federal assets that offer one time savings, but which don't provide ongoing deficit reduction.

2) Major Anti-Pork Budget: They will try to go after real pork that should be cut, but then try to lump it together with things like the crime prevention funding and other Clinton initiatives. The more dramatic they can be up-front, the more they can hide their overall shortcomings on specifics for balancing the budget.

3) Severe Cuts to the Poor, the Politics of Resentment -- Making Democrats Either Go Along or Come up with More Politically Sensitive Alternatives: Since they will not want to be seen as cruel, they will need to portray the programs they eliminate as counter-productive and the ones they consolidate as wasteful and inflexible. That means a rather brutal attack on entitlements and discretionary programs that affect the poor and urban areas.

Opening Salvo -- Welfare Reform as Platform to Justify Regressive Budget Cuts: Because budget math requires almost a 50% cut on all programs for the poor if popular middle class programs are to be exempt, Republicans must feed the politics of resentment by demonizing programs for the poor. This implies that the welfare reform debate is far more important to them than just passing tough new legislation: they must use it as a platform to make their case against the safety net programs they will want to unravel. Even if Republicans recognize that there is no way that they can pay for their agenda in a responsible way while taking defense, revenues, Social Security, and Medicare off the table, they will not want to present this. Instead, they will want their opening pitch to be a serious assault on Medicaid, food stamps, EITC and other such programs. They may also try to eliminate a Department like HUD, that would help create a wedge issue to make people antagonistic toward urban America.

Also since programs like Medicaid remain popular if they are seen as medical care for the poor, they will seek to lump things like Medicaid under the umbrella of "inner city programs" and "welfare" where polls show a greater willingness to cut.

Block Grant, Cut and Blur: They will probably not call for ending food stamps, but rather will try to show waste in current programs, and then move to block grants and cutting the overall amounts, so as to blur the harm and be able to make the claim that with waste reduction and new flexibility it will really not be harmful at all.

Make Democrats Return Salvo -- A No-Win Political Situation: Republicans may see this as creating a no-lose situation for them. While they will be willing to give up all of the black vote and the urban vote -- they will see that vote as lost anyway. The harder they go at the poor the more Democrats must either come to their defense or accommodate the Republicans. Republicans will figure that if Democrats go along they will alienate a large section of their base. On the other hand, if Democrats defend the poor, they paint themselves as the party only of the poor. The budget reality will make this all the more possible. To meet the caps, Democrats will have to replace severe cuts on the poor with other savings. Some of these alternatives could be on the very well-off, but some could be even more politically sensitive.

[**Note:** Republicans may be willing to ignore the fact that such an agenda may be viewed as a hostile act by African Americans and hope they can make their case to Hispanic Americans. Yet, their anti-immigrant stance in welfare may make this quite difficult.]

4) Vote for popular tax cuts and deficit reduction and shift to Clinton burden for coming up with specific tough cuts: They will seek to pass severe budget caps on the domestic discretionary and entitlement side, with the FY1997 being the first brutal year, so that the President -- not them -- will have to come up with the specifics for the first truly draconian budget. They also may try to be reckless with dynamic scoring so that we either have to go along, or come up with tough sequester for the cuts they wouldn't make. Again, the tactic is for them to do the attractive plan and shift the burden to us of being specific.

Three ways to shift the Burden of Coming Forward with Specifics to Clinton: These could go as follows:

A) Discretionary Shift: They will seek to put a wall around defense and increase the caps for it. Then they will ask for extremely tough domestic discretionary caps over a five-year plan that would be enormously politically painful to deal with and would severely undercut any notion of a Clinton investment initiative. The trick they could do over the next two years, however, as Bob Greenstein points out, is to lower the caps just a little in FY 1996, giving themselves a smaller burden to reach when they have go first in being specific. The second year, however, could be quite brutal, and that would force the President to come forth in January 1996 with either the specifics on the first truly severe budget or to not meet their caps and then be seen as breaking the budget caps rather than cutting spending.

B) Entitlement Shift: The same game could be played on the entitlement side of the budget. When we passed OBRA '93, we gave out our line-by-line five-year plan on the mandatory "paygo" side. Thus, at first blush it would seem that if they wanted to have severe entitlement savings to pay for tax cuts and deficit reduction, they would have to also take the political heat for recommending severe entitlement savings -- that would be very difficult and could force them to break their pledge on Social Security and entitlement savings.

Again, however, the entitlement cap could not really bite until FY1997, again putting the President in the position of having to be the first player to have to come forward with the specifics they would need to meet the new entitlement cap. Since a Democratic President would never be willing to inflict the type of pain they might on the poor, this would be a very difficult entitlement budget to present.

C) Paying For Tax Cut Shift: If the Republicans can get a CBO director to score their tax cuts as bringing in revenues, the OMB Director would still have the final word, but then we must come through with the sequester. Again, they vote for the good times and we are forced to come forth the hard specifics of how to pay for it -- or let their fiscal irresponsibility go unchecked.

What is even worse about the three "shift the burden of specific cuts to us" strategy, is that to the degree that we oppose the "caps" or other devises, the Republicans are falsely reinforced as the champions of deficit reduction, we are falsely reinforced as opposing it, and yet we are left to carry all of the political heat in proposing specifics.

5) Major Consolidation -- To States: This point is an extension of the "blur and cut" strategy mentioned above. We should expect that they will seek go back to a consolidate and cut strategy. They will try to point to anecdotes of waste to show that they are not really cutting -- that with their new flexibility the states (and it will be states not cities) will be able to do just as much with less. Consolidation serves at least four purposes for Republicans. 1) It shows less federal government -- less dictating from Washington. 2) It can undermine Clinton accomplishments by ending specific programs we have passed. 3) It gives Republican Governors, who might be hurting from budget cuts, new funds to start their own initiatives to take credit for. (Consolidation also allows the national Republicans to make the case that they are giving the Governors money that was once going directly to Democratic Mayors.) 4) Finally, it hides the impact on any specific programs -- the "blur and cut" effect.

6. Seek to Undermine Clinton Accomplishments: While many are saying that the President may have trouble passing the rest of his agenda, certainly their agenda is more ambitious than that -- they want to undermine his current accomplishments. The Earned Income Tax Credit could be squeezed on the entitlement cap -- with the justification that better enforcement could make up for the savings; our full-funding for WIC would be blurred as Kasich goes for his block grant proposals that mixes WIC together with other programs and then cuts them by 10% or something like that. (As mentioned above, the consolidation approach could be used to go after other initiatives like school-to-work and National Service.) Gingrich has already sounded the alarm that any program that has received any criticism like Head Start or Job Corp will be open to attack budget wise and rhetorically. And most of all, with dramatically more severe caps on discretionary spending, and Republican controlled appropriations, it will be extremely difficult to imagine how even current levels of funding can be maintained for current programs. (We would need to consider strongly how the line-item veto helps preserve investments within the context of a cap on domestic discretionary spending)

7) Make it difficult to veto the reconciliation with the tax cuts. Certainly, they will know that we can stop many of the things they would do above with a veto. Certainly, therefore, their goal has to be to make the veto as politically and even economically difficult as possible. Putting debt limit legislation in the reconciliation could be one way.

CLINTON PRO-ACTIVE STRATEGY:

1. Right to Know Campaign: If we start with the premise that there is not a political will for paying for the Republican agenda, then their plan rests on 1) hiding the choices; 2) shifting responsibility to Clinton to come forth with the specifics; 3) giving the impression that all of the cuts can be done without harming the middle class, 4) using consolidation to blur specific cuts, 5) and proposing short-term big cuts, that mask the lack of a long-term specific fiscal strategy.

Under this scenario, ***smoking out the truth on the specifics becomes essential. Therefore, we need a presidentially-driven plan "Right to Know" message where the President lays down the line that any plan, by anyone, must show the line by line specifics for at least five years.***

Without a right to know aspect, laying down markers alone may not work. For example, budget math may make it impossible for them to pay for their plan without cutting Social Security or Medicare. Yet, as long as they can hide them behind caps or other vague ideas, they will not appear to be violating those markers. Therefore, we must buttress those markers with a strong understanding that the American people have a right to know exactly how people would pay for their plans without cutting Social Security or Medicare or anything else.

We could start this push soon, because the press is becoming more educated to the notion that they are hiding painful specifics and not being straightforward. Indeed, the President could state that the only way the American people will know whether they can do this without hurting crime fighting and Social Security is to see a line-by-line, item-by-item seven year plan. He can state that without seeing the detailed plan, promises not to cut Social Security and Medicare are meaningless. We can push that above, all both parties must be straight with the American people and pledge that we will not even hide behind caps, and neither should they. A right to know campaign can also be a rallying cry among states who do not know what the effect of a balanced budget will be on state budgets.

2. Clear Principles To Judge Budget and Lay Foundation for Opposition and Even Vetoes: The President needs to lay out clear principles that he will not bend on so that he establishes not only where he stands, but puts the spotlight on Republican efforts to undermine them, and to provide a context from which he can veto legislation on a principled basis. These principles can focus on the economic recovery, fairness to seniors and middle class families, and also education -- or some of the President's top initiatives like Earned Income Tax Credit or National Service or WIC/Head Start/Goals 2000 as well as solid middle class programs like Social Security. As mentioned above, the "right to know" provides a good context to make the case for all of these, because the Republicans may avoid giving the details that would make it clear how their agenda would affect Social Security, seniors, or veterans or criminal justice. (National security is another issue to think through.) Therefore, we would have to say that, without people knowing all of the facts, we have no security that it will not lead to cuts in programs or principles we stand by. All of these together, therefore, provide context for the President to veto legislation on a principled basis, if we get stuck with vague caps.

3. Pork-Program Elimination Strategy: We must put forth our best package of "pork" that we want to cut, as well as the longest list we can come up with of programs to eliminate. In doing so, we must point to the reinventing government things we have already done and our record on downsizing the federal bureaucracy to the lowest level since Kennedy.

We must also consider dramatic steps. It is the case that the Republican can always out anti-government Democrats, but we must show that we have taken on cuts, and that we are doing so with a purpose. We may not be able to out-dramatize them in terms of just cutting back on government -- but that doesn't mean we couldn't be dramatic on the reinventing side -- including eliminating an existing Department.

3. Education Trust Fund and Personal Empowerment: The President must continue to stand by what he believes in regarding the need to invest in our people and give them the opportunity to reach the height of their potential.

Spending Cut Funded Education Trust Fund: In order to do this in the current environment, we must be able to clearly show that our new investments are being funded by cutting waste elsewhere. Our credibility to propose new investments -- or to maintain our current investments -- will be largely determined by the degree we are seen making dramatic cuts elsewhere. This is what we have done, but people rarely see it. The mish-mash nature of the budget process blurs that reality.

Therefore, we also must ensure that we present new investments by showing a dedicated amount of spending cuts that go to pay for them.

- We can do this with an Education Trust Fund where the caps are lowered to set aside a certain amount that must be cut to fund vital investments in education or children.

- More than enough cuts could be presented to show that we are using only a portion for new investments and that the rest are going to deficit reduction. It will be best if there are noticeable or dramatic cuts that can be seen as paying for this.

- By presenting a "no-tax, all-spending cut," funded Education Trust Fund, we create a worthy fight on our own terms, and the President lays a clear marker that while he wants government to be smaller and more effective, he still believes it should invest in people.

- The Education ideas could be presented as bipartisan types that have strong, clear messages. (See attached memo)

Personal Empowerment or Working Family Empowerment: Trying to match the Republicans in the world of consolidation will not work. We should do consolidation if it is good policy for a particular area, but we can not and should not get into a bidding war over who can consolidate and cut the most. The way to keep the focus on investing in people and yet show that we are less government oriented is not on whether a state or federal bureaucracy runs a program, but by bypassing the bureaucratic structures and directly empowering people.

Depending on what we try to do on the tax side, we could put together an agenda that promotes this notion of personal empowerment or middle class family empowerment. This means devising ideas that go directly to people. In these ideas, the President looks directly into the living room of an average working family and says here is the opportunity that I am going to provide you and your family directly that will help you send your child to college, save more, and make sure you have some resources for re-employment if you ever lose your job.

We already have a start and if we went for more tax cuts, we could do more, and have it focus strongly on the aspirations of middle class families -- education, housing, savings, retraining and re-employment. Without adopting a Medical Savings Account as Republicans support, we could also look for health care ideas that fit into this context.

- Individual Education Account
- An expanded IRA (Bentsen proposal with income cut off at $75,000)
- Re-employment and Education Tax incentives, that could be in a separate lifelong learning account or as an expansion of the IEA or IRA. Re-employment could still have reforms like one-stop shopping, but the benefit would go to the individual -- either in terms of grants or income-contingent loans.

Again, as with the Education Trust Fund idea, a personal or family empowerment initiative could be largely affected by a clear sense of a dedicated funding stream. As we have discussed before, there may be funding options for middle class tax cuts that would not be available for other priorities such as deficit reduction or new investments.

4. Isolate the Tax Breaks for the Wealthy to Show Democrats Fighting for the Middle Class: The tax cuts provided by the Republicans strongly benefit the most-well off. Even their middle class tax cut does nothing for most families making under $20,000-$25,000 and yet it goes to every family making under $200,000. The Senate version increases the exemption from $2,500 to $5,000 and thus gives families in the 15% tax bracket a $375 tax cut per child, while families in the 36% bracket would get a $900 per child tax credit. That may not seem to fair to most middle class families. If we do make the decision to propose tax cuts -- which I know won't be made for awhile -- we should consider the fact that, by cutting the tax cuts off at incomes of $80,000, we can give 90% Americans a benefit and leave them only fighting for the tax relief for the well-off at the expense of Medicare and the other programs they might need to cut.

5. Fight Budget Process: We cannot concede the budget process to Republicans. They are successfully dominating this area to the long-term detriment of the nation. Immediately, we need to consider our approach to the balanced budget amendment (see attached) and the baseline budgeting proposal. We need to consider how to fight the baseline budget proposal as well as how to create "right to know" budget process legislation. For example, Laura Tyson and I have talked about a National Security and Social Security Act that requires all budget proposals to give all the specifics so that it can be determined whether they create long-term needs to cut either defense or Social Security.

6. Defend Programs: We should determine the top 15 programs we care about and develop a separate defense strategy for each of them. Such a strategy should lay out all of the ways they are likely to be under attack, what pro-active action we can take to mobilize support and make it difficult for them to be undermined.

November 14, 1994

MEMORANDUM TO LEON PANETTA, BOB RUBIN, ALICE RIVLIN, PAT GRIFFIN, LAURA TYSON, GEORGE STEPHANOPOULOS

From: Gene Sperling

Subject: Balanced Budget

Certainly, the political momentum for a balanced budget seems nearly unstoppable. Nonetheless, it is still possible that an alternative balanced budget -- pushed hard by Congressional advocates -- could get enough votes to defeat the current bill, or at least lead to a better one. Yet, there is a danger that if we are not seen as being willing to fight, we may contribute to a self-fulfilling prophecy. My recommendation is that we at least seek out a strategy to defeat the Simon-Stenholm BBA, and to make it clear to members that we will at least expend the effort we did last year, so as to let members who want to fight know that we will be there. Whether or not we associate ourselves with an alternative BBA is another question.

We cannot get into the mind-set that, because things look bad here, we should not press this. The BBA is not like other issues: it could lock in a harsh, regressive government for years to come, and we have an obligation to at least consider whether we can stop it. And, before people assume that the votes are not there, they should recall that 33 of the 37 members who voted "No" are still in the Senate -- including Hatfield, Kassenbaum, and Stevens. Clearly, it would not be easy to hold these 33 (indeed, Moynihan has already signaled he might change), but if someone put together a strong alternative, they would have 33 existing "no" votes -- and some others such as Feinstein, Daschle and Jeffords who might be willing to consider a well-crafted alternative so that they could still be in favor of a BBA. Participating in such a fight runs the risk -- as always -- of putting us on the wrong side of the deficit issue. Yet, there is a chance that a fight will lead to no Amendment or a better Amendment, or lay the foundation for opposition at the state ratification level.

There are several points that could gain political momentum.

1. SOCIAL SECURITY: The current BBA does not exempt Social Security. A bill that does exempt Social Security may be more desirable for some members, who may like to say that they voted for the BBA that protected Social Security. The downside is that, if Social Security were taken off the table, it would make the deficit even larger (with the surplus no longer reducing the size of the deficit) -- and thus the cuts more severe. One option would be to have an amendment that would protect Social Security from sequestration.

2. DEFENSE: The same amendments could be considered for national security.

3. CAPITAL BUDGET: Reid supported a capital balanced budget proposal that was successful in pulling off some members who supported that. Jeffords wants to do more on education. It is possible that he could be pulled on to some form of capital budget.

4. ANTI–RECESSIONARY PROTECTION: The Simon–Stenholm amendment had no protection for recessions -- other than the ability of 60% of the Congress to waive the BBA requirements. Such an anti–recessionary notion could be built into the amendment as was done with the Reid alternative.

5. LONGER–TIME HORIZONS: The year 2002 is a brutal path. An amendment locking into even the year 2010 would be more prudent, if we were trying to make things worse.

6. REVENUE — 60% RULE: The Amendment calls for the Constitution to require a three–fifths majority for any measure that would increase revenues. Simon and perhaps some other Democratic supporters of the BBA may not support putting this into the Constitution. Another measure would be an amendment that states that any revenue raised on taxpayers in the bottom 95% shall require a 60% vote. Republicans also may not have considered that the way the statute is written, their Constitution would require a 60% vote on their capital gains tax cuts, since these would be seen as increasing receipts according to their dynamic scoring.

7. UNFUNDED MANDATES -- STATE BURDENS AND STATE TAXATION: Republican Governors have a large political stake in showing that they can lower taxes and still keep their states in a sound situation. At some point, it is going to hit them that an "all spending cuts" balanced budget is going to be devastating for Governors with large urban centers -- e.g., Weld, Wilson and Pataki. As the case can be made that the balanced budget will mean multi–billion dollar short–falls for states, it could lead to higher local and state taxation to make up for the federal short–fall.

8. RIGHT TO KNOW: We can begin a "right to know" campaign in our opposition to the BBA that could pick up around the states. We can state that the only way people will be able to know whether or not their taxes will go up, or national security or Social Security will have to be cut, is for those proposing the budget to at least propose a line–by–line, item–by–item plan.

9. ANTI–ELDERLY: The balanced budget is a severe threat to seniors' programs and most of them are keenly aware of that and have the resources to give their opposition high profile.

VOTES FOR THE BALANCED BUDGET

Despite assumptions that the balanced budget amendment is a certainty, it is worth looking at the actual numbers. Of the 37 members who voted "nay" in 1993, only four are out (Mitchell, Mathews, Riegle, Me[illegible]nbaum).

1. Stevens
2. Bumpers
3. Pryor
4. Boxer
5. Dodd
6. Lieberman
7. Biden
8. Inouye
9. Akaka
10. Harkin
11. Kassenbaum
12. Johnston
13. Sarbanes
14. Mikulski
15. Kennedy
16. Kerry
17. Levin
18. Wellstone
19. Baucus
20. Kerrey
21. Reid
22. Bradley
23. Lautenberg
24. Moynihan
25. Conrad
26. Glenn
27. Hatfield
28. Pell
29. Leahy
30. Murray
31. Byrd
32. Rockefeller
33. Feingold

TOP TEN REASONS TO SUPPORT THE NATIONAL ENDOWMENT FOR THE ARTS

1. **The NEA is a great investment.** The National Endowment for the Arts costs each American just **$.64 per year**. Yet, despite that modest investment, the agency helps support a breathtaking array of cultural activity in our nation's cities and rural communities: from the best in dance, theater and opera to folk festivals and music concerts, from literature, visual and the media arts to arts programs in our nation's schools that reach millions of students each year.

2. **The NEA helps leverage private support.** Grants from the National Endowment for the Arts require recipient organizations to match NEA monies at least dollar for dollar. This "Good Housekeeping" seal of approval serves as a fundraising catalyst, allowing arts groups to raise funds many more times the required match. One Endowment dollar attracts at least $11 for the arts from state, regional and local arts agencies, foundations, corporations, businesses and individuals. These public-private partnerships stimulate a tremendous return on a small investment.

3. **The arts mean jobs.** More than 1.3 million Americans are employed in the not-for-profit arts industry. More people are employed in the not-for-profit arts than in each of the following professions: legal services, police and firefighting, mining, advertising, and forestry and logging, among many others.

4. **The arts stimulate local economies.** The arts attract tourist dollars, stimulate business development, spur urban renewal, attract new businesses, and improve the overall quality of life for cities and towns large and small. For every dollar the Endowment invests in communities, there is a 20-fold return in jobs, services and contracts. On a national level, the nonprofit arts generate $37 billion in economic activity and return $3.4 billion in federal income taxes to the U.S. Treasury each year.

5. **The NEA brings the arts to young people.** Each year, the Arts Endowment opens the door to the arts to millions of school children, including "at-risk" youth. We know that the arts improve overall student learning, instill self-esteem and discipline, and provide creative outlets for self-expression. The arts also help prepare America's future high-tech workforce by helping students develop problem-solving and reasoning skills, hone communication ability, and expand creativity -- all important career skills of the 21st century.

6. **The NEA has helped spawn hundreds of new arts organizations.** In 1965, the year the Endowment was founded, there were about 100 large symphony orchestras; today, there are over twice that many. The number of professional choruses has grown from 10 to 80; dance companies from 37 to 250 ; opera companies from 27 to 120; and theater companies from 56 to more than 425. In 1965, there were but five state arts agencies. Today, every state has one.

7. The NEA brings the arts to more people. Since 1965, the Endowment has helped the audience for performing arts in the United States to grow many fold. Nonprofit theater audiences have increased from 5 million to 25 million. Symphony performances attracted 17 million in 1971 and 23.2 million in 1992. Audiences for opera grew from 4.5 million in 1982 to over 6 million. The annual audience for dance is now more than 16 million. The number of visitors to art museums has risen from 36.2 million to close to 50 million. The Endowment has helped deliver the arts to every congressional district in the nation. Without the agency's support, the arts could become the sole province of the well-to-do, the only class of Americans with the means to afford them.

8. The NEA nurtures promising artists. Over the years, scores of artists who went on to receive Pulitzer Prizes, National Book Awards, MacArthur "genius" awards, Emmys, Tonys and other prestigious national honors were supported early in their artistic lives by the Endowment. While the Endowment awards only about five percent of its annual budget to individual artists, past fellowship recipients have made a dramatic impact on the nation's cultural life. Many have credited the Endowment with sustaining them and validating their careers when they needed it most. For example, Alfred Uhry, who wrote the play, "Driving Miss Daisy," has said, "'Driving Miss Daisy' never would have gotten out of the garage if not for the support of the National Endowment for the Arts."

9. The nonprofit arts need public patronage to survive. Throughout history, the not-for-profit arts have always relied on patronage to support themselves. Just as Michelangelo had the church, Mozart the ruling Habsburgs, and Shakespeare his patrons, today's not-for-profit arts organizations could not sustain themselves solely through ticket sales or other earned income. The rising costs of producing quality art has made the necessity of public patronage all the more dramatic. In 1971, for example, symphony orchestras needed to raise about $5 per seat, per performance over and above ticket prices to break even. That figure today exceeds $20.

10. The American people want the arts. A recent Lou Harris poll indicated that a full 60 percent of the American people believe that "the federal government should provide financial assistance to arts organizations, such as art museums, dance, opera, theater groups, and symphony orchestras." Almost as many, 56 percent, say they **"would be willing to pay $15 more in their own taxes per year to support federal government efforts in the arts."**

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December 1994

CENTER ON BUDGET AND POLICY PRIORITIES

THE KASSEBAUM FEDERALISM PROPOSAL: IS IT A GOOD IDEA?

Overview

Senator Nancy Kassebaum has proposed a major restructuring of the social welfare system, under which the federal government would take over full financial responsibility for Medicaid and transfer to states full financial responsibility for the food stamp, AFDC, and WIC programs. The food stamp, AFDC, and WIC programs as they exist today would essentially end. During a five-year transition period, a maintenance-of-effort requirement would bar states from reducing overall expenditures on cash and food assistance to the poor, and states would continue to bear some share of Medicaid costs during the transition. After the transition period, the federal government would take over full responsibility for Medicaid, and states would neither receive federal funds for food stamps, AFDC or WIC nor be subject to any requirement to maintain cash or food benefits.

The idea of "sorting out" federal and state responsibilities — increasing the federal role in some areas and devolving other areas to states — has considerable merit. So does the notion of giving states more flexibility in designing their AFDC programs. Senator Kassebaum's intention clearly is to improve the welfare system and help poor families. Nevertheless, the Kassebaum proposal is seriously flawed; it devolves the wrong set of programs to the states. As explained in this paper, devolving means-tested income security programs such as food stamps is likely to lead over time to incalculable damage to the safety net and to generate substantial increases in poverty, especially among children. Under the Kassebaum plan, devolution would come in precisely the areas where state performance has been most inadequate and where proponents of realigning federal and state roles have traditionally called for a stronger rather than a weaker federal role. The proposal runs counter to the recommendations issued by a distinguished bipartisan Commission that studied these issues carefully in the 1980s, the Committee on Federalism and National Purpose, on which Daniel Evans, Charles Robb, Leon Panetta, Alice Rivlin, Barber Conable, David Durenberger, Richard Gephardt, and Richard Williamson (who handled federalism issues for the Reagan White House during the first Reagan term) served, among others.

The plan also is ill-advised from a macroeconomic standpoint. It would weaken the "automatic stabilizers" the federal government employs to lessen the depth of recessions. In addition, it would cause the federal deficit to swell significantly after the transition period ends.

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The timing of the proposal would exacerbate its problems. The plan would be implemented at the same time that federal grants-in-aid to state governments are likely to be sustaining cuts of unprecedented depth, as a result of constitutional and statutory requirements likely to be put in place in the next year or two to balance the federal budget without raising taxes or touching Social Security or defense. In such an atmosphere, the prospects that states would maintain cash and food assistance for the poor after the transition period ends would dim further. These issues are discussed below.

I. Devolving Food Stamps and AFDC

The Committee on Federalism and National Purpose, chaired by then-Senator Daniel Evans (R) and then-Governor Charles Robb (D), called in 1985 for a major realignment of federal and state roles. The Committee proposed a much larger federal role in financing and setting national standards for Medicaid and AFDC, accompanied by the devolution of scores of federal programs to the states. In issuing its recommendations, the Committee affirmed a principle that has undergirded most thoughtful examinations of federalism issues — income security for the poor should largely be a federal responsibility. The Committee wrote:

> "Wherever it occurs, poverty is a blight on our whole society, and Americans in similar circumstances should be treated alike. Children whose early years are damaged by the effects of poverty in one state may later become voters, employees, and possibly welfare recipients in other states."
>
> "Safety net programs also should furnish benefits that can be expected to provide for basic necessities. Welfare programs in many states fall far short of this mark. Even when combined with the cash value of food stamps, AFDC benefits were at or below 60 percent of poverty-level income in 10 states in 1984, and the median level of benefits was 73 percent of the poverty line." [These levels are lower today.]
>
> "Only the federal government can effectively bring about greater uniformity and adequacy of welfare services. This is because it is the only source of nationwide political authority and because it is the only level of government that commands the necessary resources."[1]

[1] Daniel J. Evans and Charles S. Robb, Chairmen, *To Form a More Perfect Union: The Report of the Committee on Federalism and National Purpose*, December 1985, pp. 13-14.

Trends in welfare programs since 1970 support the Committee's conclusion. Even though the federal government matches every state AFDC benefit dollar with between $1 and $3.65 in federal funds (depending on the state), AFDC benefits in the median state have fallen 47 percent in real terms since 1970. AFDC benefits have tumbled so far that the average combined AFDC and food stamp benefit for a family with no other income is now back to the level of AFDC benefits alone in 1960, before the food stamp program was created.

It may be argued that the decline in AFDC benefits largely reflects public antipathy to non-working, unmarried mothers rather than the role of states in setting these benefit levels. But the evidence suggests otherwise. State SSI benefit supplements for the elderly poor, a much more sympathetic group than AFDC families, have declined even more; since the SSI program started in 1974, state SSI benefits for poor elderly people living alone have dropped 63 percent in the median state that pays these benefits. State SSI benefits for elderly couples have dropped 75 percent.[2]

The Historical Pattern

In fact, when one examines benefit trends, a distinct pattern emerges. In the two programs where benefits are 100 percent federally funded and national benefit standards exist — the food stamp program and the federal SSI program — there has been no benefit erosion over the past 20 or 25 years. By contrast, in AFDC, where states set the benefit levels and pay part of the costs, benefits have fallen sharply. In the state component of SSI, where states set benefit levels and pay 100 percent of the cost, benefits have fallen even more steeply. (See Table I.) And the cuts have been most severe in state general assistance programs that receive no federal financial support and provide cash aid to poor people who aren't elderly, aren't sufficiently disabled to get SSI, and don't qualify for AFDC because they either don't care for children or live in two-parent families that don't meet the restrictive AFDC eligibility criteria that apply to such families. Most states that formerly operated general assistance programs have eliminated them or limited benefits to a fixed number of months out of the year. These deep GA cutbacks have increased the ranks of the homeless population, according to some studies.

This background is essential for assessing the Kassebaum proposal. Once the five-year transition period ends, the Kassebaum plan would place AFDC, food stamps,

[2] When federal and state SSI benefits are examined together, the combined benefit package shows a decline because of the large drop in state SSI benefits. In the median state that provides state SSI benefits, combined federal and state benefits have fallen about 10 percent in real terms since 1975. This translates into sizeable benefit declines. Combined federal and state SSI benefits for elderly couples are now about $100 a month — or $1,200 a year — lower than in 1975 in the typical state that provides SSI benefits. This is a large loss for people living below the poverty line.

Table I

Trends in Maximum Benefit Levels
Over the Past Quarter Century
(Percentage changes reflect changes in real dollars)

State-Prescribed Benefit Levels	
AFDC (1970-1994)	-47%
SSI State Supplements (1975-1994)	
elderly individuals	-63%
elderly couples	-75%
Federally Prescribed Benefit Levels	
Food stamps (1971-1994)	+3%
SSI federal benefits (1974-1994)	+6%

and WIC under a structure similar to that used for general assistance (and to a lesser extent, for state SSI benefits). States would decide whether to provide benefits, which categories of the poor to cover, and where to set benefit levels. Benefits would be paid entirely with state funds. *If states reduced AFDC benefits 47 percent in real terms over the past 24 years when the federal government paid 50 percent to 80 percent of the benefit costs, what would happen to food stamp and AFDC benefits when the federal government paid none of the costs?* The history of state government assistance programs in recent years is a chilling example of what could occur in some areas.

Advocates of the Kassebaum proposal may respond that states would reap substantial savings from being relieved of fiscal responsibilities for Medicaid and the pressures of rising Medicaid costs — and hence could provide adequate cash and food assistance. Such a response, however, would miss several key points.

First, constitutional and statutory provisions are likely to be put in place soon that require a balanced federal budget in seven years while "walling off" defense and Social Security and requiring a three-fifths vote to raise taxes on the House floor. If this series of developments unfolds, federal grants-in-aid to state and local governments — including grants for many services benefitting the middle class — will have to absorb very large hits. And if federal funds for education, infrastructure, mass transit, economic development and similar tasks are substantially reduced, there will be intense pressure in statehouses to accord higher priority to dedicating state resources to these areas than to using scarce funds to avert reductions in cash and food aid for the poor.

That, after all, has been the broad pattern in states for the past two decades. For example, in recent years most states have not appropriated sufficient state funds to draw down the full amount of federal matching funds available to the state for the JOBS program, which provides training and work experience — and enforces work requirements — on AFDC recipients. Despite the broad interest in welfare reform at the state level, most AFDC recipients remain outside the JOBS program today in no small part because state legislatures, faced with competing priorities, have placed state resources elsewhere.

The fact that the funds states provide for food and cash assistance would not, under the Kassebaum proposal, be matched by any federal dollars would heighten the difficulty of securing adequate funds for such assistance, especially when competing interest groups wield more clout than poor families and children. Furthermore, some of the programs with which cash and food aid for poor families would have to compete have their own federal matching provisions; in competing with such programs, cash and food aid for the poor would be at a further disadvantage. And while states compete with each other in areas such as higher education systems and tax incentives, states do not attempt to attract businesses by saying that they provide more adequate assistance to poor households than other states do.

In addition, the argument that states will perform satisfactorily in providing resources for cash and food assistance fails to address the problems states would face during recessions. Under the current benefit structure, the amount of federal food stamp benefits provided in a state automatically rises when the state economy turns down and unemployment and poverty mount. (For example, between June 1990 and June 1992, as the national unemployment rate jumped from 5.1 percent to 7.7 percent, the number of people receiving food stamps nationally rose by more than five million.) State-funded programs for the poor, by contrast, tend to be *cut* during recessions, because state revenues contract during economic slumps and most states have no ability to borrow to meet these needs. If AFDC and food stamps are devolved, states will be forced to choose between absorbing the additional benefit costs during recessions (which in most states would require cutting other programs or raising taxes), reducing benefits across the board, denying benefits to categories of needy families, and putting new applicants on waiting lists. History provides a strong indication of the likely outcome — most states will not be able to increase the resources available for these programs during recessions when state budgets experience strain and tax collections fall. It is more likely that funding for these programs will be cut than increased during hard times; indeed, general assistance benefits and SSI supplements were cut in numerous states during the recession of the early 1990s (and were not restored during the subsequent economic recovery).

Not only would state inability to boost funding during recessions result in greater hardship, but it also could weaken the national and state economies. The food stamp program is the federal government's most important "automatic stabilizer" after unemployment insurance; under the Kassebaum plan, it would no longer play that role. Neither would AFDC. As Alice Rivlin wrote in 1992, over the past several decades "social insurance and welfare programs not only provided income to individuals and families facing economic disaster, they also made economic disaster less likely. If economic activity dropped off sharply, the downward spiral would be cushioned, since individuals drawing social insurance benefits and welfare would be able to buy necessities and pay their rent or mortgages. This increased purchasing power would bolster the income of producers and prevent layoffs of workers and forced sales of homes. Thus, both welfare programs and social insurance would act as automatic stabilizers for the economy."[3]

Still another issue is that some of the poorest states in the nation would lose heavily under the proposal. For example, because of its relative poverty compared to other states, Mississippi receives a high federal matching rate for AFDC and Medicaid. The federal government pays about 79 percent of AFDC and Medicaid costs in the state, along with 100 percent of food stamp benefits. If Mississippi were relieved of paying Medicaid costs but received no food stamp, AFDC, or WIC funds, the state — and its poor families — would be hit hard. Mississippi would have to absorb the 79 percent of AFDC costs and the 100 percent of food stamp and WIC costs the federal government now pays, while being relieved of just the 21 percent of Medicaid costs it now bears. In fiscal year 1994, the federal government paid an estimated $574 million in AFDC, food stamp, and WIC costs in Mississippi, while the state paid an estimated $278 million in Medicaid costs, less than half as much. The state thus would suffer a large loss under the swap. Mississippi already pays the lowest AFDC benefits in the nation; they equal just 12 percent of the poverty line. When food stamps are added in, they bring a family to only about two-fifths of the poverty line. Under the proposal, Mississippi would be unable to afford even this meager level of benefits. In short, poverty would be likely to become grimmer in some very poor parts of the country.

Finally, if Medicaid is federalized and the federal government pays 100 percent of Medicaid costs, the wide variations that now exist among states in the categories of households eligible for Medicaid and in the health services covered could not be justified — and would likely be eliminated. To limit its fiscal exposure, the federal government could be expected to set national Medicaid eligibility and service levels no higher than those provided in the average state. If states with more extensive eligibility rules or service coverage wished to maintain their coverage in order to avoid increasing the ranks of the uninsured or dropping particular medical services, they would have to do so entirely with state funds. In a number of states, some of the savings that the state secured from no longer paying a portion of Medicaid costs would likely be used to maintain some of the Medicaid coverage and services that would otherwise be lost.

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[3] Alice M. Rivlin, *Reviving the American Dream, the Economy, the States, and the Federal Government*, The Brookings Institution, 1992, pp. 90-91.

If these concerns are borne out and state aid is reduced significantly after the maintenance-of-effort period ends, it is extremely unlikely that parts of the AFDC, food stamp, and WIC programs could be refederalized or the maintenance-of-effort requirement extended or reimposed. The federal government is likely to face a constitutional requirement for a balanced budget starting in fiscal year 2002 and be struggling mightily to meet it. It will be in no position to refederalize cash and food assistance, as that would carry a hefty cost that would have to be borne on top of the costs of a fully federalized Medicaid program. And with the federal government cutting grants to states substantially to help achieve budget balance, it will be in no position to reimpose or extend a maintenance-of-effort requirement. Moreover, doing so would likely run afoul of unfunded mandate legislation that Congress is likely to pass in the next few months.

A Closer Look at the Role of the Food Stamp Program

When the role of the food stamp program is examined, the problems posed by the Kassebaum plan deepen. The food stamp program has unique features, a factor that has led Senator Robert Dole on more than one occasion to call food stamps the most important social program since Social Security.

The food stamp program provides the only national benefit floor in the United States under poor children. If the national benefit structure is scrapped and federal funding for the program ends, benefits for poor children are likely to decline over time.

As noted, over the past quarter century, food stamp benefits have kept pace with need and escaped the sharp reductions in purchasing power that have marked AFDC, SSI state supplements, and general assistance. This is due in no small part to the program's national benefit structure under which the federal government fully funds food stamp benefits, the benefit levels are indexed to food costs, and the benefits are available on an entitlement basis so the program can respond automatically to increased need during recessions or when wages for low-paid jobs erode. The program's strength also is partly attributable to an apparent public preference for in-kind benefits over cash aid, especially for the non-elderly poor.

The program's political strength and durability stem in part from one other critical program feature as well — the food stamp program is the only major low-income benefit program that serves all categories of the poor *under a single benefit structure*, the one program in which the same benefit formula that applies to low-income elderly people also is used for poor mothers and children. As a result, a reduction in benefits hits the elderly poor along with poor children; this makes the program less vulnerable and more resistant to cutbacks. Various proposals to cut food stamp benefits advanced in the early 1980s by President Reagan or then-Agriculture Committee chairman Jesse Helms were turned aside primarily because of their impact on the elderly. Some of these proposals would probably have passed if they had affected only the non-elderly poor.

Another key feature of the food stamp program is its role in helping moderate what otherwise would be huge differences between states in the benefits they provide to poor children. In states that pay low AFDC benefits, food stamp benefits are large, since a family's food stamp allotment depends on its income level. This is of particular importance for poorer states with limited fiscal capacity — such as a number of states in the South — and for the poor children who live in these states. The federal food stamp program mitigates disparities among states and places a floor under children in the poorest jurisdictions.

For example, the State of Connecticut provides a family of three that has no other income with an AFDC benefit of $680 per month, about two-thirds of the poverty line. Mississippi, by contrast, pays a family of three only about one-sixth as much — $120 a month, which is less than 12 percent of the poverty line. When food stamps are added in, the benefit package in Mississippi climbs from about one-sixth of the size of the Connecticut package to half of it. The combined AFDC and food stamp benefit package pays a little more than 41 percent of the poverty line in Mississippi and a little less than 83 percent in Connecticut. Similarly, the disparity between welfare benefits in two of the largest states — California and Texas — is cut in half when food stamps are added to the package. (See Table II.)

Table II

The Impact of Food Stamps on State Variations in Benefit Levels

State	Maximum Monthly AFDC Benefit*	Monthly AFDC and Food Stamps Benefits**	Maximum AFDC as % of Poverty	AFDC and Food Stamps as % of Poverty
California	$607	$805	59%	78%
Texas	$184	$488	18%	47%
Connecticut	$680	$850	66%	83%
Mississippi	$120	$424	12%	41%

* January 1994 AFDC grant levels for a family of three with no other income, as reported by the Congressional Research Service.

** Assumes average shelter costs for food stamp households in respective states as reported in USDA's report on the characteristics of food stamp households in summer 1992 (expressed in 1994 dollars).

Under the Kassebaum plan, these unique features of the food stamp program would all be lost:

- There would be no national benefit structure or floor under poor children. In addition, in some states, various categories of the poor that now qualify for no other aid except food stamps — such as poor non-elderly single individuals — might receive no assistance at all.

- There would be no automatic increase in food benefits if food prices climbed. Nor would the number of people receiving benefits automatically rise if poverty and unemployment mounted.

- The already-wide differences among states in benefit levels would be likely to increase substantially, a particular problem for poor families living in Southern states. This also could lead to pressures on states with well-above average benefits to cut benefits in order to lessen risks of welfare in-migration (i.e., the increased gaps among states in benefit packages would increase political pressures on "high-payment" states to moderate their benefit payments).

- Moreover, the concept of a single benefit structure covering poor children and poor elderly people alike would be abandoned by many, if not most, states. It is probable that many states would end the provision of food stamps to most low-income households and instead incorporate some or all of these benefits into the cash benefit for recipients of whatever state program replaced AFDC and the SSI state supplement provided to SSI recipients. Over time, these cashed-out benefits would likely erode in purchasing power, just as state AFDC and SSI benefits have in the past.

It should be noted that the food stamp program lacked a national benefit structure in its early years. The national structure was instituted under President Richard Nixon, with bipartisan support, when large state-by-state disparities in state food stamp benefit structures emerged and studies found hunger to be a serious problem in many areas. Prior to this action by the Nixon Administration and Congress, some states were denying food stamps to families with incomes as low as half the poverty line — as some states still do today in AFDC — even though food stamps were federally funded.

II. Devolving the WIC Program

Devolving WIC also would be unwise. A 1992 GAO review of the cost-effectiveness of an array of children's programs found the data on WIC's effectiveness to be stronger than the data on any other such program. Indeed, WIC's documented impact on birth outcomes is nothing short of spectacular.

Rigorous studies have demonstrated that WIC markedly reduces infant deaths, low birthweight, premature births, and other problems. It also is associated with higher immunization rates and increased use of prenatal and pediatric care. Evidence also suggests that WIC reduces child anemia, and there are indications it improves cognitive functioning among children. In short, WIC works. A panel of Fortune 100 CEO's noted when testifying before the House Budget Committee in 1991 that WIC is "the health-care equivalent of a triple-A rated investment" and called for the program to be fully funded in five years.

Documented successes of this nature are rare among social programs, and WIC may be the most successful low-income program the federal government operates. Given its track record, devolving it — which would likely lead to changes in the program that would lessen its effectiveness — does not represent sound policy.

There are two reasons why devolving WIC is likely to compromise its effectiveness. First, funding for it would probably decline over time. In no year under Ronald Reagan's tenure — or that of any other President — has federal WIC funding been reduced. Reagan's efforts to cut WIC were decisively rejected by the Republican Senate in 1981 and 1982, at a time when most other cuts in low-income programs proposed by the Reagan Administration were being approved. Federal WIC funding has increased nearly every year. In the late 1980s and early 1990s, George Bush sought major increases in WIC funding, as Bill Clinton is now doing.

But the story is different at the state level. Even though state appropriations for WIC generally qualify a state for a larger federal WIC allocation, those states that provide funds for WIC have been reducing them in recent years. In the past two years, state funding for WIC has fallen 33 percent in real terms.

Second — and most important — devolving WIC would change its character in ways that would almost certainly lessen its effectiveness. WIC features what may be the most effective set of cost-containment measures of any federally-supported health program. Federal law requires every state to use competitive bidding to purchase infant formula for WIC. These competitive bidding procedures typically result in price reductions of 60 percent to 80 percent and saved $920 million in FY 1994, according to USDA data. The savings were used to provide WIC foods to an additional 1.5 million pregnant women, infants, and children each month. Today, nearly one of every four WIC participants is served with savings from WIC infant formula cost containment systems.

In a number of states, these systems probably would be weakened if WIC were devolved. In many states, the two largest infant formula manufacturers — which control nearly 90 percent of the domestic infant formula market between them — have considerable clout with state health departments and medical associations. Prior to passage of the 1989 federal law requiring use of competitive bidding to purchase infant formula for the WIC program, fewer than half of the states had instituted this practice.

In addition, more than half of the states have now joined in multi-state contracts for the purchase of infant formula for WIC. This increases savings; the infant formula companies offer larger price reductions when a greater volume of sales is at stake under a WIC contract. If WIC is devolved and the programs that replace it vary significantly from state to state, the extent of multi-state contracting is likely to decrease — and savings are like to fall as a consequence.

Still another problem is that if WIC is devolved, agricultural commodity interests that are potent in particular states are likely to push hard to have their commodities added to the WIC food package in these states. There is a strong likelihood that such efforts will succeed in a number of places. By contrast, at the federal level, Republican and Democratic administrations alike have stood firm against such encroachments and succeeded in making decisions on the food package entirely on scientific merit. If items are added to the food package largely due to political muscle, more nutritionally valuable foods will have to be dropped or the benefit package will grow more costly, with the result that fewer women and children are served.

In short, devolution of WIC would weaken one of the most successful and effective of all federal poverty programs. It should be noted that there has been no call from states for devolving WIC or block-granting it. As with most other programs, WIC is not problem-free, but the federal-state partnership works quite well here.

III. Swelling the Deficit

Another problem posed by the Kassebaum plan is that it would swell the federal deficit substantially once the five-year transition period ended. The state share of Medicaid costs — which would be transferred to the federal government — greatly exceeds the federal AFDC, food stamp, and WIC costs that would shift to states. In addition, Medicaid costs are rising more rapidly than costs in the three cash and food aid programs. (The proposal may appeal to some governors for this reason.)

CBO projections indicate that the state portion of Medicaid costs will significantly exceed $100 billion in fiscal year 1999. Federal AFDC, food stamp, and WIC costs will be less than $55 billion that year. While the federal government may be able to save some money in Medicaid through certain administrative efficiencies that it can more readily implement if it takes over full financial responsibility for the program, this would not yield savings of anything close to $50 billion a year.

The federal government also could eventually bear other costs if states shifted into the foster care system some AFDC cases in which the custodian is not the child's parent. States would have an incentive to do so, since the federal government provides matching funds for state foster care costs but would no longer do so for AFDC costs.

Shifting cases to the foster care system would financially benefit a state, but increase the drain on the federal treasury.

Complications During the Transition Period

A shorter-range problem is that the Kassebaum plan would be difficult to administer accurately and equitably during the five-year transition period. State maintenance-of-effort requirements, as well as federal payments to states during this period, would be determined by a formula under which HHS and USDA estimated how much AFDC, food stamp, and WIC caseloads would have risen in each state in each calender quarter during the transition if the current programs had remained intact. Such estimates would be extremely difficult to make accurately. Disputes and extensive litigation would be likely.

IV. Conclusion

Realignment of federal and state roles is an important issue, and there are strong advantages to greater federal participation in Medicaid. A "swap" that devolves various federal programs in return for increased federal Medicaid funding may be worth exploring.

But this does not mean any federal program is an appropriate candidate for devolution. Various community and economic development, infrastructure, education, and services programs may be candidates. But income security programs for the poor — especially basic safety net entitlements for poor children — are not.

Senator Kassebaum is neither a welfare-basher nor someone seeking to harm poor children. Nevertheless, her proposal would likely have severe effects. As a *New York Times* editorial noted on November 25, "States may be the right place to locate many programs Washington houses, but welfare is not one of them. States have a huge financial incentive to skimp on benefits — to drive poor residents out and persuade the poor from other states never to enter. Note that states eviscerated welfare benefits during the 1970s and 1980s while Washington kept federal benefits whole."

Devolving food stamps, AFDC, and WIC — especially at a time when the federal government is likely to cut sharply into other federal grants to state and local governments — is likely to lead to increases in poverty, hunger, and even homelessness in the decades ahead. As a result, it would risk making our society more deeply divided.

Devolution and increased state flexibility are not synonymous. Proposals can be designed to accord states substantially increased flexibility in designing and operating their AFDC programs without terminating federal support for cash and food assistance for poor families.

December 8, 1994

The Personal Responsibility Act

An Analysis

Center on Budget and Policy Priorities