

## FEDERALISM AND U.S. SOCIAL WELFARE POLICY: FUNDAMENTAL CHANGE AND NEW UNCERTAINTIES

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**AUTHOR'S NOTE:** This paper was written for the Frankfurt/Columbia symposium held in April 1996. In July 1996 the Congress enacted and in August 1996 the President signed major new welfare legislation.<sup>1</sup> The new welfare law repeals the Aid to Families with Dependent Children (AFDC) program and replaces it with a new program of block grants to the states, called Temporary Assistance for Needy Families (TANF). The TANF program is similar, though not identical, to the block grant proposals described in Part II,<sup>2</sup> and it raises the issues of federalism discussed in Part III. Thus, although the article's references to AFDC and to pending block grant proposals should now be understood as historical, the broader concerns detailed in Part III remain at the center of national debate.

The assigned topic for this paper, "U.S. social welfare policy," potentially encompasses virtually the whole range of domestic social policy, from education to health care, from labor policy to anti-poverty policy to tax policy. To make the project manageable, this paper focuses on the major transfer programs that provide cash grants, food assistance, and medical care for the elderly, the disabled, the unemployed, and the poor. Although any boundary between these and other programs is arbitrary, most Americans probably consider these to be the basic components of our social welfare policy.

The paper provides an overview of the major U.S. social welfare programs and briefly describes current legislative proposals that would change significantly the balance between federal and state control of some major welfare programs. Although these proposals would make only modest changes in the largest U.S. social welfare programs (Social Security and Medicare), which use federal funds to provide benefits to virtually all retired workers, the proposed changes would fundamentally restructure welfare programs for poor families (AFDC (Aid to Families with Dependent Children) and Medicaid). Under current law, these programs are funded and administered jointly by the federal government and the states. The proposed changes would curtail the federal government's obligation to fund these programs and would grant to states significant power to set the terms of assistance.

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\* Associate Professor, Columbia University School of Law. Lance Liebman, Ingwer Ebsen, and others provided very useful comments at the Frankfurt-Columbia symposium held on April 11, 1996. Andrea Schwartzman provided excellent research assistance.

<sup>1</sup> Pub. L. No. 104-193; 110 Stat. 2105 (1996).

<sup>2</sup> The new law does not convert Medicaid into a block grant, although such proposals remain under discussion. The new law also modifies the terms of the Food Stamps and SSI programs and denies federal (and in some circumstances, state) social welfare benefits to illegal aliens and to many legal aliens.

Welfare "reform" is perennially part of the American political agenda, and pressure from the states for greater authority over the terms of welfare programs has been growing in the last decade. The election of a Republican congressional majority in 1994 cleared the way for the enactment in 1995 of legislation that would, only months before, have been considered almost too radical to warrant mainstream attention. After a presidential veto, the fate of the welfare legislation remains uncertain.

If the legislation in some form is enacted, its impact is unpredictable. Some predict that granting greater control to the states will create a rich variety of new welfare experiments that can find new ways to use scarce resources to meet the needs of the low-income population. Other forecasts are darker, predicting that state budget woes will dictate cuts in welfare benefits and services as states compete in a desperate "race to the bottom" to avoid attracting new welfare claimants. The third section of the paper briefly reviews arguments for and against the proposed "devolution."

## I. OVERVIEW OF CURRENT LAW: THE MODIFIED NEW DEAL SYSTEM

The U.S. social welfare system has a large number of different programs and a wide variety of arrangements for sharing financial and administrative control between the federal government and the states. The basic structure of the U.S. social welfare system was established in 1935 by the Social Security Act.<sup>3</sup> The Act created a major federal role in U.S. social welfare policy, which until then had largely been the responsibility of states and localities.<sup>4</sup> Although the provisions of the Act have been amended over time, typically to give the federal government an even greater role in social welfare policy, the basic pattern of programs it established has endured.

Some common vocabulary is a useful starting point. A program is *income-tested* if benefits are explicitly reduced as earnings rise. A program is *universal* (or non-income-tested) if it is not income-tested (*i.e.*, its benefits are available to all eligible claimants, without regard to income level). A program is *contributory* if its benefits are available only to those who have qualified by making advance contributions, usually through a payroll tax on wages.

*Social Security and Medicare.* Social Security is a federal program that provides cash benefits to retired and disabled workers and their dependents and to the dependents of deceased workers. Social Security benefits are contributory and universal.<sup>5</sup> Social Security payroll taxes on employees and employers now are mandatory for most workers.<sup>6</sup> Social Security retirement benefits typically

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<sup>3</sup> Aug. 14, 1935, Ch. 531. 49 Stat. 620 (1935).

<sup>4</sup> *But see* THEDA SKOCPOL, *PROTECTING SOLDIERS AND MOTHERS* (1995) (describing the federally-funded Civil War pension system that began in the 19th century).

<sup>5</sup> The system is financed on a "pay-as-you-go" basis. Current payroll taxes are not saved to fund future benefits for contributors but instead are used to finance current benefits.

<sup>6</sup> In 1994, the employer and employee each pay a payroll tax of 7.65% on total wages up to \$60,600. That total tax funds Social Security and part of Medicare. The 1.45% attributable to

begin at age 65. Benefits are based on lifetime earnings using a progressive formula, so that lower-earning workers receive a proportionately greater return on their payroll tax "contributions."

For a worker earning average wages who retires in 1991, Social Security replaces about 42 percent of earnings.<sup>7</sup> In 1993, the average Social Security retirement benefit was \$674 per month (\$8,088 per year) for a single person and \$1,021 per month (\$12,252 per year) for a married couple.<sup>8</sup> In the same year, the official poverty level was \$6,930 per year for a single person and \$8,741 per year for a couple.<sup>9</sup>

Medicare is a federal program of health insurance for the elderly and the disabled.<sup>10</sup> In general, retired workers who qualify for Social Security benefits receive free hospitalization insurance under Medicare (Medicare Part A) but must pay a premium for insurance that covers doctors' bills (Medicare Part B). Retired workers who do not qualify for Social Security cash benefits may also receive Medicare but must pay a premium for Part A coverage in addition to the usual premium for Part B.

**Table 1. Recent Federal and State Expenditures on Major U.S. Social Welfare Programs (totals may not add due to rounding)**

Program	FY 1993 Total Cost	FY 1993 Federal Cost	FY 1993 State Cost
Social Security <sup>11</sup>	\$298 billion	\$298 billion	none
Medicare <sup>12</sup>	\$146 billion	\$146 billion	none
Supplemental Security Income (SSI) <sup>13</sup>	\$24 billion	\$21 billion	\$4 billion
Aid to Families with Dependent Children (AFDC) <sup>14</sup>	\$25 billion	\$14 billion	\$12 billion
Medicaid <sup>15</sup>	\$132 billion	\$76 billion	\$56 billion
Food Stamps <sup>16</sup>	\$26 billion	\$26 billion	none

Medicare HI is imposed on all earnings without limit. I.R.C. §§ 3101, 3201, 3111, 3121(a).

<sup>7</sup> COMMITTEE ON WAYS AND MEANS, U.S. CONGRESS, OVERVIEW OF ENTITLEMENT PROGRAMS: 1994 GREEN BOOK 16 (1994) (Table 1-7) [1994 GREEN BOOK]. The replacement rate for a low earner retiring in the same year is 57 percent, and the replacement rate for a high earner is 26%. *Id.*

<sup>8</sup> *Id.* at 4.

<sup>9</sup> *Id.* at 231-32.

<sup>10</sup> For a description of Medicare, see generally *id.* at 123-34.

<sup>11</sup> *Id.* at 32 (Table 1-13).

<sup>12</sup> *Id.* at 32 (Table 5-20).

<sup>13</sup> *Id.* at 32 (Table 6-1).

<sup>14</sup> *Id.* at 32 (Table 10-21).

<sup>15</sup> *Id.* at 32 (Table 18-13).

<sup>16</sup> *Id.* at 32 (Table 18-4).

Both Social Security and Medicare are funded and administered primarily by the federal government. Social Security cash benefits and Medicare Part A are financed primarily by payroll tax revenue; Part B is funded by beneficiary premiums and general revenue.<sup>17</sup> Social Security and Medicare account for a significant portion of the federal budget. The two programs together cost the federal government about \$493.4 billion in 1995,<sup>18</sup> when total federal spending of all kinds was \$1.52 trillion.<sup>19</sup> Over time, Medicare expenditures have grown rapidly. Since 1985, annual growth rates in outlays in excess of 10% per year have been common, and recent estimates suggest projected growth in outlays of about 10% per year.<sup>20</sup>

*Supplemental Security Income (SSI)*. SSI is an income-tested, noncontributory program for elderly and disabled people. SSI recipients often are people who do not qualify for Social Security benefits or whose Social Security benefits are very low. In 1994, the average SSI benefit was \$669 per month (\$8,268 per year) for a married couple and \$446 per month (\$5,592 per year) for a single person. States may provide supplemental SSI benefits to their residents, but only about half do so.<sup>21</sup>

SSI is primarily funded by federal revenue (states must fund their own supplemental benefits programs and reimburse the federal government for administrative costs of the supplements) and is administered by the federal government through the Social Security Administration. In 1993, SSI expenditures were \$24 billion.<sup>22</sup>

*Aid to Families with Dependent Children (AFDC)*. AFDC is an income-tested, noncontributory program that provides cash benefits to families with minor children. Although most AFDC families are headed by a single parent, usually a single mother, two-parent families also are eligible for benefits.<sup>23</sup>

Both the federal government and the states play a role in funding AFDC and determining its rules. The federal AFDC statute sets the basic eligibility rules and creates other requirements that state programs must meet in order to receive federal funds. For example, under current federal law, state AFDC programs must provide benefits to all eligible families and must require AFDC recipients to participate in work training and job search activities.<sup>24</sup> States set benefit levels

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<sup>17</sup> See *id.* at 172-182 for a detailed description of Medicare financing and the financial status of the trust funds.

<sup>18</sup> See Executive Office of the President, Office of Management and Budget, *Budget of the United States Government, Analytical Perspectives, Fiscal Year 1995* 102 (1995) (Table 7-2) [*Budget of the United States Government*].

<sup>19</sup> *Id.* at 106.

<sup>20</sup> See 1994 GREEN BOOK, *supra* note 7, at 176 (Table 5-20).

<sup>21</sup> See *id.* at 224-25 (Tables 6-5 and 6-6).

<sup>22</sup> See Table 1.

<sup>23</sup> To receive AFDC-UP (AFDC payments for two-parent families with an unemployed parent), the principal wage-earner must be attached to the labor force (by having worked 6 out of 13 calendar quarters in any 13-quarter period ending within one year of application for assistance) but must be unemployed (generally, working fewer than 100 hours per month). See 1994 GREEN BOOK, *supra* note 7, at 331-33.

<sup>24</sup> See *id.* at 337-57 (describing JOBS program).

and income and asset limits for eligibility and administer the program.

The federal government pays a percentage of state AFDC benefit costs, ranging from 50% to 80%, with a higher matching percentage for poorer states (determined based on per capita income), and pays 50% of administrative costs.<sup>25</sup> In 1993, the total cost of AFDC was \$25 billion, with federal outlays of \$14 billion and state expenditures of \$12 billion.<sup>26</sup>

Benefits differ significantly among states. In 1994, New York paid a maximum AFDC benefit of \$577 per month to a family of three, while Mississippi paid a maximum benefit of \$120 per month to a family of three. In 1994, the median AFDC benefit for all states was \$366 per month for a three-person family.<sup>27</sup>

*Medicaid.* Medicaid is an income-tested, noncontributory program that provides medical care for some categories of poor adults and children.<sup>28</sup> Medicaid serves three principal groups: children and their parents, the elderly, and the disabled. All Medicaid recipients must have assets and income that are less than certain thresholds. Many elderly and disabled recipients were formerly middle-class but have high medical expenses and have "spent down" to Medicaid income and asset limits. Medicaid serves in effect as the insurer of last resort for long-term nursing home care, which Medicare does not cover.

In 1992, Medicaid coverage was extended to 47 percent of individuals living in families with incomes below the official poverty threshold.<sup>29</sup> In 1992, approximately 12% of Medicaid recipients were over age 65, and about 15% were blind or disabled. Minor children and adults in families with dependent children were about 71% of Medicaid recipients.<sup>30</sup> Although dependent children and their families are by far the largest group of Medicaid recipients, the elderly and disabled account for a disproportionate share of Medicaid expenditures. In 1992, the elderly, blind and disabled accounted for about 69% of total expenditures.<sup>31</sup>

The federal government shares the cost of Medicaid with the states, and the states administer the program. The Medicaid matching formula ranges from 50 percent to 83 percent, with poorer states (measured by per capita income) receiving higher matching rates. In 1994, the highest matching rate was 79%. The federal government also pays 50% of administrative costs.<sup>32</sup> The federal

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<sup>25</sup> See *id.* at 324.

<sup>26</sup> See Table 1.

<sup>27</sup> See 1994 GREEN BOOK, *supra* note 7, at 368-69 (Table 10-12).

<sup>28</sup> Traditionally, Medicaid eligibility was linked to the receipt of AFDC or SSI benefits, but in recent years, legislation has extended eligibility to new groups of recipients, including some low-income pregnant women and children who do not receive or are not eligible for AFDC. See 1994 GREEN BOOK, *supra* note 7, at 784-85; see *id.* at 785-86. In addition, states have the option to provide Medicaid to certain groups of people who are "medically needy," *i.e.*, those with large medical expenses but whose income or assets are too great to qualify under the income-based standards. See *id.* at 786-87.

<sup>29</sup> See *id.* at 787.

<sup>30</sup> See *id.* at 804 (Table 18-18).

<sup>31</sup> See *id.* at 802 (Table 18-16).

<sup>32</sup> See *id.* at 789.

statute requires states to offer a basic package of services but states can offer additional services. The states also set reimbursement rates for physicians and hospitals.

In 1993, total expenditures on Medicaid were \$132 billion, with federal outlays of \$76 billion and state expenditures of \$56 billion.<sup>33</sup> Like Medicare, Medicaid has grown rapidly in recent years. In the 1980s, annual growth rates in excess of 10% were common; by the early 1990s, annual growth rates approaching or exceeding 20% or more were common.<sup>34</sup>

Program	Average or Median Benefit	Year	Number of Participants
Social Security <sup>35</sup>	\$1,021 per month for a married couple	1993	42 million
SSI <sup>36</sup>	\$478 per month for a married couple	1993	6 million
AFDC <sup>37</sup>	\$373 per month average benefit per family	1993	14 million
Food Stamps <sup>38</sup>	\$68 per person per month	1993	28 million
UI <sup>39</sup>	\$696 per month per worker (\$172 per week x 4 weeks)	1993	7.8 million
EITC <sup>40</sup>	\$945 per year	1993	14 million
Official Poverty Level <sup>41</sup>	\$761 per month for a married couple	1992	36 million

*Unemployment Insurance.* Unemployment insurance (UI) provides non-income-tested cash benefits to workers who are recently and involuntarily unemployed. UI benefits are funded by federal and state taxes on employers' payrolls; workers are eligible for UI benefits if they worked for a minimum

<sup>33</sup> See Table 1.

<sup>34</sup> See 1994 GREEN BOOK, *supra* note 7, at 796-97 (Table 18-13). In 1986, total (federal and state) outlays for Medicaid were about \$45 billion; by 1993, total outlays were \$132 billion. *Id.*

<sup>35</sup> *Id.* at 4 (Table 1-1).

<sup>36</sup> *Id.* at 209 (Table 6-1). The figure in the text reflects only *federal* SSI payments; many states provide supplemental benefits. In 1993, the average federally-administered state supplement was \$109. *Id.*

<sup>37</sup> *Id.* at 325 (Table 10-1). The average family size is 2.9 persons. *Id.*

<sup>38</sup> *Id.* at 782 (Table 18-11).

<sup>39</sup> *Id.* at 264, Table 7-1 (106 million workers covered by the program).

<sup>40</sup> *Id.* at 704 (Table 16-13).

<sup>41</sup> *Id.* at 115 (Table H-2) (annual poverty threshold of \$9,137 divided by 12 months); *id.* at 1154 (Table H-1).

period and their employers were required to participate in the program.<sup>42</sup>

UI is mandated by the Social Security Act, but the federal statute calls for administration by the states and gives the states significant leeway in administration and in setting eligibility rules, benefits, and duration of benefits. In general, unemployed workers must have a work history and must be willing and able to seek and accept work. Unemployed workers who were fired or laid off are generally eligible for UI, but those who voluntarily leave work without good cause are not. Benefits are typically set at a fraction of an individual's prior wages (typically 50 to 70 percent) up to a maximum benefit. Benefits typically last 26 weeks, with an additional 13 weeks of extended coverage.<sup>43</sup>

In 1994, weekly payments across the U.S. averaged \$177, with 8.5 million receiving benefits and another 2.7 million having already exhausted available benefits.<sup>44</sup> In 1993 it was estimated that, although 90% of all employed persons were covered by the UI system, only 48% of unemployed persons received UI benefits in that year.<sup>45</sup>

*Earned Income Tax Credit (EITC).* Although the EITC is technically part of the tax code, it is a major federal transfer program.<sup>46</sup> The EITC currently provides income-tested, noncontributory benefits of as much as \$3,500 annually to a low-income worker with two children.<sup>47</sup> The EITC is in part an earnings subsidy and has been promoted as a work incentive program for the poor.<sup>48</sup> Although the EITC is income-tested, income limits are much higher than those in most welfare programs.<sup>49</sup>

The EITC is entirely funded by the federal government and is administered through the federal income tax system. (Recipients must file an income tax

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<sup>42</sup> The federal tax (FUTA) is 6.2% of the first \$7,000 of wages paid to each employee, but most employers pay only a net FUTA tax of 0.8 percent. State payroll taxes differ in tax rate and wage base and typically base each employer's tax rate on its unemployment history. For a more detailed description, see *id.* at 263-72.

<sup>43</sup> See *id.* at 268-81.

<sup>44</sup> See *id.* at 264-67.

<sup>45</sup> See *id.* at 264-67. The high percentage of the unemployed not receiving UI benefits is typically explained by a combination of factors. Some long-term unemployed workers exhaust their UI benefits; some eligible workers do not claim benefits, particularly if they are unemployed only a short time; and some workers are ineligible (in some cases their employment was not covered by the UI system; in others they worked for too short a period to qualify or were fired). See DIANA DINITTO, *SOCIAL WELFARE: POLITICS AND PUBLIC POLICY* 120 (1995).

<sup>46</sup> The EITC provides a "refundable" tax credit to low-income workers; the "refundable" tax credit is simply a fiction that permits the tax authorities to mail checks to workers too poor to owe any income tax. See generally I.R.C. § 32.

<sup>47</sup> I.R.C. § 32; for projected 1996 benefit levels, see 1994 GREEN BOOK, *supra* note 7, at 700 (Table 16-11). Benefits available to childless workers are much smaller. Budget legislation passed by Congress but vetoed by the President would eliminate EITC benefits for childless workers and reduce EITC benefits for other groups.

<sup>48</sup> See Anne L. Alstott, *The Earned Income Tax Credit and the Limitations of Tax-Based Welfare Reform*, 108 HARV. L. REV. 533 (1995).

<sup>49</sup> In 1996, for example, the income limit for EITC recipients with two children is projected to be \$28,524 per year. See 1994 GREEN BOOK, *supra* note 7, at 700 (Table 16-11). In contrast, the gross income limit for AFDC benefits for a family of three in the median state in 1994 was \$11,256 (\$938 per month).

return showing their family status and earnings.) Some states have adopted their own EITC programs, but federal and state programs are not legally connected in administration or financing.

In fiscal year 1995, federal expenditures on the EITC totalled about \$17 billion,<sup>50</sup> and about 20 million families received the credit.

*Food Stamps.* Although not part of the Social Security Act, the Food Stamp Program is one of the federal government's major social welfare programs. It is an income-tested, noncontributory program that provides food coupons to eligible families. The program is funded almost entirely by the federal government and has uniform rules and benefit levels determined by federal law. States have responsibility for day-to-day administration of the program, in accordance with federal rules.

Unlike AFDC, the Food Stamp Program sets income limits and maximum benefit levels that are uniform across states.<sup>51</sup> Further, eligibility is based only on income without regard to family structure, with the result that (unlike AFDC benefits) food stamps are available to single people and childless couples. Food stamps are also available to the elderly, to families with children and to unemployed workers. In 1991, approximately 41% of food stamp recipients also received AFDC, and approximately 19% of recipients received SSI.<sup>52</sup>

In 1993, federal outlays for food stamps were \$26 billion.<sup>53</sup> In 1993, the average food stamp benefit per person was \$68 per month.<sup>54</sup>

*General Assistance.* Some, but not all, states provide income-tested, noncontributory cash benefits to low-income people who do not receive AFDC or SSI — principally working-age single men and women without children. General assistance programs are entirely funded and administered by the states, and benefit levels and eligibility requirements vary significantly among states. A typical general assistance program provides very small cash payments, often for a short period of time, and often in connection with relatively strict work requirements.

*Family Allowances.* U.S. readers of this paper will be surprised by this heading, because the United States has *no* national or state program of family allowances. I include this topic simply to emphasize, for U.S. and European readers alike, one significant difference between the U.S. social welfare system and those of Western Europe.

Very generally, the kind of family allowance commonly found in Europe is a dollar payment per child that is equally available to single-parent and married-parent families. Family allowances are usually universal, although often there is an additional, income-tested supplement, and sometimes an extra supplement for single-parent households. Although the federal income tax system contains

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<sup>50</sup> See *Budget of the United States Government*, *supra* note 18, at Table 6-2.

<sup>51</sup> One result is that food stamp benefits to some extent offset variation in state AFDC benefit levels. Under the food stamp rules, families with lower AFDC benefits tend to get higher food stamp allotments.

<sup>52</sup> 1994 GREEN BOOK, *supra* note 7, at 775 (Table 18-8).

<sup>53</sup> See Table 1.

<sup>54</sup> 1994 GREEN BOOK, *supra* note 7, at 768.

several benefits for families with children, none amount to a coherent approximation of a family allowance.<sup>55</sup>

## II. THE FEDERALIST IMPACT OF CURRENT WELFARE LEGISLATION

In 1995, the Congress enacted legislation that would significantly restrict the federal role in funding and setting the terms of AFDC and Medicaid. The President vetoed the legislation as part of the continuing budget standoff with Congress.<sup>56</sup> The ultimate fate of the legislation once the budget stalemate is resolved is uncertain. Although the President indicated in the fall of 1995 that he would be willing to sign some version of Republican-proposed welfare reform, more recent statements by the White House are equivocal, and the issue is likely to be determined by election-year politics. After the veto of the 1995 welfare reform bill, there is no single definitive welfare reform plan, but rather a number of possibilities, including compromise proposals put forward by the national association of governors.<sup>57</sup> The following discussion draws on the 1995 House and Senate bills to illustrate the basic components of current proposals affecting AFDC and Medicaid.

Although current budget negotiations also may result in changes in Medicare, SSI, and Food Stamps, the proposed changes in AFDC and in Medicaid are the most sweeping and the most controversial. Very generally, these proposals would make two major types of changes: (i) the conversion of the programs from "entitlements" to "block grants", and (ii) a corresponding "devolution" (or transfer to the states) of greater responsibility for setting the terms of assistance.

Under current law, AFDC benefits are said to be an "entitlement" guaranteed by the federal government. States may choose not to participate in AFDC (in fact, all 50 states do), and states have significant authority to determine the level of AFDC benefits, but participating states must provide AFDC cash assistance to all eligible claimants. The cost of funding the AFDC entitlement is shared by the federal government and the states. Although AFDC benefit levels are set by the states, eligibility rules are largely determined by the federal statute, and these AFDC rules govern the spending of state as well as federal funds.

The major welfare reform proposals now under consideration would end the federally-mandated AFDC entitlement. The federal government would continue to contribute funds to state programs for low-income families, but the federal government's contribution would be structured as a "block grant," or a fixed

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<sup>55</sup> In 1995, the Congress and the President both proposed \$500 per child tax credits. These tax credits have also been held hostage to the budget standoff, but their eventual enactment is likely. The child tax credits resemble a family allowance with two key differences: (i) they are quite small, and (ii) because they are not "refundable," they are available only to taxpayers with incomes of approximately \$20,000 or more and so provide no benefit to the very poor.

<sup>56</sup> See Judith Havemann, *Clinton Vetoes Welfare Measure That Would Have Shifted Power to States*, WASH. POST, Jan. 10, 1996, at A4.

<sup>57</sup> For a description of the governors' proposals and of a recent bill modeled on them, see Robert Pear, *On Social Policy, Governors Quietly Split the Difference*, N.Y. TIMES, Feb. 8, 1996, at A1; Judith Havemann and Barbara Vobejda, *G.O.P. Tailors Welfare Package to Clinton's Veto Objections*, WASH. POST, May 23, 1996, at A6.

annual contribution of funds to the states, roughly equal to or somewhat smaller than the current federal contribution to AFDC.<sup>58</sup> The block grant would not generally increase in response to changes in the low-income population or to economic conditions in the states.<sup>59</sup> The total block grant would be divided among states which plan to use the funds to run a program of cash assistance for low-income families.

Under the new system, federal rules would impose some restrictions on the use of federal block grant funds, but states would have much greater flexibility than under current law to set the terms of their programs. In addition, remaining federal restrictions would apply only to the use of the federal funds. Any state funds contributed could be used as the states chose, without regard to federal restrictions. Under some proposals, the states would be free not to contribute any state funds at all to the program (regardless of their current spending on AFDC).<sup>60</sup>

Thus, a block grant system would end the federally-guaranteed entitlement to benefits. A state that accepts a block grant must use the federal funds to pay benefits to low-income families, but the funds may simply run out before all such families are paid. States are permitted to step into the breach and fund a full entitlement, but they are not legally required to do so.

Block grant proposals typically contain some substantive restrictions on the use of cash assistance funded by the block grant. The House and Senate bills require adult AFDC recipients who receive cash assistance for more than two years to participate in work programs.<sup>61</sup> Both bills also require states to terminate cash assistance to individuals after a (lifetime) total of five years of benefits.<sup>62</sup> The House bill contains additional restrictions, including a prohibition on assistance to children born to parents already receiving AFDC or to unmarried teenage parents and their children.<sup>63</sup> The bills also require or permit the denial of AFDC benefits to legal aliens.<sup>64</sup>

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<sup>58</sup> The House bill would cap federal spending at \$15.4 billion per year; the Senate bill would cap federal spending at \$16.8 billion per year. H.R. 4, 104th Cong., 1st Sess. § 101 (1995); S. 4, 104th Cong., 1st Sess. § 101 (1995).

<sup>59</sup> Some proposals provide limited "rainy day funds" or emergency loan programs to the states to accommodate high unemployment, but the amounts provided are small. For example, the House bill provides a rainy day loan fund of \$1 billion, and the Senate provides a contingency fund of \$1 billion and an additional emergency loan fund of \$1.7 billion. H.R. 4, § 101; S. 4, § 101. In addition, some proposals provide limited accommodation to increasing population. The House bill, for example, provides an additional \$100 million per year to be allocated among states with growing populations. The Senate bill provides an additional \$900 million over four years to be allocated to states with low benefits or high population growth. *Id.*

<sup>60</sup> The House bill passed in 1995 permits states not to contribute any funds at all. The Senate bill contains a "maintenance of effort" requirement that requires states to spend at least 80% of their 1994 expenditures on AFDC and penalizes noncompliance through a dollar-for-dollar reduction in block grant funding.

<sup>61</sup> H.R. 4, § 101; S. 4, § 101.

<sup>62</sup> *Id.*

<sup>63</sup> The Senate bill permits states to deny assistance to additional children or to teenage parents and their children. *Id.*

<sup>64</sup> H.R. 4, §§ 402 et seq; S. 4, §§ 501 et seq.

The House and Senate bills also would convert Medicaid from an entitlement into a block grant. States would receive a fixed allotment of federal funds to be used to fund medical care for low-income children and families. States would be permitted, but not required to supplement federal funding with their own funds, and states would have even more leeway than under current law to set the terms of assistance.

### III. BLOCK GRANTS, WELFARE MAGNETS, AND THE RACE TO THE BOTTOM

The proposed move to block grants would significantly reduce the federal government's role in providing cash assistance and medical care to poor families. States would assume new responsibility — unprecedented in the last 60 years — for the financing and for the substantive content of these programs. The enactment of the proposal could quickly transform the AFDC and Medicaid programs in unpredictable ways.

Praise and criticism for these proposals have centered on two issues: (i) the termination of the federal entitlement to assistance and the devolution of responsibility to the states, and (ii) the substantive policy changes incorporated in the federal block grants that are likely to be adopted by the states.

*The End of Entitlement.* Advocates argue that block grants appropriately delegate primary responsibility to the states to determine the size, generosity, and content of their welfare programs. Proponents argue that fifty different state welfare programs will provide a “laboratory” for experimentation that is stymied by current federal regulation. Supporters of the block grant approach also contend that states are likely to have better information about the characteristics of their populations and can more easily tailor assistance to meet their needs. The optimistic story is that, once freed from federal control, the states can both innovate quickly and respond flexibly to the outcomes of their experiments, keeping the good and scrapping the bad.

The move toward experimentation at the state level has been gaining strength in recent years, as a number of states have applied for and received “waivers” to alter the terms of their AFDC or Medicaid programs in ways not permitted by the federal statute.<sup>65</sup> Advocates of block grants argue that waivers move in the right direction but are insufficient. Block grants allow states to experiment freely without having to document their intentions in advance, wait for federal approval for a temporary experiment, and then report results to the federal government.

Critics of these proposals worry that unfettered state discretion would create more problems than it would solve. First, critics argue that block grants could

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<sup>65</sup> For a description of waivers approved in the early 1990s, see Michael Wiseman, *The New State Welfare Initiatives*, INSTITUTE FOR RESEARCH ON POVERTY (“IRP”) DISCUSSION PAPER #1002-93 (1993); Michael Wiseman, *State Strategies for Welfare Reform: The Wisconsin Story*, IRP DISCUSSION PAPER #1066-95 (1995) [*The Wisconsin Story*]. See also Jennifer Preston, *Region's Governors Draw Own Blueprint for Welfare*, N.Y. TIMES, Feb. 17, 1996, at 1, 29 (describing Connecticut's AFDC waiver, approved in 1995, which permits imposition of a twenty-one month time limit on benefits and permits welfare recipients to earn more without losing welfare benefits).

result in significant economic hardship for welfare recipients. Senator Moynihan argues that block grants would undermine the "political economy of the New Deal" by ending national responsibility for anti-poverty efforts.<sup>66</sup> Critics of the new approach argue that the federal government's role in welfare policy (including both AFDC and Medicaid) has helped stabilize the national economy by guaranteeing a greater federal contribution to states suffering high unemployment or persistent high poverty rates. A federal entitlement thus redistributes not only from richer to poorer states but also from states enjoying boom times to those suffering recessions. Although the House and Senate bills contain modest emergency loan funds upon which states can draw, critics argue that the funds are too small to accomplish much.

Second, critics contend that the dynamics of intra- and interstate politics will drive states to limit sharply the resources they devote to welfare programs. State governors have in recent years often been elected on platforms including welfare cuts and tax reductions for the middle class. The results have been significant budget cuts in state programs, including in some cases sharp reductions in general assistance — the welfare program that states currently control without federal intervention.<sup>67</sup> In recent months, states also have begun to outline proposals in response to the prospect of federal block grants, and these programs too often would achieve budget savings through a mixture of time limits and benefit cuts.<sup>68</sup>

Put another way, the adoption of block grants alters the marginal cost to the states of new state welfare programs in a way that may discourage state supplementation of the federal grant. Under the current matching system, states with AFDC programs pay only 50% of any increase in AFDC benefits. In a pure block grant system (with no requirement that states maintain current spending), the cost to a state of creating welfare benefits up to the block grant amount is zero; further expansions come completely out of state funds.

In addition to these pressures to limit spending and taxes, critics also argue that interstate competition may drive states into successive rounds of welfare cuts — a "race to the bottom." State politicians may worry that having more generous welfare benefits than neighboring states will induce immigration of

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<sup>66</sup> See generally Daniel P. Moynihan, *The Devolution Revolution*, N.Y. TIMES, August 8, 1995, at E15.

<sup>67</sup> See Preston, *supra* note 65, at 29 (describing recent and proposed changes in Connecticut's general assistance program, including recent imposition of a six-month time limit for "employable" recipients and a proposed two-month time limit); *id.* at 29 (describing proposed changes in New York's welfare program for childless couples and single individuals that would include a 60-day time limit).

<sup>68</sup> See *id.* at 29 (describing changes proposed in AFDC by Governor Pataki of New York, including reductions in cash benefits and a five-year time limit); Keith Bradsher, *Michigan Moves to Untie Joblessness and Welfare*, N.Y. TIMES, Jan. 18, 1996, at A14 (describing an experimental project in Michigan that would offer job search assistance, transportation, and child care but would deny benefits to recipients who were capable of working but declined work); Whitman *Proposes Welfare Plan Intended to Ease a Shift to Work*, N.Y. TIMES, Jan. 30, 1996, at A1 (describing New Jersey's proposed plan to limit benefits to five years, increase funding for child care and job-training, and allow recipients to keep more welfare benefits while working).

welfare claimants from other states and increase program costs as the state becomes a "welfare magnet." Conversely, politicians may perceive that cuts in welfare benefits or the imposition of stringent time limits could not only avoid immigration but perhaps create a "welfare repellent" effect, inducing welfare recipients to leave the state.<sup>69</sup> These dynamics create the potential for a race to the bottom in welfare benefits.

Empirical studies on the "welfare magnet" effect have reached conflicting results, with some studies finding a significant effect and others finding little or none.<sup>70</sup> Most studies that inquire into motivation find that family relationships and work opportunities are much more significant motivations for moves than the promise of higher welfare benefits. In any event, the empirical controversy may be less important than it seems — in this case as in many aspects of welfare policy, perception matters more than reality, and many state political leaders apparently believe that welfare magnets attract. Although durational residency requirements for welfare benefits are barred by the federal Constitution,<sup>71</sup> several states have adopted rules that limit new residents' welfare benefits to the level of benefits in their former state of residence.<sup>72</sup>

What factors might constrain a race to the bottom? Many advocates of block grants, including a number of state governors, argue that states will be responsive to the needs of poorer residents and to demands for services for the poor by local communities. Historically, more liberal states have provided more generous welfare benefits and may continue to do so. Some also argue that states interested in attracting business have an interest in welfare-to-work

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<sup>69</sup> For a description of recent proposals by California and Wisconsin, see Russell L. Hanson and John T. Hartman, *Do Welfare Magnets Attract?*, IRP DISCUSSION PAPER # 1028-94, 1 (1994).

<sup>70</sup> See, e.g., Rebecca M. Blank, et al., *A Primer on Welfare Reform*, in LOOKING BEFORE WE LEAP 27, 73 (R. Kent Weaver and William T. Dickens eds., 1995) (noting that "scholars have been unable to prove whether welfare magnets actually exist"); PAUL E. PETERSON AND MARK C. ROM, WELFARE MAGNETS 82-83 (1990) (finding that welfare benefits influence migration); Hanson and Hartman, *supra* note 69, at 26 (finding "no evidence that poor women are attracted to high benefit states by the possibility of receiving more assistance, or that poor women already living in high benefit states are liable to take advantage of relatively generous benefits provided therein"); James R. Walker, *Block Grants, Interstate Competition, and Welfare Migration*, 17 FOCUS 36, 36 (Summer 1995) (arguing that "[t]he available evidence suggests that welfare magnets exert very little force on poor households"). Blank et al. suggest that the empirical uncertainty arises because "it is devilishly difficult to test whether welfare influences migration. As it turns out, poor people decide where to live for a complex mix of personal and economic reasons, so it is not easy to determine how important welfare is in that decision." *Id.* They conclude that "the magnetic effect, if any, of the existing welfare programs must be small. If welfare magnets were strong and stable, the research conclusions would be more consistent." *Id.* See also Robert Moffitt, *Incentive Effects of the U.S. Welfare System: A Review*, 30 J. ECON. LIT. 1, 31-36 (1992) (summarizing studies on welfare's effects on migration; finding that earlier studies show weak effects but that more recent studies with better methodology find "positive and significant effects" on migration; and noting remaining methodological issues).

<sup>71</sup> *Shapiro v. Thompson*, 394 U.S. 618 (1969).

<sup>72</sup> In 1992, California received a federal waiver that permitted it to create a "two-tier" system, in which new residents applying for AFDC are limited to the level of benefits in their former state for up to one year, but the California system was struck down as unconstitutional. *Green v. Anderson*, 811 F. Supp. 516 (1993), *aff'd*, 26 F.3d 95 (1994).

programs that create a well-trained work force. Statutory "maintenance of effort" rules, like those in the Senate bill, would also constrain states' ability to cut expenditures significantly, at least in the short run.

Third, critics argue that the block grant program as currently structured may actually hinder innovation and productive experimentation.<sup>73</sup> Unlike the current waiver process, the block grant structure does not create any mechanisms for gathering and distributing information about the results of various experiments. These analysts worry that states may fail to share information about successes or, especially, failures — leading states to waste money and time replicating one another's experiments. They also fear that states eager for immediate gains in work performance or reductions in welfare rolls may terminate experiments before an evaluation of their long-term potential can be made. Critics also worry that poorer states may lack the resources or knowledge necessary to create and test new programs on their own.

Finally, the move to a block grant structure creates a number of political changes that will have unpredictable influences on relations between Washington and the states (or among states) and on the terms of state welfare programs. The structure of these initial block grant proposals is incomplete in certain respects, and political forces may significantly change the parameters of a block grant system over time. For example:

- Experience suggests that Congress will be tempted to expand federal restrictions and mandates attached to the block grant. Current proposals differ significantly; the House bill contains more mandates and restrictions, while the Senate bill is more permissive. Experience also suggests that block grant funding (in real terms) may stagnate, particularly in an era of deficit reduction.<sup>74</sup>
- The allocation of block grant funds among the states may be a difficult political issue, and the infighting among states has already begun. Critics of the allocation formulas in the current block grant proposals argue that freezing current allocations will ignore future changes in population and demographics, and that current formulas are inaccurate even judged in static terms.<sup>75</sup>
- The formulae and procedures for allocating block grant funds among states also may influence the content of state programs. Some academics recommend that renewals of block grants be conditioned on the provision of information by the states about their efforts or on demonstrated performance according to specified criteria. The danger in establishing performance standards in advance is twofold: (i) the measure or measures may be inadequate or inaccurate, and (ii) states may respond by structuring programs or manipulating results to maximize only those performance measures. (For example, rewarding reductions in welfare rolls could encourage states to lower benefits or make it more difficult to claim

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<sup>73</sup> See Evelyn Z. Brodtkin, *Administrative Capacity and Welfare Reform*, in *LOOKING BEFORE WE LEAP*, *supra* note 70, at 75-90.

<sup>74</sup> See Barbara Wolfe, *Issues Involved in Federalism*, 17 *FOCUS* 33, 34 (Summer 1995).

<sup>75</sup> New York, for example, argues that traditional allocations of AFDC and Medicaid funds based on per capita income understate need. (New York has a relatively high per capita income but also has a relatively large number of poor people.)

them.)<sup>76</sup>

*Teenage Pregnancy, Family Caps, and Work Requirements.* The substantive rules of the federal welfare block grants mirror recent trends begun in state welfare programs and state AFDC waivers. Politicians argue that denying benefits to unmarried teenage mothers could reduce out-of-wedlock births. They argue that denying welfare benefits to children born while their mothers receive welfare could promote responsible family planning and eliminate the incentive to have more children in order to increase the welfare check. Politicians also argue that stricter work requirements and time limits on welfare receipt could help prevent "welfare dependency."

Although a complete discussion of these claims is well beyond the scope of this paper, two preliminary points suggest that these claims are almost certainly too optimistic. First, popular claims about the effects of current welfare programs and of proposed "reforms" on behavior are often exaggerated. For example, in a 1992 survey of empirical studies, Robert Moffitt concludes that, although the U.S. welfare system discourages work effort and may encourage the formation of female-headed households, these effects are not nearly large enough to explain high rates of poverty among single-mother households or the increasing numbers of such households.<sup>77</sup> Many studies suggest that welfare recipients' lack of job skills, disabilities, and child-care responsibilities are the principal explanation for low levels of work effort,<sup>78</sup> and that changes in social attitudes and the limited economic expectations of many low-income women largely explain the increasing proportion of teen and out-of-wedlock births.<sup>79</sup> Thus, welfare itself makes only a limited contribution to poverty and that underlying economic and social trends — including stagnant or declining real wages for low-income workers, and constraints on the employability of welfare

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<sup>76</sup> Charles Sabel's "democratic experimentalism" suggests an alternative vision that might be adapted to welfare reform. In Sabel's system, the (federal) legislature would declare an intention to address a problem, appropriate resources, and supervise state and local efforts to solve the problem. This approach would (i) require states to define their goals by consulting affected groups (including welfare recipients, administrators, etc.) and (ii) require states to agree on common performance measures that would be applied to states in similar circumstances, thus permitting comparisons among jurisdictions. The new system is intended to draw on information known only to participants and to facilitate the exchange of information among participants and jurisdictions; the proposed system adapts to public administration the "learning by monitoring" techniques that have become increasingly common in private firms. See CHARLES F. SABEL, *DESIGN, DELIBERATION, AND DEMOCRACY: ON THE NEW PRAGMATISM OF FIRMS AND PUBLIC INSTITUTIONS* (1995).

<sup>77</sup> Moffitt, *supra* note 70, at 56-57.

<sup>78</sup> See generally *id.* at 15-19 (finding that AFDC work disincentives are "nontrivial" but that the estimates of effects vary considerably; and finding that work effort and earnings would increase only modestly in the absence of AFDC, and that most AFDC recipients would remain at very low income levels); Kathryn J. Edin, *The Myths of Dependence and Self-Sufficiency: Women, Welfare, and Low-Wage Work*, 17 *FOCUS* 1, 1-9 (finding that a number of welfare mothers already are engaged in (largely unreported) work and that these women's prospects for self-sufficiency through low-wage work are limited).

<sup>79</sup> See Rebecca M. Blank, *What Are the Causes Behind Declining Marriage Rates and Rising Numbers of Single Mothers?*, in *LOOKING BEFORE WE LEAP*, *supra* note 70, at 30, 33.

recipients with few job skills and child-care responsibilities — are far more important causes of poverty.

In addition, studies of past welfare “reform” efforts suggest that the efficacy of the new proposals is likely to be quite limited. States have created a wide variety of job search, job training, and workfare programs intended to encourage welfare recipients to leave welfare for work. Although some programs have been successful in getting recipients to combine welfare with work, the programs are expensive, and even the most “successful” programs have not enabled significant numbers of welfare recipients to become economically self-sufficient.<sup>80</sup> Studies of the New Jersey experiment with a “family cap” program reach mixed results.<sup>81</sup>

#### IV. CONCLUSION

Predicting the outcome of these changes, if enacted, is impossible. In the best case, devolution could begin a new era of productive experimentation that could substantially improve the performance of welfare programs from both recipients’ and taxpayers’ perspectives. The current AFDC program has long been a target of public dissatisfaction, and it does not serve recipients particularly well, providing only small cash payments and little effective assistance in finding good jobs. The darker scenario is that even this minimal provision will be lost as the federal government abandons its commitment to redistribution and states compete in a destructive race to the bottom.

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<sup>80</sup> See Joel F. Handler, *The Transformation of AFDC: The Family Support Act in Historical Context*, 16 N.Y.U. REV. LAW AND SOCIAL CHANGE 458 (1987-88); Gary Burtless, *The Effect of Reform on Employment, Earnings, and Income*, in WELFARE POLICY FOR THE 1990s (Phoebe H. Cottingham and David T. Ellwood eds., 1989); see also Moffitt, *supra* note 70, at 43-51 (concluding that “even taking the relatively optimistic view that the programs can consistently increase earnings by \$1,000 per year for AFDC female heads, a large change in the poverty rate of female heads is not likely to result from implementation of the programs”). Cf. Wiseman, *The Wisconsin Story*, *supra* note 65, at 31-36 (describing constraints on Wisconsin’s continuing ability to reduce welfare rolls and difficulties in translating Wisconsin’s success into other states’ programs).

<sup>81</sup> William T. Dickens, *What Effects do Family Caps Have?*, in LOOKING BEFORE WE LEAP, *supra* note 70, at 49, 49-52.