## MEDICAID: BUDGET AND POLITICAL ENVIRONMENT

- **Congressional Republicans need hundreds of billions of dollars** to finance tax cut and deficit reduction pledges.

- **Medicaid is seen as major cash cow** because it is vulnerable as it serves the poor and because many Governors may be willing to negotiate over a cap. (In addition, Republicans growing increasingly nervous about excessively large Medicare cuts.)

- **Speaker Gingrich discussing a 5% cap on Medicaid program growth,** which would yield $130 billion ($193 billion using CBO numbers) in Federal savings through 2002 and $375 billion ($500 billion using CBO) in Federal savings through 2005.

- **Republican Governors either supportive or staying quiet for now** because they philosophically support. Moderate Republicans from states with high growth rates are evaluating just how they could live with these reductions in Federal dollars.

- **Governor Dean sending signals he might be open to a cap, although most Democratic Governors appear to be extremely nervous about it.** Governor Chiles, for example, is very opposed to eliminating individual entitlement. Having said this, some low growth rate states think it might not be a bad deal for them and others are nervous about defending a program for the poor. The fear that unifies almost all of the Democrats, however, is the size of potential reductions in Federal support.

- **Not on NGA agenda for this weekend, although DGA meeting may discuss** to plan out a more unified Democratic Governors' strategy. Medicaid capping may also come up in context of balanced budget disucssions that may be raised at NGA meeting.

- **Any block grant deal on welfare reform will serve as precedence** and political cover for Republicans who need the Medicaid money.

- **Weak but vocal advocates are opposed and scared:** many of these are considered our traditional Democratic base.

# ADVANTAGES AND DISADVANTAGES OF MEDICAID CAP

## Advantages

- Allows Federal Government to achieve savings by lowering or capping growth rate.
- Increases flexibility for States to design and administer Medicaid programs to reflect their priorities.
- Avoids requiring Congress or the Administration to specify cuts.
- Provides greater predictability in future Federal Medicaid funding.

## Disadvantages

- Impact on States
  - Leaves States at risk during recessions.
  - Places States at risk for cost of aging population.
  - Makes States less able to expand coverage.
  - Forces Governors -- not the Congress -- to specify cuts.
- Impact on health reform
  - Increases number of uninsured.
  - Exacerbates cost shifting.

# MEDICAID CAP/BLOCK GRANT BACKROUND INFORMATION

## PURPOSE:

To review the implications for states and for coverage under the Medicaid program of NGA and likely Republican proposals to cap Medicaid spending.

## BACKGROUND:

Although not on the formal agenda, it is possible that the topic of capping the Medicaid program may be raised at the upcoming meeting with the Governors. (In all likelihood, if it is raised, it would come up in the context of the balanced budget amendment discussion.)

NGA's proposed policy would give states the choice between continuing Medicaid as an individual entitlement or accepting a capped federal payment. The NGA staff recognize this "choice" is a political and not a practical policy response to a desire by many Republican Governors to assure that a Medicaid cap/block grant proposal is on the table for consideration. Democratic Governors, like Governor Chiles, have made the point that such a choice would not work in the Congress or in the budget world since states could choose what is best for them financially; as a result, the primary incentive for enacting a cap -- saving Federal dollars -- would likely not be achieved in any significant way.

A number of Governors have been discussing a Medicaid block grant with the Republicans in Congress. Both Governor Dean and Governor Thompson have indicated that they might be able to "live with" a Medicaid block grant that caps the growth in federal contribution at a 5% growth rate (the projected baseline growth rate is 9.3%). Under a 5% growth rate scenario, the reduction in federal spending would be very large -- about $375 billion over ten years (over $500 billion under the CBO baseline). In recent days, however, Governor Dean and his office have made clear he has made no deal and does have concerns.

It is worth pointing out that a 5% cap means that the states (in aggregate) must reduce total program costs by the $375 billion before they can begin reducing their own spending levels. While there are some low growth with fairly large base levels who could save money in the short-term, it is unlikely they could do so over the long term without cut-backs in services or programs.

Obviously, the Governors are interested in block grants because they free states from federal requirements and oversight. Many Governors appear to be willing to consider reductions in federal payments in exchange for greater flexibility that results from eliminating the individual entitlement. However, if the Administration can come up with proposals that are responsive to the flexibility requests of the States that do not include Federal caps, such an approach could well be more attractive. (Such approaches are discussed at end of the memo).

Proposals to convert Medicaid to a block grant raise a number of serious concerns. Some relate to converting Medicaid from an individual entitlement to a block grant. Others relate to the effect that significant reductions in federal payments would have on coverage. The following outlines these concerns.

**Converting from Individual Entitlement to a Block Grant Raises State Concerns:**

- **States At Risk from Inflation and Recession.** As an individual entitlement program, Medicaid automatically adjusts federal payments to meet changes in medical costs or the level of need. For example, when a recession occurs, the number of people without work that qualify for Medicaid can rise dramatically, increasing program costs. Under an individual entitlement, the federal government shares the additional costs. Under a block grant, states must address the increased need on their own, either by increasing state spending or reducing services and coverage.

- **Block Grants Do Not Recognize Differences Among State Programs.** A block grant that fixes the growth in federal payments at a set percentage would benefit some states and penalize others. State growth rates can vary for many reasons, including changes in population, regional medical costs, enrollment patterns or service mix. States also have very different opportunities to achieve savings through managed care (e.g., some states already have achieved savings; rural states have less capacity to implement capitated payment arrangements). An individual entitlement adjusts federal payments to these changing circumstances; a block grant does not. The variation in state growth rates for the 1990 to 1993 period is shown in Attachment 1.

- **States At Risk for Cost of Aging Population.** As the population continues to age, the growing need for long-term care services will put increased stress on the Medicaid program. Under a block grant approach with a fixed federal payment, states would bear the burden for providing these services as the population ages.

- **Tough Choices Are Devolved To States.** Under a block grant approach, the federal government can achieve substantial federal budget savings without taking responsibility for identifying specific cuts in payments, services or eligibility. The tough choices about where to cut are left to the states. This problem is likely to get worse over time, since reducing the rate of growth of a block grant payment is much easier than making specific program cuts.

## Effects of Capping Federal Payments

Given the magnitude of cuts necessary to fulfill Republican promises, a block grant would inevitably result in a significant reduction in federal Medicaid payments to states. For example, the 5% growth proposal that Speaker Gingrich has discussed with the Governors would reduce federal payments to states by $130 billion between 1996 and 2002, and by about $375 billion between 1996 and 2006. (Under the slightly higher CBO baseline, the reduction is over $500 billion over the ten-year period). In 1997, projected federal payments would be reduced by about 7% to 10%; in 2006, the reduction rises to 35% (40% under CBO baseline). This is due to the cumulative effect of annual reductions in federal payments. This is shown graphically in Attachment 2.

You may hear from some Republican Governors (and particularly Republicans from the Hill) that large reductions in the growth of federal payments are acceptable because managed care can produce enormous savings. Although managed care can improve efficiency and thereby produce meaningful savings , the savings are not nearly enough to compensate for the very large reductions being discussed with the block grant proposals.

Given the rapid expansion of managed care that already is occurring in states, a significant portion of the potential savings are already being realized. Also, managed care is applied almost exclusively to the nonelderly, nondisabled population, who account for only about one third of Medicaid expenditures. Preliminary OMB estimates show that if all nondisabled, nonelderly recipients were enrolled in managed care by the year 1999, any additional savings through 2005 would be less than $5 billion. However, some states may use managed care as a mechanism simply to make large cuts in provider payments. In reality, this is a cost shifting strategy rather than cost containment.

Under the current baseline, Medicaid enrollment is projected to grow at about 4% annually. Medicaid per capita spending actually is projected to grow at approximately the same rate as per capita private health spending. Therefore, capping federal Medicaid payments substantially below baseline would appear to assume either that states can contain costs much better than the private sector or that substantial reductions in the scope of the program (including cuts in eligibility) are acceptable. While some states may be able to adapt to such a large reduction in federal support for a few years, most probably cannot. Over a longer period, few states could respond to this level of reduction without significant program cuts.

### Illustration of State Responses to Capping Federal Payments

The following discussion illustrates the impact on states of a block grant that caps the federal payments at a 5% rate of growth. For ease of presentation, the information is presented under the assumption that states would respond to reduced federal payments entirely through one of the following: (1) higher state spending, (2) lower provider payments, (3) benefit cut backs, or (4) eligibility cutbacks. Although a few states might increase spending in response to federal payment reductions, most would likely reduce eligibility, benefits or payment levels.

The following scenarios assume that states maintain (or in the first case, increase) the level of spending projected in the baseline. The state responses shown below merely offset the reductions in federal spending -- they do not produce any savings to states. If states were to reduce their spending below the projected levels in order to achieve savings in their own budgets, additional reductions would be needed.

- **Increase State Medicaid Spending**
  If states chose to increase their own spending in response to the reduction in federal payments, between 1996 and 2002, state spending would need to increase by over 20% over baseline projections. However, because the size of the federal payment reduction would grow each year, the percentage increase in state spending would also need to grow:

  - In 2002, the increase in state spending would be 32% over baseline projections;
  - In 2005, the increase in state spending would be 43% over baseline projections.

- **Reduction in Provider Payments**

  If states chose to reduce provider payments in response to the reduction in federal payments, between 1996 and 2002, payments to hospitals, physicians and nursing homes would be reduced on average by 13.7%. And because the size of the federal payment reduction would grow each year, the percentage reduction in provider payments (relative to baseline projections) would also need to grow. For example:

  - In 1997, a 6% reduction in hospital payments would be needed;
  - In 2002, a 22.9% reduction in hospital payments would be needed;;
  - In 2005, a 32.8% reduction in hospital payments would be needed.

  These reductions are on top of Medicaid's already low payment rates. This level of provider cuts will disproportionately harm public hospitals and clinics, for whom Medicaid is a significant payment source.

- **Reductions in Benefits**

  States also could choose to reduce benefit levels in response to the reduction in federal payments. The amount of savings that could be achieved through eliminating particular categories of benefits is shown in Attachment 3. For example, eliminating all dental benefits could achieve about 28% of the necessary savings from baseline in 1997. Eliminating personal care services would achieve about 55% of the necessary savings.

These reductions, however, would not be sufficient over time, because the size of the federal reduction would increase each year. For example, in 2002, eliminating dental benefits would produce only 8% of the necessary savings, and in 2005, only 6%. In 2005, eliminating all benefits for dental, prescription drugs, EPSDT, home health care, hospice, personal care services and payments for Medicare premiums and cost-sharing still would not be sufficient to compensate for the lost federal funding.

- **Reductions in Program Eligibility**

  States also could choose to reduce coverage eligibility in response to the reduction in federal payments. The amount of savings that could be achieved through eliminating particular eligibility categories is shown in Attachment 3. For example, eliminating eligibility for non-cash children (the OBRA expansions) would achieve about 62% of the necessary savings in 1997, but only about 14% in 2005. Again, because of size of the federal reduction would grow each year, the reductions in eligibility also need to grow.

In reality, states would respond through a combination of these approaches. However, given the magnitude of the reduction in federal payments, even when states spread the cuts over several of these categories, the reductions in each category would still be quite large. For example, a 5% cap would reduce federal payments to states in 2005 by about $66.3 billion below baseline projections. If a state chose not to increase spending and were to allocate their portion of this reduction roughly equally to reductions in provider payments, benefits and eligibility, it could achieve approximately the necessary savings through:

- Reducing provider payments by 12 to 13%.
- Eliminating coverage for prescription drugs and EPSDT, and
- Eliminating coverage for noncash children and qualified and special Medicare beneficiaries (QMBs).

And, because federal payments would continue to decline, further reductions would be needed in each future year. Other options are, of course, possible. Chart 3 gives you a partial menu of how much the elimination of particular populations and services (on a nantional level) would save. Some would argue that states would be more likely to choose eliminate AFDC adults rather than noncash kids and QMBs.

Even under less extreme proposals, federal payment reductions can be significant over time. For example, a 2 percentage point reduction in baseline rate of growth would result in a large reduction in federal payments -- $ 66 billion-- between 1996 and 2002. In 2006, projected federal payments to states would be reduced by nearly 20%.

## CONCLUSION

Medicaid block grant proposals under discussion would dramatically reduce federal Medicaid payments to states over time. Increased use of managed care cannot generate the savings necessary to make up for these reductions and there is little room in state budgets to increase state Medicaid spending to compensate for the reduced federal commitment.

Unless states choose to offset federal reductions with increases in state spending, they would be forced to respond by reducing provider payments, services, and/or coverage. Given the inflexibility of a block grant to respond to the needs of individual states and differences in state political environments, the level and nature of the reductions in the scope of the program would vary significantly from state to state.

Reducing the scope of the Medicaid program to such a large extent would not only put those served by Medicaid at some risk, but also set back movement towards more comprehensive health reform in a number of ways, including:

- **Increasing the number of uninsured.** Recipient growth currently accounts for two-fifths of overall Medicaid program growth. In fact, spending per person under Medicaid is increasing at about the same rate as in the private sector.

  During the early 1990s, Medicaid increased coverage as employers decreased coverage. This trend would be reversed under a block grant, increasing the number of people who are uninsured. The changes in employer-based coverage and Medicaid are shown in Attachment 4.

- **Exacerbating cost shifting**. One of the central problems in our health system is the shifting of uncompensated care costs and Medicaid underpayments to business and families who purchase insurance. Reductions in Medicaid provider payments or increases in the number of people uninsured would exacerbate this problem.

**Alternative To Capping Federal Payments that States May Find Attractive.**

The obvious question is how to be responsive to States' legitimate need and desire for more flexibility without imposing significant reductions in Federal support. We have reviewed the NGA's health policy position paper's recommendations and have conducted our own internal analyis, which included discussions with OMB and HHS, and have come up with some interesting possibilities -- there may be even more -- that Iwe believe would be welcomed by the Governors. (Since Medicaid is not scheduled to come up before the NGA meetings, we probably should discuss when would be the most strategic and opportune time to begin discussions with the Governors on this issue.)

**Specific and preliminary options to Medicaid cap now include:**

- **Agree to NGA's request to eliminate the 1915(b) waiver approval process for states implementing managed care programs.** Instead, the states would simply file a standard state plan amendment and would be approved as long as basic accountability measures, such as budget neutrality, are achieved.

- **Consistent with NGA request, agree to eliminate the waiver approval process for states implementing home and community-based care programs.** Instead, the states would simply file a standard state plan amendment and would be approved as long as basic accountability measures, such as budget neutrality, are achieved.

- **Enable states to target programs and services to specific populations and communities.** Requirements that programs and services be uniform statewide would be removed for Medicaid managed care, home and community based programs, and optional services.

- **Agree to NGA's request to establish safe harbors under the Boren amendment for state hospital payments.**

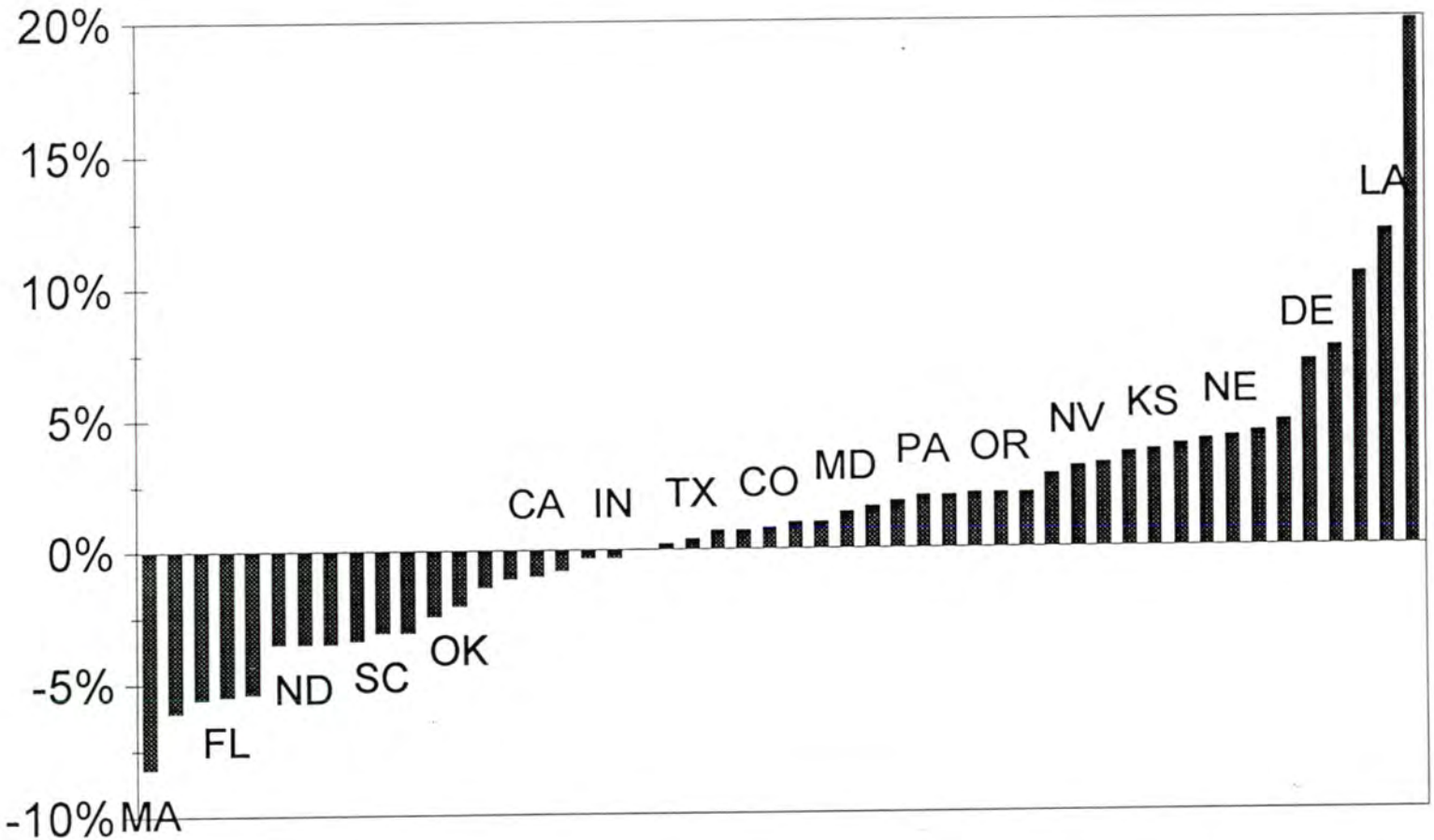
- **Agree with NGA that Boren amendment requirements do not apply to managed care arrangements.**

- **Agree to NGA's request for substantial modifications to the PASARR provisions under nursing home reform**. For example, agree that the annual resident review should be repealed.

- **Agree to NGA's request for the development of more demonstration programs that investigate the integration acute and long-term care services.**

# Variation in State Medicaid Growth

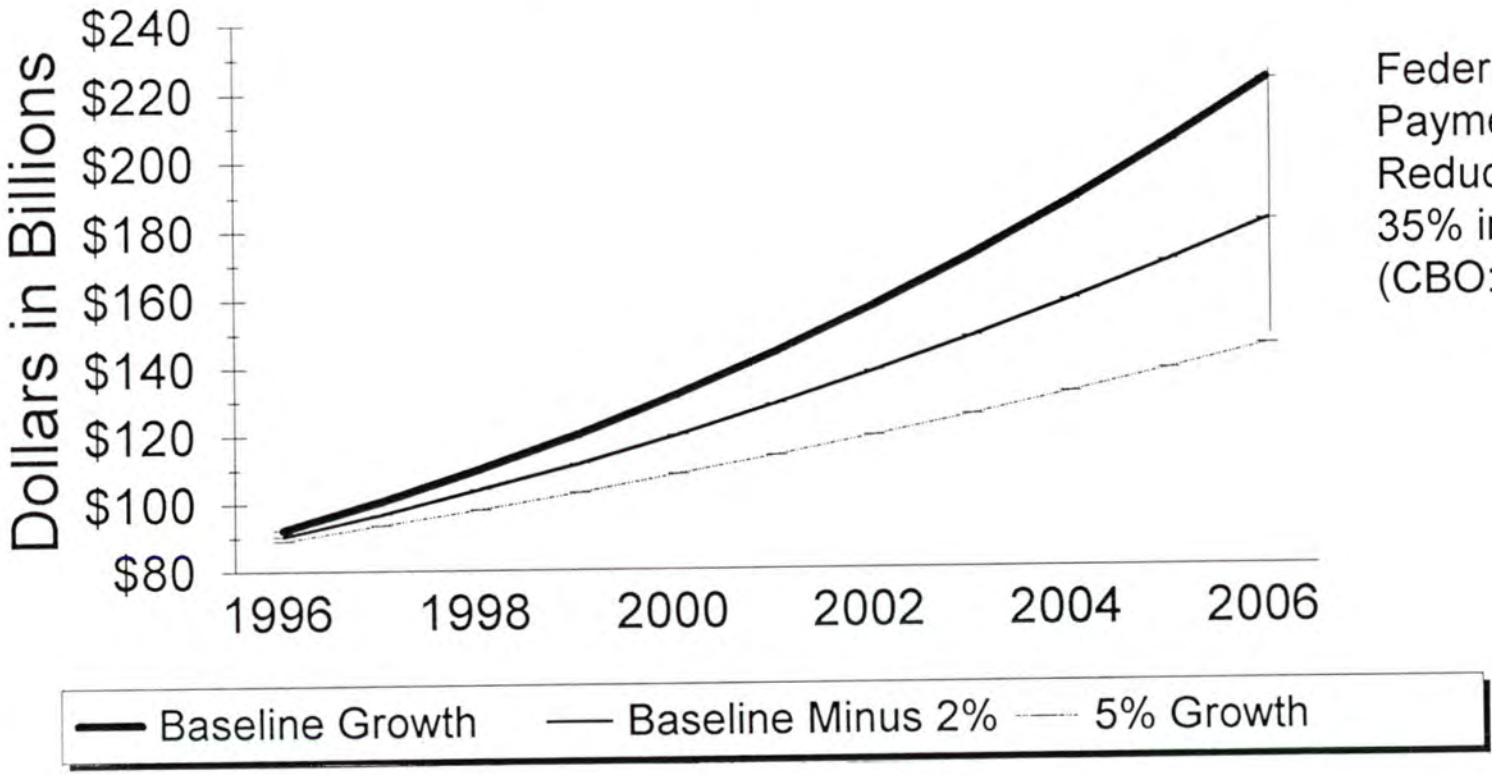
## Difference from Average, 1990-1993




* Note: Average annual per capita growth rates, excluding Disproportionate Share Expenditures
Data from The Urban Institute and HCFA

# Federal Medicaid Payments 1996-2006

## Baseline & Capped Federal Payments




This wedge Ilustrates the cumulative effect of capped expenditures. Over time, the size of the federal payment reduction grows.

## Potential Savings From Eliminating Selected Services or Recipient Categories

| | 1997 $ in billions | 2005 $ in billions |
|---|---|---|
| **Reduction in Federal Payments with Growth at 5%** | -7.0 | -66.3 |
| **Cost of Services** | | |
| Dental | 1.9 | 3.9 |
| Drugs | 9.3 | 17.6 |
| EPSDT | 1.1 | 4.0 |
| Home Health & Hospice | 2.5 | 5.8 |
| Medicare Premiums & Cost Sharing | 4.7 | 10.8 |
| Personal Care Services | 3.8 | 7.1 |
| **Cost of Services for Recipients** | | |
| AFDC Adults | 12.0 | 24.4 |
| NonCash Kids (OBRA Expansion) | 4.3 | 9.5 |
| QMBs/SLMBs (1) | 4.7 | 10.8 |
| Medically Needy | 22.1 | 38.8 |

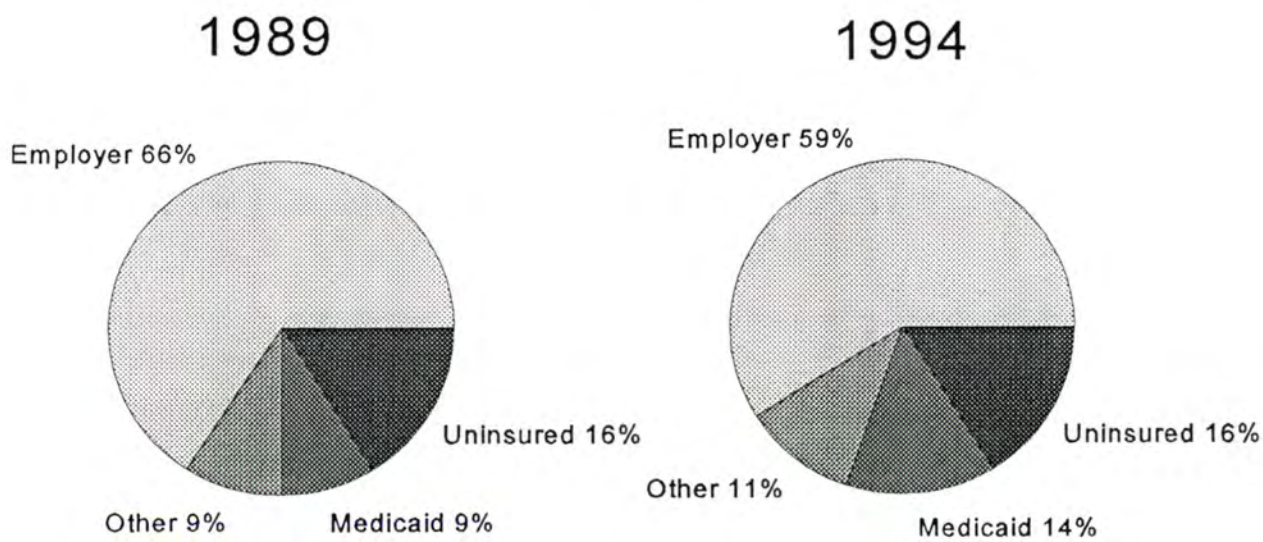
- The 1997 reductions will not be sufficient over time, because the size of the federal reduction would increase each year. For example, while eliminating dental benefits could achieve 28% of the required savings in 1997, in 2005 this service reduction would produce only 6% of the necessary savings.

(1) Since there are no data that separately estimate costs associated with QMBs/SLMBs, this estimate is the full cost of Medicare premiums and cost sharing.

NOTE: All of these effects vary significantly across states, and overstate savings, because of interactions in the expenditure categories.

# Changes in Insurance Coverage

## 1989 to 1994




SOURCE: The Urban Institute analysis of the TRIM2-edited March 1993 Current Population Survey.

The 1989 data represent an average of three years, 1988-1990, with 1989 data having a weight of .50 and 1988 and 1990 data having weights of .25. The 1994 estimates are based on 1993 CPS data on insurance coverage as adjusted by The Urban Institiute's TRIM2 microsimulation model and 1993 HCFA data on Medicaid enrollment. Estimates for 1994 were derived using CBO projections of changes in insurance coverage.

CENTER ON BUDGET AND POLICY PRIORITIES

## ACHIEVING GREATER STATE FLEXIBILITY IN AFDC AND FOOD STAMPS WHILE PROTECTING STATES AND POOR FAMILIES

Interest is growing in the idea of providing states greater flexibility in designing welfare programs. One approach being pursued by some Republican Members of Congress would be to turn AFDC and several smaller programs into a cash assistance block grant and to turn food stamps and several smaller nutrition programs into a food assistance block grant.

Doing so, however, would cause serious problems. The problems are of sufficient gravity to make these undesirable policy options from the standpoint both of state governments and low-income families. Fortunately, there is an alternative way to give states substantially increased flexibility without using a block grant structure. This memo discusses the problems with block-granting AFDC and food stamps and describes an alternative that would retain the desirable features of a block grant without its drawbacks.

### Problems with Block-Granting AFDC and Food Stamps

Turning AFDC and food stamps into block grants would pose significant problems.

- Insufficient federal funds would likely be made available for the block grant. These block grants would likely be structured by Congress as discretionary — or non-entitlement — programs whose funding levels are determined each year in Congressional appropriations battles. While some Republican Members of Congress and governors have talked of a block grant that would reduce the AFDC funds which states receive by 10 percent to 20 percent, the actual reductions would *almost certainly be much larger than that over time.*

  The block grant legislation might include an appropriations *ceiling* that represents a 10 percent to 20 percent cut. But the actual amount appropriated would likely be well below the ceiling. With Congress about to tighten greatly the already-austere spending caps that govern the total amount that can be spent on discretionary programs (while raising spending on defense at the same time), domestic discretionary programs will be squeezed hard in the years ahead. Welfare block grants, which have weak political constituencies, would likely fare poorly in the intense

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competition for the shrinking pot of funds that will be available under the spending caps. Over time, the federal funds provided to states for these block grants are likely to decline substantially. In short, the potential conversion of the federal funding structure for AFDC and food stamps from one under which states and poor families have an entitlement to funds to one in which the funding provided to states for these programs is squeezed in each year's appropriations fight should be of profound concern to states.

One additional concern on this front is that states frequently would not know until October 1 (or even later) how much block grant funding they would receive for the fiscal year starting October 1. Congressional appropriations battles typically are not over — and funding levels not known — much before October 1. Often these issues are not settled until November or December. This would make it difficult for states to plan and operate their low-income programs efficiently.

- Of equal concern is that a block grant would not respond to the increases in need that states face during economic downturns. Under the current financial structure for AFDC and food stamps, increased federal matching funds for AFDC — and an increase in 100 percent federally funded food stamp benefits — automatically flow into a state when recession hits and more families apply for aid. 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 rose by more than five million. Under a block grant, this provision of additional federal resources during recessions would end. A fixed amount would be provided to a state at the start of a year. If unemployment subsequently rose, *the state would have to bear 100 percent of any additional cash and food assistance costs itself.*

  This would pose serious problems for states. State revenues shrink during economic downturns, and many state programs are cut. Under a welfare block grant structure, states would be forced to choose between raising taxes (or cutting other programs more deeply in recessions) to address the mounting needs for low-income assistance or instituting across-the-board benefit cuts, making some categories of needy families and children ineligible for the rest of the year, or placing poor families that recently lost their jobs on waiting lists for aid.

  If states instituted waiting lists, two-parent families could be significantly affected. The subpopulation whose participation in AFDC rises most sharply in recessions is two-parent families.

The loss of the automatic increase in federal funding during a recession would have two other adverse effects as well. It could weaken the national and state economies. The food stamp and AFDC programs function as what economists call "automatic stabilizers" — federal programs that moderate economic downturns by infusing more purchasing power into state and local economies when recession sets in. Under a block grant structure, the automatic stabilizer role played by these programs would be lost. This is especially troublesome in the case of the food stamp program, which is one of the most important automatic stabilizer in the federal government's recession-fighting arsenal. Converting these programs to block grants that fail to respond to recessions is likely to make recessions somewhat deeper and more protracted.

- These problems are aggravated by another shortcoming of a block grant structure — it would badly misallocate funds among states. Any formula that could be used to allocate block grant funds among states would be based on data for a year in the past; the formula would not be able to reflect economic and demographic changes since that time. States whose economies had grown robustly since the year in which the data were collected would receive more funds than warranted, while states where economic conditions had deteriorated would receive too little.

  Of particular concern is the fact that during a recession, the hardest-hit states would likely be subject to a "triple whammy." First, there would be insufficient federal funds nationally, since the federal funding level would not automatically rise with a recession. Second, the allocation formula would not recognize the depth of the downturn in states that had been hit hard. Finally, the states hit hardest by the recession would generally face large declines in state revenues and be among the states least able to provide state funds to respond to the additional need the downturn had created.

- A block grant also could hinder welfare reform efforts in some states. A number of states want to expand their JOBS programs, create work slots, and impose work requirements more broadly. Some states may want to expand child care for AFDC mothers seeking to work their way off welfare and for mothers who have just done so. Since a block grant approach would provide fewer federal AFDC funds — rather than additional matching funds for states adopting such approaches — these states could be forced to abandon reforms aimed at promoting self-sufficiency unless they were willing to cut AFDC benefits to pay for the reforms.

- One final problem deserves mention as well. There would inevitably be a major fight among states over the formula for allocating block grant funds among them. If the formula reflected current expenditure patterns, it would penalize states with low benefit levels and risk locking them into that status permanently. Moreover, if the formula gave each state the same percentage of federal AFDC matching funds that it currently receives, this would fail to recognize the differences that will occur among states in coming years in rates of population growth, demographic changes, employment levels, or wages. If the formula attempted to adjust for these factors, it would be out-of-date (as noted above), always reflecting economic and demographic conditions several years earlier. And if the formula were based primarily on economic and demographic data (such as the number of poor families in each state) rather than on current expenditure patterns, the distribution of funds among states would be substantially altered. Some states that pay above-average benefits could suffer heavy losses of federal funds and be driven to cut benefits significantly even though their current benefit levels leave children below the poverty line.

It should be noted that once these programs lose their entitlement status and are converted to block grants, there will be no turning back, despite whatever problems may ensue. Given the federal government's fiscal problems — and the politics surrounding these issues — it would be virtually impossible to regain entitlement status for programs such as these for years to come.

*What About Administrative Savings?*

A response sometimes offered to these funding problem issues is that states would reap large savings in administrative costs if federal rules were loosened. This response is weak. Even if significant administrative savings could be achieved, they would constitute only a small fraction of the federal funds that states would lose under the block grant proposals. Federal and state administrative costs combined make up about 12 percent of AFDC and food stamp expenditures. Thus, if administrative costs were cut a fifth, total program costs would be reduced just two to three percent. Under the proposed cash and food block grants now being developed, the cuts in federal funding would be far larger — at least 10 percent to 15 percent initially and probably more in subsequent years.

### What About a Capped Entitlement to States?

Some states officials may believe that a solution to the funding problems described here is to structure welfare block grants as "capped entitlements" rather than as discretionary programs. Under a capped entitlement, states would be entitled to their respective shares of a fixed amount of federal funding. For example, if $20 billion a year were provided for a block grant, each state would be entitled to its respective share (in accordance with a funding formula) of the $20 billion. Under most proposals for capped entitlements, low-income families, as distinguished from states, would not be entitled to benefits. As a result, the amount of federal funding provided in a state would *not* rise if need increased in the state and more families applied for aid.

While it may sound attractive, this approach actually would do little to address the problems described here. Under the capped entitlement approach, a state's federal funding would remain fixed for the year, just as it would if the block grant were structured as a discretionary program. A state's funding level would not rise if a recession set in or the number of applicants in a state rose for other reasons. States still would have to reject the new applicants, cut benefits, or meet these additional needs entirely with state funds.

In addition, the fixed amount of federal funding available under a capped entitlement would have to be allocated among states in accordance with a funding formula. All of the problems described above regarding funding formulas would hold true. Some states would receive too much, while others would get far too little, especially when their economies turned down.

The only advantage that a block grant structured as a capped entitlement has over a block grant structured as a discretionary program is that the federal funding levels probably would not be ratcheted down further during annual appropriations battles. While this would be helpful, it does *not* mean that funding levels for a block grant structured as a capped entitlement would be adequate or would fare well over time. In the early 1970s, for example, Congress converted funding provided to states to deliver social services to low-income households from an uncapped entitlement to a capped entitlement. Since then, funding for this capped entitlement — the Social Services Block Grant — has fallen about 60 percent, after adjusting for inflation.

It should be noted that converting AFDC and food stamps to capped entitlements is not a step needed to control federal entitlement costs. AFDC and food stamp expenditures are not among the significant factors driving federal entitlement spending upward; health care and Social Security costs are the main causes of these upward pressures. Moreover, AFDC and food stamps combined constitute just five percent of federal entitlement spending.

If policymakers seek savings in these programs, they can be achieved without converting the programs to block grants under which poor families have no entitlement to benefits. Savings can be achieved through such means as making specific changes in federal food stamp eligibility and benefit rules without turning the program into a block grant.

## An Alternative of Greater Benefit to States and Families

The alternative is to give states extensive flexibility to design their own AFDC programs, much as a block grant would do, while maintaining the federal-state financial structure for AFDC. This would be done by identifying and eliminating every provision of the Social Security Act that needlessly restricts state flexibility in shaping their own AFDC programs and enabling states to largely fashion their own programs without having to secure waivers. The federal government would continue to match state AFDC expenditures on an entitlement basis as it does now.

This avoids the drawbacks of block-granting described above, while providing states great flexibility. States should prefer this approach to a block grant. It is in their fiscal interest to do so.

Under the alternative, each state would be free to develop its own rules concerning such matters as:

- what is income and how it should be treated (for example, how earnings are treated, what income is deemed, etc.);
- what resources would be permitted, and under what circumstances;
- what requirements (JOBS, work, other) must be met to qualify for assistance;
- what time limits (if any) are to be imposed on assistance to adults and what work or participation requirements would be imposed on adults who reached the time limit;
- circumstances where rules are varied in a part of the state, so that states have broad freedom to attempt their own demonstration projects.

Under this approach states would also have broad flexibility to design efforts to boost self-sufficiency. For example:

- States would have much greater freedom in deciding how to spend their JOBS funds. Federal rules governing JOBS expenditures would be minimal so states could determine how best to use their JOBS resources;
- States could opt to convert AFDC dollars into wage subsidies to create new employment opportunities for families;

- States could opt to extend child care assistance to working poor families without requiring that the families first enter the welfare system.

This approach would allow much the same kind of flexibility as a block grant, while retaining the principles that states have a duty to provide cash assistance to families that qualify under their state plan and that the federal government has a duty to join in the cost of assistance to eligible families. (In other words, families that meet the state's eligibility criteria would continue to be entitled to benefits, and states would retain their entitlement to federal matching funds for these benefits.) Federal rules would be limited to those where there is a clear federal policy interest; in all other areas, states would be free to establish their own rules. States would describe their choices in their state plans. A federal role would be retained in gathering information about state approaches, providing technical assistance to states, and providing for research and evaluation efforts.

A question may be raised as to what the fiscal impact of this approach would be on the federal budget. This approach should not entail significant new costs. States are already free to set AFDC benefit levels wherever they wish, and these benefit levels are the key determinant of program costs. Why should giving states more freedom on what counts as income, what work requirements and time limits to impose, and similar matters have a large impact on costs when states would continue to have to pay their share of the costs created by the choices they make?

If, however, analysis shows there is some cost, it could be offset through changes such as those the Administration and various Members of Congress have developed to pay for their welfare reform bills. Similarly, if a reduction in federal costs of a particular percentage is insisted upon by federal policymakers, offsetting savings provisions (or modifications in the federal matching formula) can be designed to yield these savings. Such an approach ensures that the funding reductions will be limited to the percentage amount by which federal officials tell states that funding will decline, without that amount being ratcheted down further in each year's appropriations catfight. And it would ensure that when need increased in a particular state, federal funding would increase along with it.

*Food Stamps*

This approach would not extend to food stamps. Food stamp benefits are 100 percent federally funded, and there needs to be a federal benefit structure.

The national food stamp benefit structure serves important functions. It provides the only national benefit floor under poor children. The benefit levels are indexed to food costs, and federal food stamp resources rise automatically when need increases during recessions or when wages for low-paid jobs erode.

Moreover, the food stamp program is the only major low-income benefit program that serves all categories of the poor under a single benefit structure in which the same benefit formula applies to low-income elderly people and to poor families with children. The fact that reductions in food stamp benefits hit the low-income elderly along with poor children has provided important protection to poor children over the years and is one reason food stamp benefits have kept pace with inflation during the past quarter century, rather than eroding as AFDC benefits have.

Still another of the food stamp program's attributes is that it moderates what would otherwise be extremely large differences among states in the benefits they provide to poor children. In states paying low AFDC benefits, food stamp benefits are greater, since a family's food stamp allotment depends on its income level. This is of particular importance for poorer states with limited fiscal capacity and for the poor children living in these states. For example, the AFDC benefit level in Mississippi is one-sixth the level in Connecticut; when food stamps are taken to account, the ratio falls from 6:1 to 2:1.

With food stamps being 100 percent federally funded, there also is another reason why it would not make sense to authorize states to set their own food stamp benefit levels and benefit structures. Doing so could lead to sizeable increases in federal costs.

Thus, the question is how the federal food stamp benefit and financing structure can be maintained while according states increased flexibility, especially in areas where food stamp rules cause problems for states. We suggest states be given more flexibility in certain key food stamp areas.

- The limitation on food stamp cash-out projects written into the FY 1995 agriculture appropriations bill could be repealed. States could be given more flexibility concerning the delivery of benefits through coupons, Electronic Benefit Transfers or cash.

- States could be given more flexibility in how to use their federal food stamp employment and training funds. This would enable states to make changes to increase coordination with JOBS. In addition, states could be given more flexibility to use food stamps to provide wage subsidies to employers.

- States could be allowed to modify the rules on what counts as income and resources in the food stamp program for food stamp households that also receive AFDC. This would enable one set of rules to cover families applying for both AFDC and food stamps. Federal review and approval

would be needed, but approval would be limited to assuring that federal costs would not rise.

This approach provides added flexibility without unraveling the national food stamp benefit structure that serves as the only national floor under poor children and the "gap filler" between high-payment AFDC states with strong fiscal capacity and low-payment states with more limited fiscal capacity. The important role of the food stamp program in responding to and cushioning the effects of recessions also would be retained.

## Conclusion

This alternative would represent a major departure from current practice. It would enable states to design their own AFDC programs and to modify their food stamp programs in certain ways without having the federal government shift costs to them during recessions or through cuts to fit within a discretionary cap. This approach would represent a new partnership between the federal government and the states.

This alternative reflects a basic judgment: states should not be forced to take a block grant to get substantially enhanced flexibility. This approach seeks to provide that flexibility without the major pitfalls involved in block-granting AFDC and food stamps.

It should be noted that the issue of block granting food stamps arose once before in the mid-1980s when the Reagan administration and Senator Jesse Helms, then chairman of the Senate Agriculture Committee, proposed making food stamps a block grant at state option. The National Governors Association opposed this proposal, which was defeated. NGA recognized that even as a state option, this approach was dangerous for states because it would begin to unravel the fiscal structure under which the federal government funds 100 percent of state food stamp needs on an entitlement basis.

*December 17, 1994*

CENTER ON BUDGET AND POLICY PRIORITIES

## STATE AND LOCAL GOVERNMENT AND THE BALANCED BUDGET AMENDMENT

Governors have reason to be concerned about whether a constitutional balanced budget amendment will result in the federal government shifting massive fiscal burdens to states. While governors have asked for — and are likely to get — some federal legislation protecting state and localities against new "unfunded mandates," it appears that state and local governments will nevertheless have to absorb a highly disproportionate share of the federal budget cuts required to balance the federal budget by fiscal year 2002. The major threat to states from the balanced budget amendment is extremely large reductions in grants-in-aid and other programs affecting state budgets.

This threat now looms large because the emerging plans of the new Congressional leadership call for enacting statutory and procedural changes that achieve budget balance by 2002 while taking Social Security and all or most defense programs off the table. Along with interest payments on the debt (in which cuts cannot be made) this would put nearly 50 percent of the federal budget off the table, requiring extremely deep cuts in the other half.

In addition, a new procedural rule that will be approved in early January by the House of Representatives will place barriers in the way of enacting federal tax increases. It will virtually assure that the more than $1 trillion in cumulative deficit reduction required to balance the budget over the next seven years — or as much as $1.4 trillion if proposed tax cuts are enacted — would have to be paid for entirely with spending cuts.

### Heavy reductions in state and local aid would be unavoidable

The arithmetic of achieving a balanced budget without cutting Social Security or defense or raising revenues — and while cutting taxes — virtually assures a heavy hit on states and localities.

- **All federal expenditures other than Social Security, defense, and the required interest on the national debt would have to be cut by more than one dollar out of four compared to spending projected under current law for fiscal year 2002.** Congressional Budget Office data indicate that if there are no tax cuts, 20 percent to 25 percent of non-defense, non-Social Security spending would have to be eliminated by fiscal year 2002 to balance the budget that year. If tax cuts similar to those in the *Contract with America* are factored in, the percentage rises to 25 percent to 30 percent.

  These percentages climb higher in years after 2002. Federal deficits are projected to grow in those years due to rising health care costs and the aging of the population. Revenue losses from the tax cuts would mount after 2002 as well.

- **Grants to state and local governments constitute one-third of the total spending that will have to be reduced by more than one dollar in four.** In fiscal year 1994, federal grants to state and local governments absorbed 32

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percent of the part of the federal budget that remains when Social Security, defense, and interest payments on the debt are excluded.

In addition, spending important to state and local governments is not likely to be considered the highest priority within the portion of the federal budget that would remain on the table.

- Essential federal functions such as protecting the borders, maintaining embassies overseas, fighting forest fires, constructing and operating federal prisons, operating the FBI and Social Security offices, and making pension and disability payments to veterans are unlikely to suffer more than modest cuts.

- In addition, there is virtually no chance that Medicare would be cut as much as 20 percent to 30 percent. Cuts of that magnitude in Medicare would likely lead to massive cost-shifting to employers and almost certainly swell the ranks of the uninsured as a result. In addition, doctors, hospitals, and elderly groups are too powerful for Medicare cuts of this size to be secured. In fact, the new chairman of the House Ways and Means Committee, Rep. Bill Archer, has said that Medicare hospital insurance (over which he has jurisdiction) should not be reduced at all.

- To the extent that large portions of the budget other than Social Security and defense spending are reduced by significantly less than one dollar in four, the likelihood increases that grants to states and localities will be cut substantially more than one-fourth.

Furthermore — and of particular importance — substantial tax cuts are in the offing. Each dollar lost in revenues is a dollar that would have to be paid for with additional spending cuts from the half of the budget not placed off-limits.

- The tax reductions proposed in the Contract with America will cause an estimated revenue loss of $712 billion over the next 10 years, according to a Treasury analysis. This would be one of the largest tax cuts ever passed.

- The Clinton tax cuts, while smaller, are also substantial. They would lose $174 billion over the next 10 years.

To balance the budget by 2002 *without* any tax cuts would require a cumulative total of $1 trillion in spending cuts over the next seven years. Over the 10 years from 1996 through 2005, about $1.75 trillion in cuts would be needed.

When the tax cuts are taken into account, these numbers grow still larger. To balance the budget and pay for the tax cuts in the Contract would require approximately $2.5 trillion in cumulative spending cuts over the next 10 years, all of which would need to come from the unprotected half of the federal budget. This is the part of the budget in which grants to states and localities are found.

**Unfunded mandate protection does not address these issues**

Unfunded mandate protection would affect only those situations where the federal government *requires* other levels of government to perform certain tasks without paying the cost of the tasks. An unfunded mandate provision, whether legislative or constitutional, cannot protect states from the disproportionate cuts in federal funding for state and local functions that become inevitable when large parts of the federal budget are placed off-limits.

An unfunded mandate measure would not forestall federal decisions to shed functions that some level of government must perform, thereby leaving other levels of government little incentive but to pick up the pieces without any federal funds to undertake the work. It would not, for example, protect against increases in Medicare cost-sharing requirements that result in more low-income elderly people qualifying for state Medicaid payments. Nor would it forestall cuts in child care funding that increase burdens on public schools operating pre-school programs with state or local funds. Unfunded mandate protection also would not replace lost federal funding for primarily state and local functions, such as mass transit, education, and economic development.

Protection against unfunded mandates also will have relatively little effect if federal programs are returned to the states as block grants and funding for the block grants is then reduced substantially as fiscal year 2002 draws near. Unfunded mandate relief also offers no protection against sharp rises during recessions in the costs of basic benefit programs for the poor that may be block-granted. The number of people receiving food stamps, for example, rose by five million during the recession of the early 1990's. Under a block grant structure, states likely would either have to absorb all of the increase in costs during recessions in programs such as food stamps or risk leaving millions of newly unemployed and impoverished residents without food assistance.

**A Possible Course of Action**

Accordingly, state and local officials may wish to call for the deferral of consideration of the balanced budget amendment until legislation laying the framework for getting to a balanced budget — and potentially taking large pieces of the budget off the table — is taken up. They may wish to withhold support for a balanced budget constitutional amendment unless they are offered more than protection from unfunded mandates. They may wish to insist on assurances that spending caps or block grants will not result in cost-shifting and disproportionate reductions in state and local aid — in short, that the federal budget not be balanced heavily and disproportionately at their expense.

State and local officials may wish to ask for these matters to be considered up-front, before the constitutional amendment passes Congress and especially before governors consider endorsing the amendment in return for unfunded mandate protection. If an amendment is sent to the states for ratification in a form that is a dagger aimed at state and local government, governors may have political difficulty in opposing state ratification if they have earlier endorsed the amendment.

*December 21, 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]

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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.

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,

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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% |

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*

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# The Personal Responsibility Act

*An Analysis*

CENTER ON BUDGET
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