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New TANF Requirements Could Result in New Large Costs and Risk of Federal Penalties for California

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The budget reconciliation bill awaiting a final vote in the House of Representatives revises the work requirements for families receiving assistance in the Temporary Assistance for Needy Families (TANF) Program, with significant penalties for states that fail to meet the requirements. California will face large costs to increase participation in work activities to meet the new requirements, and still be at very great risk of being penalized. Based on available federal data, the cost of increasing participation in work activities to meet the new requirements in California could exceed \$400 million in 2007 and be in the range of \$2 billion for the state for the next five years if the state's caseload does not fall. If the state fails to meet the requirements, it risks a maximum federal penalty that begins at \$185 million and grows over time, with a requirement to spend additional state funds to compensate for the lost federal funds.

Background: Current Law and New Provisions

In order to avoid a federal penalty, states must meet an "all-families" and a "two-parent families" participation rate for families receiving TANF assistance each year. To count toward the participation rate, families must be involved in one or more listed activities for a specified number of hours each week. Required participation rates can be adjusted downward if the state's caseload falls for reasons other than changing eligibility rules.

Under the 1996 law, a state's required participation rate was determined by the rate listed in the law, adjusted downward by a "caseload reduction credit". In and after 2002, states were required to meet a 50 percent participation rate for all-families, and a 90 percent rate for two-parent families receiving TANF assistance, adjusted downward by the number of percentage points by which the state's caseload fell below 1995 levels for reasons other than changing eligibility rules. Until now, most states, including California, faced low required participation rates because of their large caseload declines during the 1990s. Based on caseload reduction, California was only required to meet a 6 percent rate in 2003, although the actual participation level achieved was considerably higher.

Under the 1996 law, states were free to assist two-parent families in separate state programs that were not subject to TANF participation rate requirements. California was one of twenty-one states that assisted all or most two-parent families in a separate state program; this approach was commonly used as a way to assist these families without risking federal penalties since it was broadly seen as extremely difficult to meet a 90 percent participation rate.

The reconciliation bill says that starting October 1, 2006, a state must meet a 50 percent participation rate for all families, and a 90 percent rate for two-parent families, with the rates only adjusted downward if the state's caseload falls below **2005 levels**. The rates will be calculated based on the combination of families receiving assistance in TANF and in separate state programs. This means that California will face required participation rates of 50 percent for all families and 90 percent for two-parent families in the year beginning October 1, 2006, adjusted downward only if and to the extent that the state's caseload falls between 2005 and 2006.

The Costs of Increasing Participation

The participation rate provisions of the TANF reauthorization debate have been controversial for many reasons. One key concern is that a participation rate is not, in itself, a good measure of a state's effectiveness in helping families get jobs or earn enough that they no longer need welfare. Indeed, the best program outcome will often be getting a job so that the family no longer needs welfare, and that family will not appear in a participation rate calculation. There has also been concern that since federal law specifies which activities do and do not count as participation, a high participation rate significantly restricts state flexibility to make judgments about which activities are most effective in helping families enter sustainable employment.

As discussed below, increasing participation in work activities is projected to cost money, because of the work and child care costs of the activities. An additional concern is that if the law imposes substantial increases in effective participation rates without providing corresponding funding to meet those new requirements, it will create conditions under which states must spend more state funds on program activities or feel pressure to curtail help to needy families as a way of avoiding federal penalties.

The projected costs of meeting the bill's requirements through increased participation are substantial, because states face costs for operating work programs, meeting child care costs for participating families, and program administration. In fact, the Congressional Budget Office has issued a preliminary estimate that the national cost of meeting the new requirements through increased participation would be \$8.4 billion over five years.¹ However, Congress has provided no new TANF funding, and only \$1 billion in new child care funding – only about 12 percent of the estimated funding needed to meet the new requirements through increased participation.

The Congressional Budget Office has not estimated state-by-state fiscal impacts; nor has the Congressional Research Service (CRS). However, using a similar (although not identical) methodology, CRS has estimated that for the nation, 236,000 additional families would need to be participating in work activities to meet a 50 percent participation requirement. CRS estimates that over one-fourth of those families – 60,700 – would be needed to meet the requirements in California.²

CLASP estimates that if California's share of the new costs is proportionate to the share of the new participants needed, it would mean that the estimated costs of meeting a 50 percent participation rate through increased participation in California if the state's caseload does not fall would be in the range of \$2.16 billion over five years.³ By contrast, the amount of funding California will actually receive in new child care funding is \$128.5 million over the next five years—resulting in a \$2.03 billion shortfall.

¹ Preliminary CBO Estimate. *Potential Additional Costs to States of Meeting Proposed Work Requirements in the Reconciliation Conference Proposal*. December 18, 2005. In a note, CBO explains: "The estimate illustrates the costs to states if states choose to meet the new requirements by funding more activities for recipients such as work experience programs. Actually, CBO expects that states are more likely to meet the requirements by applying a combination of approaches including funding more activities, imposing tighter up-front requirements and adopting stricter sanctioning policies. States may also be able to make changes in their programs to partially avoid the new requirements. However, the bill applies the requirements to families in separate state programs and requires the Secretary of Health and Human Services to issue new standards about who counts as a participant; those provisions would limit states' ability to avoid the requirements." CBO further notes "The estimate assumes a constant caseload at the level in the first half of FY 2004. It assumes that states will have to begin to ramp up their programs in 2006 in order to meet the requirements in 2007. Finally, the estimate does not reflect costs related to the requirements on two-parent families."

² Congressional Research Service Memorandum *TANF Work Participation Standards: Revising the Caseload Reduction Credit*. December 19, 2005.

³ This calculation is based on using the Congressional Research data to calculate that 25.7 percent of the increased number of needed participants would be attributable to California, and then calculating that 25.7 percent of the Congressional Budget Office \$8.4 billion projected cost would be \$2.16 billion.

In 2007 alone, the Congressional Budget Office's preliminary estimate projects national costs of meeting the requirements through increased participation to be \$1.7 billion. If one assumes that California's share is proportionate to the share of the national shortfall, this would mean costs of about \$437 million. However, additional child care funding for California in 2007 will only be \$26 million, and the state would need to commit \$26 million of state funds to receive the new federal funds.

Note that these are the costs of increased participation to maintain a 50 percent rate if the state's caseload does not fall. The state's caseload could fall, because of improved program effectiveness, a stronger economy, or more restrictive policies. The state could also, at least in part, seek to expand participation through improved coordination with the community college system and the workforce development system, though there will still necessarily be some increased costs even for such efforts. Moreover, the state could identify approaches that broaden help to working families and also help the state meet the new requirements. Thus, the state will have a critical set of choices to make if the provisions become law. But, while the precise fiscal impact is necessarily uncertain, the state should anticipate significant increased costs to meet the new requirements through increased participation.

The Risk of Penalties

Even with a major effort, can California meet the new requirements? The bill provides very little time for states to adjust to the new requirements, as they would apply in the fiscal year starting October 1, 2006. The Congressional Research Service has estimated that if the bill's requirements had been in effect in 2003, California's participation rate would have been 27 percent.⁴ The state would have had 70,000 countable participants, and would have needed 60,700 more – an 87 percent increase in the number of countable participants -- to reach a 50 percent rate. State officials indicate that neither the state's caseload nor the share of participating families has changed in a substantial way since that time, so the state would need a very large increase in a very short period of time to reach a 50 percent rate in 2007.

Under the bill, states can lower their required participation rates by cutting their caseloads below 2005 levels for reasons other than changing eligibility rules. However, if the state's caseload does not fall, it will risk penalties for failing to meet the fifty percent rate.

Like virtually every other state, California would also be at great risk of failing to meet the two-parent rate requirements. If the bill's rules had been in effect in 2003, the Congressional Research Service estimates California's participation rate for two-parent families would have been 34 percent.⁵ The ninety percent standard is widely viewed as virtually unattainable. Indeed, the Administration had recommended dropping it from federal law, and the reauthorization bills previously passed by the House would have repealed it. However, the provision turned up at the last moment in the reconciliation bill. It is hard to see how the state could come close to meeting it in the foreseeable future.

What happens if a state fails to meet participation rate requirements? The penalty for failing to meet the all-families participation rate can involve a loss of up to 5 percent of the state's \$3.7 billion TANF block grant – a penalty of about \$185 million unless the federal government reduces or waives some or all of the penalty. In addition, when a penalty is imposed, the state is required to contribute state funds equal to the lost federal funds, so if the state lost \$185 million in federal funds, it would need to spend an additional \$185 million in state funds to compensate for the lost federal funds. Moreover, when a state fails to meet participation rates, it is also required to increase its state "maintenance of effort spending level" upward from 75 percent of a historic state spending figure to 80 percent of that figure. In California's case, this

⁴ See Congressional Research Service Memorandum, TANF Work Participation Standards: Revising the Caseload Reduction Credit (December 19, 2005)

⁵ See Congressional Research Service Memorandum, Work Participation Rates for All and Two-Parent Families, January 9, 2006.

would mean an additional \$181 million in state spending each year for which the state failed to meet federal requirements.⁶

The maximum penalty for failing to meet participation rates grows with each year of failing to meet the requirement, and would be 7 percent of the state's block grant in the second year, 9 percent in the third year, 11 percent in the 4th year, and continue to grow by 2 percentage points a year up to a maximum of 21 percent. Thus, under this structure, the amount of the maximum federal penalty would grow by \$74 million for each subsequent year of noncompliance.

Conclusion

If the TANF provisions of the reconciliation bill become law, California will face significant costs to increase program work activity participation, and will be at significant risk of federal penalties. The participation rate is not, in itself, a good measure of the state's effectiveness in helping families get jobs or earn enough that they no longer need welfare. If the provisions do become law, it will be essential to identify ways that help the state meet federal requirements by helping families get and keep jobs, rather than simply restricting assistance to families. At the same time, the new federal requirements will make the challenges of welfare reform far more difficult for California's state budget and needy families.

⁶ The two-parent penalty is considerably smaller—the maximum penalty is limited to 5 percent of the state's block grant times the percentage of the state's cases that are two-parent family cases. However, even if the state only fails to meet the two-parent rate, it will still be required to meet the 80 percent maintenance of effort requirement.