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## WELFARE REFORM AND FUNDING CHOICES: WHAT DOES THE TANF MAINTENANCE OF EFFORT REQUIREMENT MEAN FOR CALIFORNIA?

### INTRODUCTION

The Temporary Assistance for Needy Families (TANF) program, established when the President signed the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) into law in 1996, transformed the financial and programmatic structure of the nation's safety net for poor families with children.<sup>1</sup> Under the previous system, Aid to Families with Dependent Children (AFDC), the federal government paid a share of each dollar spent by the states on eligible programs and federal law governed most aspects of the program's structure. In California, the state received one federal dollar for each state and county dollar spent. Under the TANF program, states must spend a minimum amount of their own funds -- the maintenance of effort requirement -- in exchange for a fixed block grant of federal TANF funds and increased flexibility with respect to program design.

Because AFDC was an entitlement -- ensuring that all that met the eligibility requirements would receive benefits when the economy faltered and welfare caseloads increased -- federal funding increased proportionately with states' costs. The TANF program provides states with a fixed amount of funding that does not increase if demand for benefits rises or falls when caseloads decline. Consequently, states must carry the full burden of financing increases in caseloads. When caseloads fall, however, states can use the savings generated from lower assistance payments to fund additional services for poor families.

### WHAT IS THE TANF MOE REQUIREMENT?

The TANF maintenance of effort (MOE) provision requires states to spend a minimum of 80 percent of "historic state expenditures" on TANF-related assistance for "eligible families."<sup>2</sup> Federal law defines historic state expenditures as the amount a state spent on AFDC, JOBS, Emergency Assistance, and Title IV-A child care programs in federal fiscal year (FFY) 1994. States that meet all federal work participation requirements can reduce spending to 75 percent of their historic expenditure level. Federal law requires 25 percent of all families to have at least one parent working at least 20 hours per week in FFY 1997. The

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<sup>1</sup> For more information see California Budget Project, *Federal Welfare Reform: What Does It Mean For California?* (January 1997) and *How Are Counties Implementing CalWORKs?* (March 1998). Throughout this brief, the changes enacted by and as a result of the PWORA are referred to as welfare reform. California's TANF program is the California Work Opportunity and Responsibility to Kids (CalWORKs) program, established in 1997.

<sup>2</sup> An "eligible family" is defined as a family consisting of a child living with a custodial parent or other adult caretaker relative, or a pregnant woman, who are financially needy according to criteria established by the state's TANF plan. For more information on TANF and MOE regulations see US Department of Health and Human Services, Proposed Rule on the TANF Program, <http://www.acf.dhhs.gov/hypernews/topics2.html> or Center for Law and Social Policy, *The New Framework: Alternative State Funding Choices Under TANF*, <http://www.clasp.org/pubs/TANF/fnlfnfd.html>.

share of families that must work increases by 5 percent a year to 50 percent of families in FFY 2002. The most difficult work requirement for California to meet will be the two-parent family requirement. Federal law required 75 percent of two-parent families to be working or in a work activity for a combined total of 35 hours per week by FFY 1997. Ninety percent of two-parent families must be working or engaged in a work activity by FFY 1999. California barely complied with the federal work participation rate during the initial reporting period (FFY 1997), with 20.6 percent of all families engaged in qualifying activities, as compared to an adjusted standard of 19.5 percent.<sup>3</sup> California fell significant short of the required rate for two parent families, with 24.5 percent of the state's two-parent families engaged in qualifying activities as compared to an adjusted standard of 68.0 percent.

In order to meet the basic MOE requirement, state funds must not only be *appropriated* in the annual state budget, but must actually be *spent* in the year the TANF block grant funds are received. The amount appropriated in the state budget is based on caseload estimates. Over the last few years, the state's CalWORKs caseload has declined more rapidly than anticipated in the Department of Social Services' (DSS) budget forecasts. It is unclear exactly why caseloads have dropped faster than anticipated, but the magnitude of the changes in the new CalWORKs program has made accurate forecasting and, therefore, budget estimates more difficult. Accurate forecasts are important since the state faces financial penalties if it fails to spend enough state funds to meet the federal MOE requirement. States that fail to comply with the MOE requirement risk a dollar-for-dollar reduction in their federal TANF block grant funds and the loss of federal Welfare-to-Work grant funds. States that fail to meet their MOE must increase their state TANF spending the following year by the amount they fell short the previous year, or face additional penalties. The state can avoid penalties through careful monitoring of the proportion of state and federal funds spent for MOE eligible purposes. Since unspent federal TANF funds can be carried over from year to year, states can spend state and local monies to meet the MOE first and carry over any leftover federal funds to the following year.

<b>Table 1: California's basic MOE requirement is \$2.9 billion. If the state satisfies federal work requirements, the MOE drops to \$2.7 billion. California's TANF block grant from the federal government is fixed at \$3.7 billion per year through FFY 2002</b>		
<b>FFY 1994 State and Local Expenditures</b>	<b>80 percent Maintenance of Effort Requirement (MOE)</b>	<b>75 percent Maintenance of Effort (MOE) Requirement</b>
\$3,643,207,905	\$2,914,566,324	\$2,732,405,929

### What Counts Toward The MOE?

In general, non-federal (i.e. state and county) expenditures made on behalf of eligible families and that are "reasonably calculated to accomplish the purpose" of the TANF block grant can count toward a state's MOE requirement. Allowable uses of state MOE funds include:

- Cash assistance payments to meet basic needs, work-related transportation costs, or clothing allowances.
- A portion of the child support payments collected on behalf of eligible families. State MOE expenditures include amounts that are passed through to families and not counted as income (or "disregarded") when determining a family's eligibility for assistance.

<sup>3</sup> US Department of Health and Human Services, *Characteristics and Financial Circumstances of TANF Recipients July - September 1997 (December 29, 1998)* downloaded from <http://www.acf.dhhs.gov/news/prrate97.htm>. The adjusted standard is the work participation requirement adjusted to reflect the decline in the state's caseload. For FFY 1997, work participation rates are calculated based on the months of July through September 1997.

- State expenditures on behalf of eligible families as part of a state Earned Income Tax Credit (EITC) program.
- Child care, including expenditures used to meet the MOE and matching requirements for the Child Care and Development Block Grant (CCDBG), up to the amount a state spent on Title IV-A child care programs (AFDC/JOBS child care) in FY 1994 or FY 1995, whichever is greater.
- Spending on education or activities that are not generally available to other residents of the state.
- Administrative costs up to 15 percent of the total amount of qualified state expenditures for the fiscal year.
- Services such as substance abuse treatment or pre-pregnancy family planning when these services help accomplish the goals of the TANF program.
- Support services, including teen parenting programs, youth and family counseling, or crisis assistance.
- Cash assistance, employment assistance, and other social services to immigrants who are ineligible for federally funded assistance.

### **Which Expenditures Cannot Count Toward The State's MOE?**

Not all expenditures authorized under federal law can count toward a state's MOE. Federal law specifically prohibits the following expenditures from counting toward a state's MOE requirement:

- Expenditures on services provided to children in the juvenile justice system, even though federal TANF funds may be used for this purpose. California currently spends federal TANF dollars for services provided to eligible youths within the juvenile justice system.
- State funds set aside in a "rainy day" or contingency fund do not count toward a state's MOE requirement until the funds are actually spent on behalf of families for eligible MOE activities.
- Expenditures made with federal funds, Medi-Cal expenditures, expenditures a state uses to match federal funds in other programs, or expenditures made as a condition of receiving federal funds other than TANF funds or the selected child care funds mentioned above.

### **HOW IS CALIFORNIA MEETING ITS MOE REQUIREMENT?**

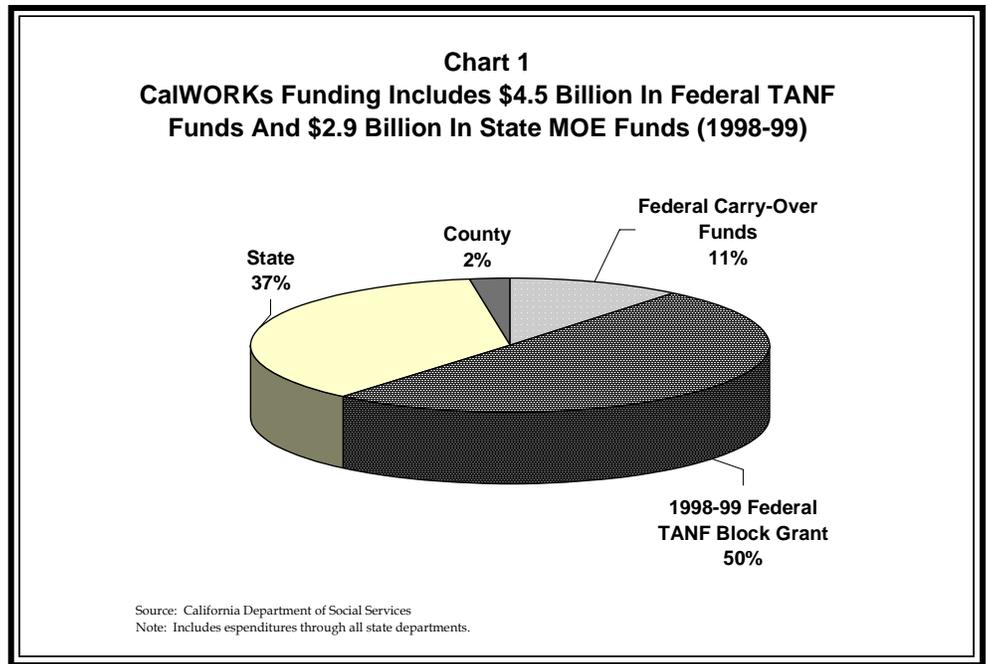
The 1998-99 Budget Act assumes the state will not meet federal work requirements and budgets \$2.9 billion in state funds in order to meet the 80 percent MOE. The 1998-99 budget appropriates \$7.2 billion, which includes the annual TANF block grant of \$3.7 billion, \$609 million in federal TANF funds carried over from the last two years, and \$2.9 billion in state and county spending for MOE eligible purposes (Chart 1).<sup>4</sup> Counties also have an additional \$201 million in federal funds appropriated in prior years to apply toward 1998-99. This \$7.4 billion "total" amount, however, does not reflect the amount the state receives from child support collections. Because the federal TANF law calculates the MOE before the state pays itself back from child support funds collected on behalf of recipients, the actual amount of funds provided in the state budget (including counties' required matching funds) for TANF activities is \$6.6 billion.

Expenditures counted toward California's MOE requirement include state and county spending for grants and services provided to CalWORKs recipients, funding for other programs administered by the DSS, and MOE-eligible spending for programs administered by the Departments of Education, Health Services, and Alcohol and Drug Programs. Within the DSS, MOE expenditures include a portion of

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<sup>4</sup> As amended by the Department of Finance in an October 1, 1998 letter. This letter increased county CalWORKs block grants by \$45.2 million for mental health services out of federal funds carried over from prior years' TANF block grant.

Child Welfare Services' spending.<sup>5</sup> Most of the MOE expenditures administered outside of the DSS go toward child care, community college, and adult education programs. For example, the state counts 25 percent of the spending increase since 1994-1995 for child care programs run by the Department of Education toward the MOE.<sup>6</sup> In total, California counts \$709 million of spending in programs outside of CalWORKs toward the MOE requirement.



### Per Case Spending Up

Although the DSS estimates that the CalWORKs caseload will drop 8.4 percent between 1997-98 and 1998-99, spending for the CalWORKs program is budgeted to increase by \$776 million over the same period.<sup>7</sup> The budget appropriates \$9,092 per case in 1998-99, a 25 percent increase over the 1997-98 per case funding amount of \$7,275. In 1998-99, about 55 percent of the funds went for assistance payments, 19 percent for supportive services, and 14 percent for child care (Chart 2). Child care and supportive services received significant funding increases in 1998-99. In fact, while CalWORKs recipients will receive a grant increase in 1998-99, due to the caseload reduction, total payments for grants will actually decrease in 1998-99.

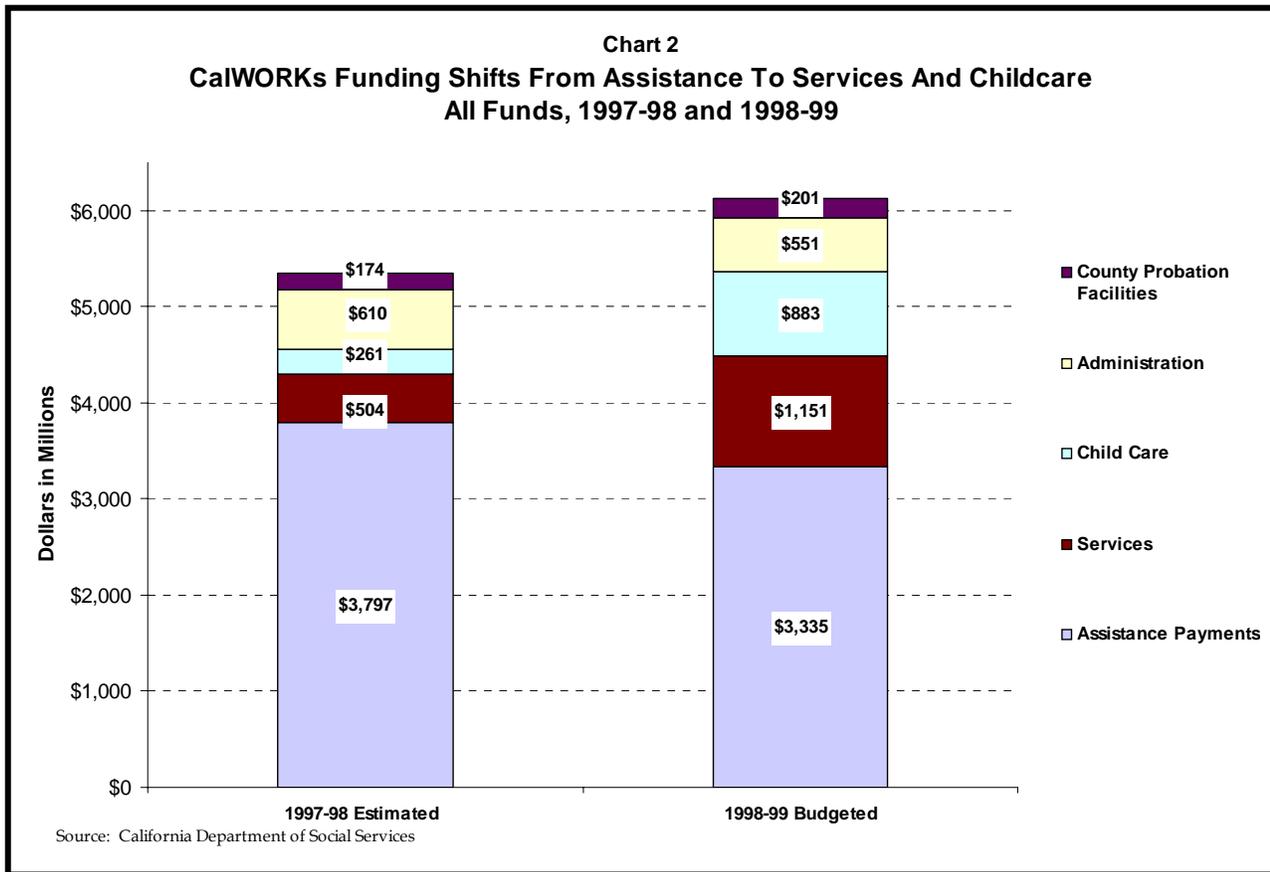
### Counties Have Considerable Flexibility

Counties will determine the actual amount spent on services as compared to administration and child care. Unlike the previous AFDC program, the CalWORKs program provides counties with a flexible pot or "block grant" of funds. While the state DSS estimates expenditures for the different program components, counties are free to move funds between services, child care, and administration. However, federal law limits spending on administration to 15 percent of the sum of federal funds and state MOE eligible spending.

<sup>5</sup> Since the TANF block grant includes funding that was previously provided for the AFDC-EA program, states are allowed to count spending for comparable activities toward the MOE.

<sup>6</sup> California counts 25 percent of the spending on the Department of Education's child care programs toward the MOE. This represents the Department of Social Service's estimate of the portion of total spending that goes to families who are currently receiving or who are eligible for CalWORKs.

<sup>7</sup> This figure includes CalWORKs funding, as defined by the DSS, minus child support collections, plus amounts carried over by counties for similar programs and TANF funds transferred to the CCDBG and held in reserve for Stage I and II child care in 1998-99.



Most states are maintaining overall welfare spending levels, despite falling caseloads. Thirty-three states experienced a 25 percent or more decline in the number of recipients on welfare between August 1996 and March 1998. However, only seven states reduced state spending to the minimum 75 percent MOE level.<sup>8</sup> Instead, states are spending significantly more per TANF recipient than they did under the old AFDC program. This trend illustrates the reality that states now face. In order to prepare low income families for the eventuality of time limits, states must invest in programs and services to help families transition from welfare to work.

The significant drop in caseloads has left California in an unusual position. If expenditures on employment, supportive, and child care services are below budget forecasts, the state could fail to meet the federal MOE requirement. DSS officials believe that they will be able to avoid this problem in the short term by monitoring CalWORKs expenditures on a monthly basis with an eye toward the MOE and will alter the mix of federal versus state funds it uses to pay the bills. If caseloads continue to decline, the state will use more state and fewer federal dollars to pay for CalWORKs' benefits and services. The ability to carry unused federal funds over into future years allows the state to increase the share of costs paid by state funds to insure compliance with the federal MOE requirement.

## USING FEDERAL VERSUS STATE FUNDS TO PAY FOR PROGRAM SERVICES -- THE IMPLICATIONS FOR RECIPIENTS

<sup>8</sup> Tweedie, Jack, *Welfare Spending More for Less*, *State Legislatures*, Vol. 24, No. 3 (Washington, DC: March 1998) and US Department of Health and Human Services Administration for Children and Families (May 1998).

Federal law gives states three options for expending TANF and state MOE funds.<sup>9</sup> States can commingle state and federal funds in a single TANF program; expend state funds segregated from federal funds in a single TANF program; or expend state funds in a separate state program in which no federal TANF funds are used. Most federal restrictions, including the 60-month

<b>Federal TANF Restrictions And Requirements</b>	<b>Commingled Federal And State Fund Assistance</b>	<b>Segregated State Fund Assistance</b>	<b>Separate State Program Assistance</b>
<b>Restrictions On Assistance To Immigrants And Most Other TANF Prohibitions</b>	X		
<b>60-Month Limit</b>	X		
<b>Participation Rates</b>	X	X	
<b>TANF Child Support Assignment And Distribution Rules</b>	X	X	

lifetime limit on cash assistance, do not apply if an individual receives assistance with segregated state dollars or state dollars spent in a separate state program. The federal government also views expenditures of county funds as state funds. Federal requirements which define allowable work activities, minimum work participation requirements, and the amount of child support collected by the state that must be returned to the federal government do not apply to persons aided through a separate state program.<sup>10</sup> Thus, the way state MOE funds are organized and used to provide benefits to TANF recipients has broad policy implications for the design of a state’s TANF program.

All federal requirements, including time limits, work and participation requirements, and child support requirements, apply to families receiving benefits paid by a commingled federal and state fund program (Table 2). Families receiving assistance paid out of state funds in a segregated state fund program, however, are not subject to many of the federal requirements. In particular, months in which a family receives assistance paid out of segregated state funds do not count against the 60-month federal time limit. These families, however, must still meet TANF, work participation, and child support requirements.

Finally, families receiving assistance through a program using only state funds are not subject to TANF prohibitions, work participation requirements, or child support requirements. By utilizing separate state programs, states essentially have the discretion to design their own welfare system irrespective of several federal limitations. States, however, may forfeit eligibility for high performance bonuses, work participation caseload reduction credits, or a “reasonable cause” reduction in penalties accrued for failing to meet work participation requirements.<sup>11</sup> In addition, neither MOE funds nor matching funds spent in separate state programs count toward meeting Contingency Fund spending requirements (see below).

<sup>9</sup> This discussion is a summary of the Center for Law and Social Policy’s *The New Framework: Alternative State Funding Choices under TANF*, Steve Savner and Mark Greenberg (Washington DC: March 1997).

<sup>10</sup> Federal law prohibits spending TANF funds on: teen parents not in school, teen parents not in an adult-supervised setting, undocumented immigrants, and adult recipients who reach the 60-month lifetime limit on aid. Legal immigrants who arrive in the US after August 22, 1996 are ineligible for assistance provided with federal funds for a five-year period. Each state must achieve a minimum overall work participation rate, which gradually increases to 50 percent in the year to 2002 and thereafter.

<sup>11</sup> In order to prevent states from using separate programs to circumvent compliance with work participation requirements, avoid returning a share of their child support collections to the federal government, or shift a large portion of their caseload into separate programs and then assert a dramatic caseload decline, the federal Department of Health and Human Services (DHHS) proposed that states should provide the same data on recipients in separate state programs that must be collected for recipients in TANF programs who are subject to federal reporting requirements. The information collected will be used to look at overall participation levels in order to assess how well states are meeting their responsibilities to move recipients toward self-sufficiency. However, conclusions drawn from data on separate programs will not initially be used to determine whether a state is subject to any penalties.

## WHICH METHODS ARE CALIFORNIA UTILIZING?

California has the ability to design a welfare system consistent with its own priorities by taking full advantage of the flexibility granted under the PROWRA. As families become subject to time limits and the pool of federal dollars diminishes, policymakers may wish to consider modifying the state's welfare system to take advantage of the flexibility allowed under federal law. California currently utilizes all three MOE funding structures, to a limited extent, in order to make child care services more accessible to TANF-eligible families and to accommodate some families who are ineligible for federal assistance.

**Commingled Funds**     **California Work Opportunity and Responsibility to Kids (CalWORKs) program**, California's TANF program, is mostly funded with commingled federal and state expenditures except as noted below.

**Segregated Funds**     **Legal Immigrants.** California is using segregated state MOE funds to provide assistance under CalWORKs to qualified immigrants who entered the country after August 22, 1996 and are ineligible for federal TANF assistance because of their immigration status.<sup>12</sup> Although federal time limits are not applicable to recipients aided with segregated funds, state time limits still apply. These recipients are also included in the state's work participation rates.

**Separate State Program**     **The California Food Assistance Program (CFAP)** was established as a separate program to provide food stamp benefits to eligible qualified immigrants who are under 18 or over 64 and who were in the country prior to August 22, 1996. Congress subsequently restored benefits to this group of immigrants. The 1998-99 Budget Act expanded the CFAP program to non-elderly adult legal immigrants under certain conditions. Funding for benefits received by parents of children in CalWORKs families program count toward the MOE requirement.

**Child Care.** California's child care system is divided into three stages. Stage I serves CalWORKs families when they first begin to receive assistance. Funding for Stage I comes from commingled TANF and state funds. Stage II serves adults who are participating in training, working but still receiving aid, or transitioning off of assistance. Stage III serves CalWORKs recipients who secure stable employment with incomes up to 75 percent of the state median. Stage II and III are funded with federal Child Care Development Fund (CCDF) and state funds. Because there are no federal TANF funds involved in stages II and III, months for which TANF eligible families do not receive cash assistance but continue to use child care services will not count against federal time limits.<sup>13</sup> The 1998-99 Budget Act includes \$183 million in federal TANF funds for a reserve for Stage I and II child care. However, these TANF funds were first transferred to Title XX. Federal law allows states to transfer up to 10 percent of their TANF funds to Title XX and provides that once these funds are transferred they must be spent according to the rules of Title XX. Transferred funds are no longer considered TANF funds and do not carry the federal TANF requirements.

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<sup>12</sup> Qualified immigrants are (1) lawful permanent residents; (2) refugees, asylees, persons granted withholding of deportation, or paroled for at least one year; (3) Cuban-Haitian entrants; and (4) battered spouses and children with a pending or approved spousal visa or petition for relief under the Violence Against Women Act (VAWA).

<sup>13</sup> 100 percent of state funding for stage II child care and 25 percent of state funding for stage III child care is for families who are eligible for or who are currently receiving CalWORKs benefits and is countable toward the MOE requirement.

**Continuing Assistance for Children.** Aid for the children of adults who hit the 60-month time limit continues under CalWORKs. Because federal law prohibits the use of federal TANF funds by recipients who have been on aid more than 60 months, these benefits will be paid out of state funds.

## HOW IMPORTANT IS ACCESS TO THE FEDERAL CONTINGENCY FUND?

One of the fundamental policy changes enacted as part of federal welfare reform was a shift in the structure of the financial relationship between states and the federal government. Under the prior system, states and the federal government shared responsibility for cost increases resulting from increased demands for assistance during an economic downturn and shared savings resulting from declining caseloads when the economy improved. Under welfare reform, states receive a fixed block grant and bear full responsibility for increased program costs. Congress established a contingency fund within the TANF program in recognition that a recession could leave states ill-equipped to meet increased demands for assistance.

In order to access the contingency fund, states must meet a stricter maintenance of effort requirement of 100 percent of "historic state expenditures" during the year in which contingency fund moneys are received. In addition, states must match contingency fund dollars based on their FY 1995 Medicaid matching rate -- a one to one match for California. California's 1998-99 budget funds CalWORKs and associated MOE eligible programs and services at a level equal to 80 percent of FY 1994 spending levels on welfare. Based on 1998-99 spending levels, California would need to spend approximately \$1.5 billion on eligible services to qualify for a maximum of \$740 million from the contingency fund.<sup>14</sup> States, and California in particular, are unlikely to utilize the contingency fund due to its tough MOE requirement. While the contingency fund is intended to help states experiencing an economic downturn, most states will not have the resources to qualify for the fund during hard economic times. Consequently, few states have considered the contingency fund when considering how much to spend on MOE eligible programs and services.

## CONCLUSION

The 1996 federal welfare law gave states new flexibility to restructure the programs and services that constitute the safety net for low income families. While federal time limits and work requirements constrain states' use of federal funds, states now have broad flexibility to determine how their own and local dollars will be used. California has utilized this flexibility to establish the new state CalWORKs program and separate state programs to provide assistance using state and local dollars. While the number of Californians receiving assistance has dropped significantly, it is still too soon to assess the long term impact of welfare reform on low income Californians and California communities. As the state and counties move toward full implementation of the CalWORKs programs, policymakers and program officials may wish to utilize the flexibility available under federal law to:

- Provide continued assistance to individuals ineligible for federally-funded programs and services. The state currently counts a portion of the cost of the California Food Assistance Program toward the federal MOE. Current law sunsets the CFAP at the end of June 2000.
- Provide assistance to certain families out of state and local funds. Months in which families receive services supported by state funds would not count toward families' five year limit on receipt of

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<sup>14</sup> Spending toward the Contingency Fund MOE cannot include spending on child care programs and any funds drawn down would have to be matched with additional state funds.

federally funded benefits. The state may, for example, wish to fund child care, job retention, or the reduced CalWORKs benefits received by employed recipients out of state and local funds.

- Establish a reserve fund to help offset increased program costs that are likely to accompany an economic downturn.

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*Kimura Flores, Marga Ortiz, and Jean Ross prepared this Brief. The California Budget Project (CBP) is a nonpartisan, nonprofit organization whose goal is to promote a better understanding of state fiscal issues in order to promote a healthy public sector based on a fair and equitable tax system. General operating support for the California Budget Project is provided by grants from the California Endowment, James Irvine, Ford, Annie E. Casey, and California Wellness Foundations and individual donations and subscriptions.*

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