Issue Paper

California's AFDC Program
Current Trends, Issues, and Options

EXECUTIVE SUMMARY

The Aid to Families with Dependent Children (AFDC) Program provides cash grants to families whose income is not adequate to provide for their basic needs. The principal component of the program—AFDC-Family Group (AFDC-FG)—will cost the state approximately $4.2 billion ($1.9 billion General Fund) in 1990-91.

Despite a relatively strong California economy during most of the 1980s, AFDC-FG caseloads and the welfare "dependency rate" (number of cases per 10,000 women of childbearing age) increased significantly over that time. There are various factors that explain these increases: demographic (such as changes in the composition of the state's population), societal (such as increases in the number of unwed mothers), and programmatic (such as a major 1981 federal law change).

Our review indicates that the Legislature has limited options to control AFDC costs in the short run—other than by reducing grant levels—because of the entitlement nature of this program. It does have, however, some ability to change the work incentives inherent in the program. Currently, the AFDC grant structure, when analyzed in conjunction with other sources of income and taxes, offers little incentive for recipients to work. In fact, in many cases there are strong disincentives to work. Consequently, in developing legislative options, we focus on policies designed to make it more feasible, or attractive, for actual and potential AFDC recipients to seek and obtain employment and, ultimately, earn enough to leave the welfare rolls.

We identify four options that have the potential for reducing welfare dependency and controlling program costs in the long run: (1) reduce grant levels (as proposed by the Governor), (2) increase the "need standard" above the existing maximum grant, (3) provide medical coverage for the working poor, and (4) increase the number of recipients who receive services through the Greater Avenues for Independence (GAIN) Program. With the exception of the first option, however, all of these options could involve short-term costs to the state.

The *1991-92 Governor's Budget* proposes a significant change in the state's Aid to Families with Dependent Children (AFDC) Program. It proposes to reduce the maximum AFDC grants available while at the same time increasing the incentive for recipients to work. Presumably, the administration's proposal is an attempt to control the program's caseload and the state's welfare "dependency rate," both of which have risen rapidly over the past decade.

In this analysis, we document the recent increases in caseload and welfare dependency in the AFDC-FG Program and identify the factors contributing to this trend. We then examine various options—including the administration's proposal—which are available to the Legislature to help control the program's costs and reduce welfare dependency.

THE AFDC-FG PROGRAM: COST AND CASELOAD TRENDS

The AFDC Program provides cash grants to certain families whose other income, if any, is not adequate to provide for their basic needs. The program consists of three major components, of which AFDC-FG is the largest, accounting for 80 percent of all AFDC cases. Generally, AFDC-FG cases consist of single-parent families, most of which are headed by women. The other major components are AFDC-Unemployed Parent (AFDC-U) and AFDC-Foster Care (AFDC-FC), which account for 11 percent and 8 percent of all AFDC cases, respectively. This analysis focuses exclusively on the AFDC-FG component.

AFDC-FG Costs Increased During the 1980s

In 1980-81, expenditures for the AFDC-FG Program totaled $2.1 billion ($0.9 billion General Fund, $1.1 billion federal funds, and $0.1 billion county funds). By 1990-91, the cost of the program doubled to an estimated $4.2 billion ($1.9 billion General Fund, $2.1 billion federal funds, and $0.2 billion county funds). As a percent of all state General Fund expenditures, AFDC-FG increased slightly, from 4.3 percent in 1980-81 to 4.6 percent in 1990-91.

Program costs rose because of cost-of-living adjustments (COLAs) and caseload growth. About 60 percent of the increase in AFDC-FG costs during the 1980s is attributable to increases in grant amounts resulting from COLAs (the COLAs, however, only offset about two-thirds of inflation during this period, as measured by the California Necessities Index). The remaining increase is from caseload growth, which is discussed in detail below.

AFDC-FG Caseload Increased Faster Than the State's Population

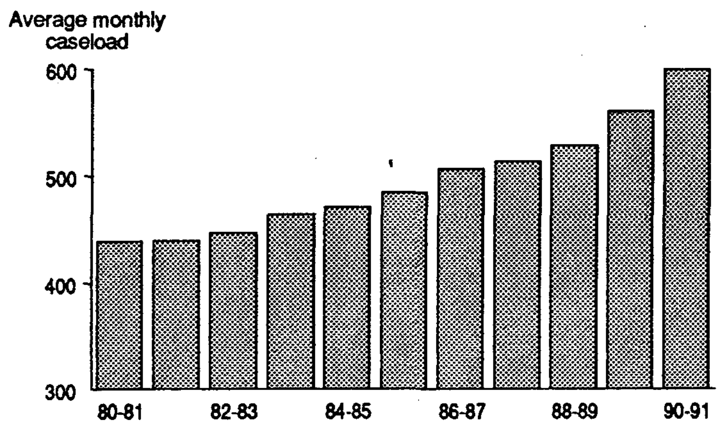
Figure 1 shows that the AFDC-FG Program provided benefits to an average of 439,000 cases each month in 1980-81. The Department of Social Services (DSS) estimates that the average monthly caseload figure for 1990-91 will be 599,600. This is an increase of 37 percent over 1980-81, which reflects average annual growth of 3.2 percent. During this same period, California's population grew by an estimated 2.3 percent per year.

Figure 1 also shows that caseload growth has accelerated significantly in recent years. From 1980-81 to 1985-86, caseloads increased by an annual average growth rate of 2.0 percent. From 1985-86 to 1988-89, caseloads rose by an average annual rate of 2.9 percent. The DSS indicates, however, that caseloads would have increased at a rate of about 4.7 percent annually over this period if two factors had not artificially de-

Figure 1

AFDC-FG Caseload Has Risen Sharply In The Last Two Years

1980-81 through 1990-91 (In thousands)



Source: Department of Social Services.

pressed the caseload level: (1) a short-term drop in the caseload in Los Angeles County due to the implementation of the Immigration Reform and Control Act of 1986, and (2) a diversion of cases to the Refugee Demonstration Project between 1985 and 1989.

The AFDC-FG caseload growth rate in the last two years has been even more dramatic: an increase of 6.1 percent in 1989-90 and an estimated 6.9 percent in 1990-91. The budget projects that the AFDC-FG caseload will continue to grow at this accelerated rate—a 1991-92 increase of 6.0 percent.

Caseload Growth in California Was Higher Than the National Average

One way to place California's caseload growth in perspective is to compare it with trends in other states. During the 1980s, California's caseload increased at a rate three times greater than the national average. Of the 10 largest states, only Texas experienced more rapid caseload growth than California. Besides Texas, only 2 other states, Florida and Ohio, experienced caseload growth on the scale of California, and caseloads actually *decreased* in 5 of the 10 largest states.

California's Dependency Rate Has Risen

Not only has the AFDC-FG caseload risen during the 1980s, but so has the state's welfare "dependency rate." This rate is defined as the number of AFDC-FG cases per 10,000 women between the ages of 15 and 44 in the state's population. This is a good indicator of welfare dependency because 75 percent of AFDC-FG cases are headed by women 15 to 44 years of age. (Most of the other cases consist of needy children who live with adult relatives who are not on welfare.) Changes in the dependency rate are significant because they indicate that factors other than population growth are affecting AFDC caseloads.

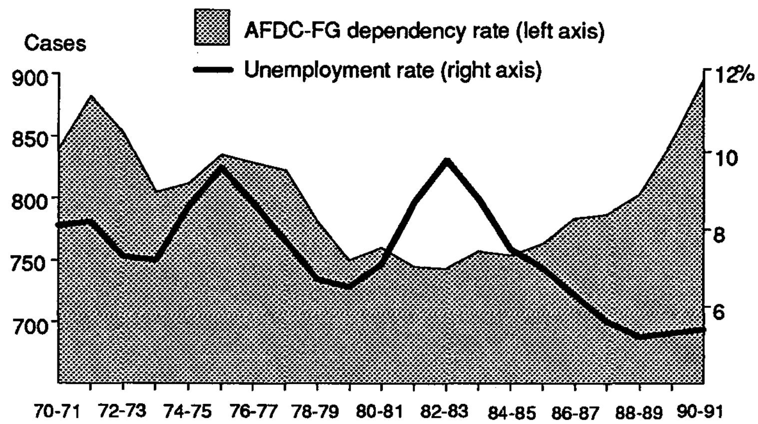
Figure 2 displays changes in California's welfare dependency rate since 1970. It shows that the estimated AFDC-FG dependency rate for 1990-91 is higher than for any other year in this period. The dependency rate has displayed an upward trend since 1982-83, and particularly dramatic growth since 1988-89.

California's dependency rate is high when compared with other states. In 1988 California's rate was 25 percent higher than the national average. Of the 10 largest states, only Michigan, New York, and Ohio had a dependency rate greater than California's. Moreover, between 1983 and 1988 the dependency rate fell in 7 of the 10 largest states, as did the national average. Only California, Ohio, and Texas experienced an increase during that period.

Figure 2

AFDC-FG Dependency Rate Has Risen Significantly In Recent Years[a]

1970-71 through 1990-91 (in thousands)



[a] "Dependency rate" is based on the number of AFDC-FG cases per 10,000 females aged 15-44.

Dependency Rate Has Increased Despite A Decrease in Unemployment

Figure 2 shows that during the 1970s California's welfare dependency rate tracked the state's unemployment rate. Welfare dependency increased during times of high unemployment and dropped off during periods of lower unemployment. As the figure shows, this connection between welfare dependency and the unemployment rate was broken in 1980. Most noticeably, unemployment has declined significantly over the 1980s yet the dependency rate has increased dramatically during that same time. Presumably, the improvement in the economy had some effect in reducing the AFDC caseload, but this effect was outweighed by factors working in the opposite direction.

Length of Time on Aid Has Increased

The dependency rate can increase either because a greater portion of the potentially dependent population is on aid *or* because those who go on aid stay on for longer periods. The available data suggest that at least some portion of the increase in California's welfare dependency rate has been due to an increase in time on aid. Specifically, surveys of recipients show that, by two measures, the length of time families stay on aid increased during the 1980s:

- The median total number of months on aid—including current and, if any, previous spells on aid—for households receiving AFDC-FG at the time of the survey increased from 32 months in 1981 to 39 months in 1986 (the most recent year for which these data were reported).
- The median length of the current spell on aid also rose, from 22 months in 1981 to 26 months in 1986.

FACTORS CONTRIBUTING TO THE INCREASE IN AFDC-FG CASELOADS AND THE WELFARE DEPENDENCY RATE DURING THE 1980s

There are several factors that help explain the rise in the AFDC-FG caseload and the dependency rate over the past decade. These factors are summarized in Figure 3.

Demographic Factors

Increase in Women of Childbearing Age

As indicated previously, most AFDC-FG cases are headed by women aged 15 to 44. Figure 4 shows the actual and expected growth in this subset of the state's population for the period 1970 to 2010, based on estimates and projections by the Department of Finance (DOF).

Between 1970 and 1980, the state experienced almost 3 percent average annual growth in the population of women aged 15 to 44. In the 1980s, however, the growth rate fell by half as the baby-boom generation aged. During this decade, the number of women of childbearing age rose from 5.7 million to 6.7 million—an 18 percent increase. During this same period, the AFDC-FG caseload increased by 37 percent. Thus, holding all other variables constant, the increase in the population of women in this age group could account for about one-half of the caseload increase.

The DOF's projections indicate that the growth rate of this part of the population will drop even further in the 1990s and in the first decade of the next century. If so, some of the pressure on welfare caseloads should diminish as well.

Figure 3

Factors Contributing to an Increasing AFDC-FG Caseload and Dependency Rate

DEMOGRAPHIC

- ☑ Increase in Number of Women of Childbearing Age
- ☑ Change in Ethnic Composition of State's Population

SOCIETAL

- ☑ Increase in the Proportion of Women Having Children
- ☑ Increase in the Birthrate for Teenagers
- ☑ Increase in Births to Unwed Women
- ☑ Increase in the Cost of Medical Care
- ☑ Shift of Caseload to Low-Cost, High-Unemployment Areas
- ☑ Increase in Nonneedy Relative Caseload

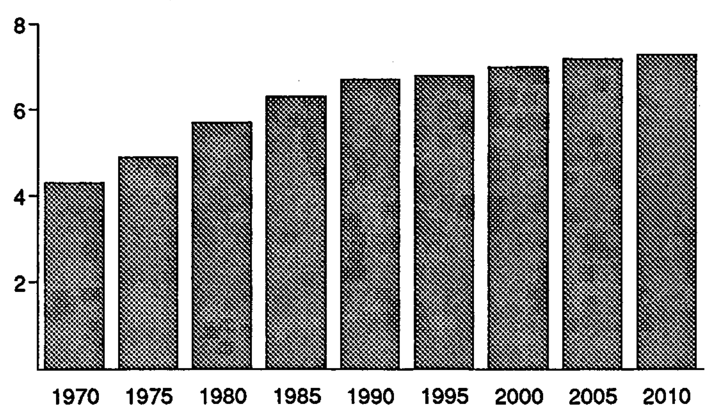
PROGRAMMATIC

- ☑ 1981 Federal Legislation Reducing the Work Incentive

Figure 4

Population Of Females Aged 15-44 In California[a]

1970 through 2010 (in millions)



[a] Projections for 1995 through 2010 are by the Department of Finance.

Change in Ethnic Composition of the State's Population

During the 1980s, the population of California changed significantly to include more members of two groups with higher-than-average welfare dependence: Latinos and refugees. According to the Current Population Survey, the Latino population of the state increased by almost 75 percent between 1980 and 1989, rising from 3.9 million to 6.8 million. The refugee population in the state also surged in this period as California experienced a wave of immigration from Southeast Asia and Eastern Europe. The DOF estimates that California's refugee population (primarily Southeast Asian) nearly tripled between 1980 and 1988, from 175,000 to almost 500,000.

These two groups—Latinos and refugees—are among the population groups whose welfare dependency rate is currently substantially higher than the dependency rate of the general population. In 1990, the AFDC dependency rate for Latino women was 23 percent higher than the rate for all other women. Refugees also have a welfare dependency rate significantly greater than that of the general population. The DSS estimates that nearly half of all refugees in the state are dependent on public assistance. Whether the dependency rate for these groups will remain at these higher levels in the future is unknown.

Societal Factors

Increase in the Proportion of Women Having Children

If an increasingly greater proportion of women have children, a related increase in AFDC caseloads and the dependency rate might be expected. The statewide birth rate rose from 70.4 (births per 1,000 women) in 1980 to 79.9 in 1988, an increase of 14 percent. Since the average family size stayed about the same during the period, this suggests that the increase in the birth rate reflects a trend toward a greater proportion of women having children, rather than an increase in the number of children born to each woman.

Increase in Teenage Birth Rate

The birth rate for teenage mothers increased from 52.5 in 1980 to 59.5 in 1988 (a 13 percent increase). This is noteworthy because teenage mothers are especially prone to welfare dependency. Most of the increase in the teenage birth rate occurred in 1987 and 1988, perhaps helping to explain the escalation of caseload growth that has occurred in recent years.

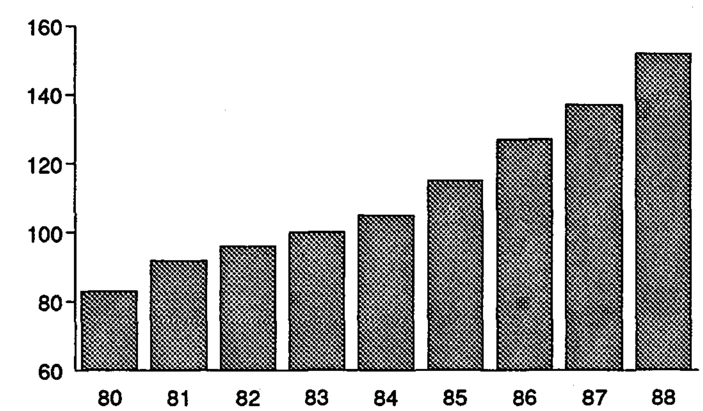
Increase in Births to Unwed Women

Figure 5 shows that the number of births to unmarried women also increased significantly during the 1980s. Specifically, the number of births to unmarried women grew from 83,373 in 1980 to 152,368 in 1988, an increase of 83 percent. In comparison, the number of births to married

Figure 5

Births To Unwed Mothers In California

1980 through 1988 (in thousands)



women for this same period rose by only 19 percent.

The increase in births to unwed women is significant because unwed mothers tend to have lower incomes and a higher likelihood of going on welfare. For example, according to the most recent AFDC-FG data, over 40 percent of the approved applications are in the "never married" category. In addition, the increase in out-of-wedlock births has been greater during the latter part of the 1980s. This appears to be correlated to the increase in the birth rate among teenage mothers, and adds to the explanation of why overall AFDC-FG caseload increases were higher in the late 1980s than in the early part of the decade.

Increase in the Cost of Medical Care

The cost of health care and health insurance could be a significant factor in determining whether someone eligible for AFDC-FG applies for welfare or seeks employment. This is because AFDC-FG recipients are fully covered under the Medi-Cal Program. The "value" of this Medi-Cal coverage increased significantly during the 1980s, commensurate with the rapid rise in private health insurance costs. Thus, the cost and difficulty of obtaining coverage comparable to Medi-Cal may have contributed to the increase in the caseload.

Shift of Caseload to High Unemployment Areas

Figure 6 shows that during the 1980s, a substantial portion of AFDC-FG caseload growth occurred in the lower-cost areas of the state (basically, counties in the Central Valley and all rural counties). These areas accounted for 41 percent of the total caseload increase even though they accounted for only 14 percent of the state's population during this period. Migration of AFDC-FG recipients from high-cost to low-cost areas of the state is likely to have occurred in order to maximize the purchasing power of the grants, which are the same dollar amount in all 58 counties. This is consistent with anecdotal evidence provided by many county welfare program administrators.

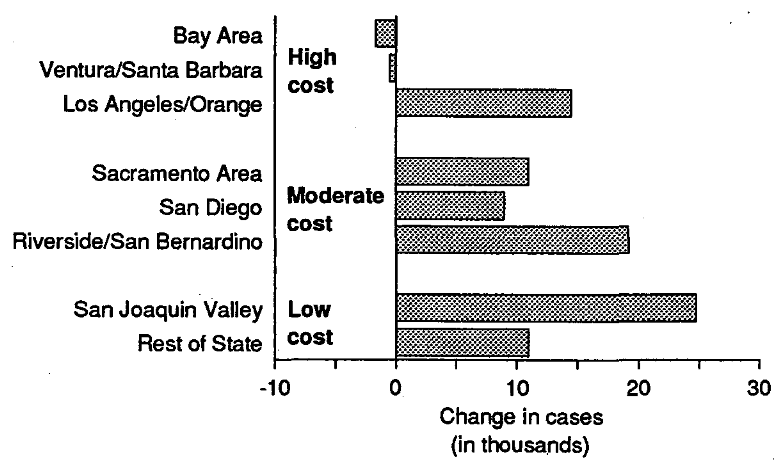
We also note that unemployment has been relatively high in the low-cost areas—an average of 9.7 percent in 1988-89, compared to approximately 4 percent in Bay Area counties and Los Angeles and Orange counties, and 5 percent in San Diego County and Sacramento-area counties. If AFDC recipients are in fact migrating to low-cost areas, they may be confronted with fewer job opportunities, thereby making it more likely that they will remain on aid for a longer period of time and contributing to caseload growth in the program. This would also have the effect of increasing the state's welfare dependency rate.

If this is true, it means that the state is—unintentionally—providing an incentive to many recipients to act in a way that *increases* their

Figure 6

AFDC-FG Caseload Changes By Region

1980-81 through 1988-89



dependency. One way to reduce this incentive to move is to vary grant levels by region—either by lowering grants in low-cost regions of the state or raising them in high-cost areas. This is currently done by several states.

Increase in Nonneedy Relative Caseload

Another component of the AFDC-FG caseload growth in the 1980s was an increase in the number of cases in which a nonneedy relative acts as the caretaker of a child who is eligible for AFDC. For instance, a child can be placed with nonneedy relatives when the parent is deemed unable to care for the child due to the parent's drug dependency. In these cases, the nonneedy relative receives a grant for the child but not for him or herself. Between 1980 and 1989, the number of these cases in the average month almost tripled, from 15,000 to nearly 44,000.

Programmatic Factors

1981 Legislation Reduced the Financial Incentives for Recipients to Work

In 1982, California implemented a variety of AFDC rule changes mandated by the federal Omnibus Budget Reconciliation Act of 1981 (OBRA). The major effect of these changes was to significantly reduce the work incentive both to persons *already* on aid and to *potential* recipients (working single parents with incomes near the AFDC grant levels). For instance, prior to OBRA—in 1981—17 percent of AFDC-FG recipients had earned income, which averaged $540 per month. Within one year after the implementation of the OBRA rules, only 5 percent of recipients had earned income and their average monthly earnings had fallen to $295. In 1989, the most recent year for which these data are available, recipients with earned income accounted for 7.6 percent of the AFDC-FG caseload and their average earnings were $352 per month.

To the extent that the OBRA rule changes reduced the work effort of recipients, they probably contributed to the overall welfare dependency rate increases of the 1980s. This is because recipients who work are substantially more likely to leave welfare than those who do not. For example, surveys conducted in 1988 and 1989 indicate that AFDC-FG recipients who worked were more than twice as likely to leave welfare in a given month than those who did not work.

(For a more complete discussion of the work incentives implicit in the AFDC-FG Program, please see below.)

OPTIONS FOR THE LEGISLATURE

In this section we discuss the Legislature's options for controlling the costs resulting from AFDC caseload growth and for reducing welfare dependency. It is important to note, however, that in the short run the goals of reducing poverty among California's children and of controlling expenditures in the AFDC Program are probably in conflict. Increasing the AFDC grant level, for example, would reduce the number of California families living in poverty, but it would also result in major cost increases to the state. Over the long term, however, it may be possible to work toward both goals by adopting strategies to increase the *nonwelfare* income of poor families and thereby reduce their dependence on welfare.

In this section, we discuss four options for reducing welfare caseloads and the welfare dependency rate in the long run: (1) reduce grant levels to most AFDC recipients (primarily those not working) by lowering the maximum grant below the existing AFDC need standard, as proposed for 1991-92 by the Governor; (2) increase the grants to working recipients by raising the "need standard" above the existing maximum grant; (3) provide medical coverage for the working poor; and (4) increase the number of recipients who receive services through the GAIN Program.

With the exception of the Governor's proposal (Option 1) the options listed above would involve significant *costs* in the *short term*, although each has the *potential* to reduce welfare dependency and thereby generate net *savings* over the *longer term*. In light of the state's current budget problem, it may be difficult for the Legislature to adopt any of these options unless it can find a way to offset these increased costs in the short term.

Because the first two of these options are based, in large part, on the concept of increasing the incentive for AFDC recipients to work, we begin our discussion with an examination of the existing AFDC rules and how they affect a recipient's incentive to work.

The Work Incentive in the AFDC-FG Program

Why Is It Important?

Clearly, the state has a strong interest in providing an adequate work incentive in the AFDC-FG Program. Such an incentive not only encourages recipients to minimize their welfare dependency, but also has the potential effect of reducing state costs.

Figure 7 illustrates this latter point. It shows how the AFDC grant level (for a family of three) *decreases* from the *maximum* grant of $694 as a recipient works. As income increases, the state's cost (in the form of grant payments) declines.

What Are the Work Incentives in the Current Program?

While receiving aid, an AFDC-FG recipient's grant generally is reduced—*on a dollar for dollar basis*—by the amount of any earned income. There are, however, allowances for work-related expenses and the following earned income "disregards:"

- During the first four months of aid, the first $30 and one-third of the remaining earned income are not counted for purposes of reducing the grant.
- During the 5th through 12th months of aid, the first $30 of earned income is not counted.

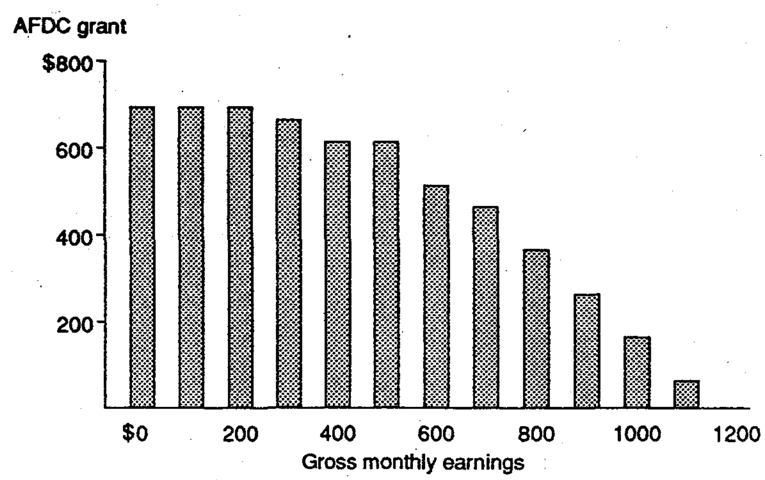
There are many other factors that influence the work-related decisions of AFDC recipients and persons earning income at a level close to the grant levels. For instance, working also affects taxes (including the impact of the federal earned income tax credit) and other benefit programs (such as food stamps).

We have attempted to account for these factors in evaluating the work incentive provided AFDC

Figure 7

Grant Reductions Resulting From AFDC-FG Recipients Working[a]

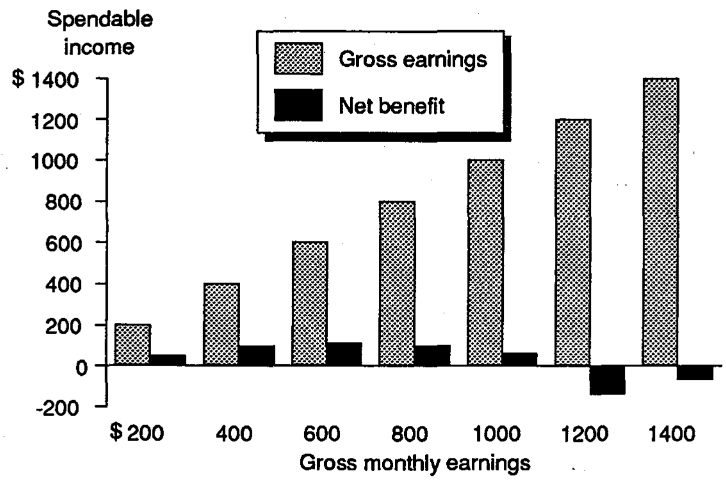
1990 - 1991



[a] Assumes a family of three with child care expenses.

Figure 8

The Current Work Incentive In The AFDC-FG Program[a]

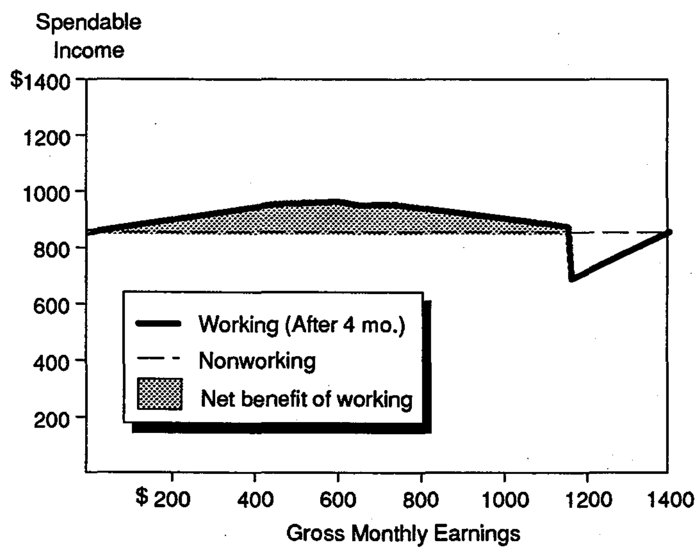


[a] Assumes a family of three with child care expenses.

Figure 9

Spendable Income For Working And Nonworking AFDC-FG Parents[a]

1990 - 1991



[a] Assumes a household of three with child care expenses.

recipients, as illustrated by Figure 8. The figure shows what a recipient would gain (after accounting for grant reductions, taxes, etc.) from taking a job at various levels of income. For example, a job grossing $800 monthly would result in the recipient being "better off" by about $100. A job paying $1,200 a month, however, would leave the recipient *worse off by $150* (primarily due to the loss of the AFDC grant and food stamps, in conjunction with the continuation of work-related expenses and taxes).

It should be noted that the data in the figure do not reflect the value of Medi-Cal benefits. This is because for the income range shown in Figure 8, families generally are eligible for Medi-Cal coverage whether they are working or not.

The figure can also be used to show the incentives facing recipients in choosing whether to *increase* their work effort, once employed. For instance, someone currently making $600 and deciding whether to increase earnings to $800 would actually be *worse off*. This can be seen from the fact that the "net benefit" bar becomes *smaller*. This occurs because the additional income is more than offset by grant reductions and taxes.

Figure 9 summarizes the information presented above in a slightly different form, which we will be using later in discussing the options. It shows an AFDC-FG family's "spendable income" (grant and food stamps plus any earned income, adjusted for tax impacts, work-related costs, and expenses such as child care) at various levels of gross monthly earnings. The shaded area between the solid and dashed lines shows the net benefit of working at various income levels.

Figures 8 and 9 present a dramatic picture of the lack of financial incentives to work that characterizes the current program. At virtually all of the pertinent income levels, *AFDC-FG recipients gain little net dollar benefit—and in many cases come out behind—from going to work or working more.*

It is important to note that this disincentive effect is only of major significance at income levels near the ranges shown in Figures 8 and 9. For example, it is unlikely that the head of a family of three would regard welfare as a significant option if she could find work at $33,000 per year, which was about the median income of California households in 1989. The problem, of course, is that many welfare recipients have limited employment prospects beyond entry-level jobs, at least in the short term. Thus, for many recipients and potential recipients, their immediate options involve incomes within the ranges displayed in Figures 8 and 9.

We conclude, therefore, that the fiscal incentives facing a welfare recipient—or potential recipient—have the following adverse effects:

- For individuals who have never been on welfare, the incentives could induce them to go on welfare rather than work.
- For individuals who have worked their way off of welfare, the incentives could induce them to stop working or reduce their level of work and return to the welfare rolls.
- For individuals who are receiving AFDC benefits, the incentives could discourage them from seeking employment or increasing their level of employment.

We do recognize that these findings do not encompass all of the factors that determine whether an AFDC recipient will seek and find employment. For some individuals, the relatively small net benefit of working might be offset by other positive factors associated with working, such as increased self esteem, potential opportunities for obtaining a better job in the future, and the importance of the added income. Other individuals, however, might require a relatively large net benefit from working in order to offset perceived negative factors associated with employment, such as the difficulty of work or the substitution of paid child care for direct parental care. In any case, it appears that there is *relatively little* fiscal incentive for AFDC-eligible parents to work, unless they can earn enough to lift their families well beyond the poverty level.

What Can the State Do to Increase the Work Incentive?

Many of the AFDC grant determination rules that result in the lack of a work incentive, as illustrated in Figures 8 and 9, are not within the control of the Legislature. For example, the elimination of the "one-third" portion of the "$30 and one-third" disregard after four months is a requirement of *federal* law. *There are, in fact, only two areas in which the state has discretion to change the incentive pattern by altering the manner in which the grants are determined: setting the AFDC "need standard" and setting the AFDC maximum aid payment (MAP).*

Need Standard and Maximum Aid Payment. The need standard—technically referred to as the minimum basic standard of adequate care (MBSAC)—is a schedule, adopted in state law, that reflects each state's determination of the incomes that families of various sizes need to subsist. Many states have need standards that are higher than their MAPs. Thus, they acknowledge in state law that the grants they are willing to provide are not sufficient to support a minimum basic standard of living. Since 1981, California has set its need standard equal to its

MAP (except for a slight difference for families of nine or more persons).

The actual grants that working families receive in California are currently determined by subtracting "net nonexempt income" (basically this means earned income less the allowable "disregards") and all unearned income (such as unemployment insurance payments) from the MAP. It would be permissible under federal law, however, (1) to determine these grants by subtracting net nonexempt income from the *need standard*, rather than the MAP, and (2) to set the need standard *higher* than the MAP, either by raising the need standard or reducing the MAP. We examine both of these options below.

Figure 10

AFDC MAP and Need Standard Budget Proposal Compared to Current Law

1990-91 and 1991-92

Family Size	Current Law MAP and Need Standard[a]		Budget Proposal 1991-92	
	1990-91	1991-92[b]	MAP	Need Standard
1	$341	$360	$311	$341
2	560	591	511	560
3	694	732	633	694
4	824	869	753	824
5	940	992	859	940

[a] Under current law, the MAP and the need standard are the same for all family sizes except for a slight difference for families of nine or more persons.

[b] Assumes a 5.49 percent COLA, effective July 1, 1991, based on the estimated change in the California Necessities Index. Current law also provides that this statutory COLA be reduced by up to 4 percentage points if the Commission on State Finance certifies that General Fund revenues are more than 0.5 percent less than the amount needed for a workload budget, as defined.

OPTION 1—Reduce the MAP (Governor's Proposal)

As noted above, the only major area of AFDC policy over which the Legislature has discretion under federal law is the setting of the need standard and the MAP. For this reason, the only way to achieve significant savings in the AFDC Program in the *short term* would be to reduce the MAP, either by suspending future COLAs applied to the MAP or by actually reducing it below the current level.

The Governor proposes to (1) reduce the MAP below the existing need standard by an average of 8.8 percent and (2) base actual grants—for those recipients with income—on the need standard. In other words, grants would be determined on the basis of the need standard, but the actual grant could not exceed the new MAP. Figure 10 shows the MAP and need standard for the current and budget years under current law and the Governor's proposal.

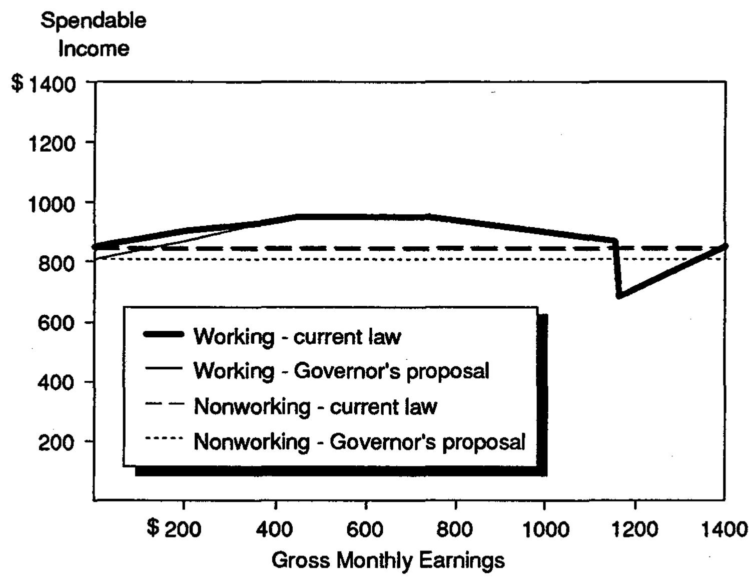
The effect of the Governor's proposal generally would be an 8.8 percent reduction in grant levels to *nonworking* AFDC recipients (more specifically, to those who currently have no "net nonexempt income") and a reduction of up to 8.8 percent to some part-time working recipients. Grants to most working recipients would not be reduced because their grants currently are below the proposed MAP.

By reducing grants to nonworking recipients while leaving grants to most working recipients unchanged, the Governor's proposal would increase somewhat the incentive for recipients (and, in effect, potential recipients) to work. The general effect of the proposal is illustrated in Figure 11.

The Governor's proposal reduces "spendable income" to nonworking recipients (the dotted line in Figure 11), which has the effect of increasing the net benefit of working. In our example—a family of three in which a working parent incurs child care expenses—the proposed reduction in the MAP would have no effect on grants allocated to families that have gross earnings exceeding $375 per month. For families

Figure 11

Option 1 (Governor's Proposal): Impact of Reduced MAP On AFDC-FG Recipients[a]



[a] Assumes a household of three, with child care expenses.

with gross earnings of less than $375, grants would be reduced by up to $61. Generally, then, the Governor's proposal does increase the work incentive since the dollar gain from working, versus not working, is larger than under current law. It is important to note, however, that it achieves this by allowing recipients to *avoid a loss* in spendable income (by working), rather than to achieve any gain. The overall impact of the proposal on the work incentive would appear to be minimal given the current strong disincentives faced by grant recipients.

Focusing on the impact on nonworking AFDC-FG recipients, grants would be reduced by 8.8 percent, or $61 per month for a family of three, which would be partly offset by an increase of $19 per month in food stamps. Nonworking recipients could offset the proposed MAP reduction by taking a minimum wage job for a few hours a week. On the other hand, for recipients unable to find employment or unable to work for some other reason, a reduction in the MAP would result in a reduction in their spendable income. (We will provide a more detailed discussion of the fiscal impact of the Governor's proposal in the *Analysis of the 1991-92 Budget Bill* to be published later this month.

OPTION 2—Raise the Need Standard

The Governor's proposal (Option 1) would increase the work incentive by lowering the MAP, thereby reducing the income available to nonworking AFDC recipients. Another approach would be to increase the work incentive by raising the need standard *above* the current MAP. (Both options would also use the need standard, rather than MAP, as the basis for determining the actual grant, up to the level of the MAP.) Figure 12 shows how the implementation of Option 2 would affect the incentive to work.

Figure 12 compares spendable income at the current need standard (heavier solid line) with what the spendable income would be if the need standard were increased to $860 (lighter solid line). We chose this amount as an example because it corresponds to what the need standard would have been if it had received the full statutory COLA in each year since it was created in 1972.

The figure shows that increasing the need standard would increase the work incentive. This increase could be significant for some AFDC recipients. For example, Figure 12 shows that recipients could, by taking a full-time minimum wage job, increase their spendable incomes by

$91 per month (by increasing their net benefit of working from $99 to $190 per month) at the higher need standard. To the extent that nonworking recipients respond to the increased incentive, the work experience they gain could significantly enhance their prospects for finding employment at higher wage levels, potentially high enough to carry them beyond the range where they would consider returning to welfare.

We would note, however, that even with the increased work incentive, many recipients—whether working or not—would *still* receive little net benefit from increasing their earnings, and many would actually *lose* spendable income by increasing their earnings.

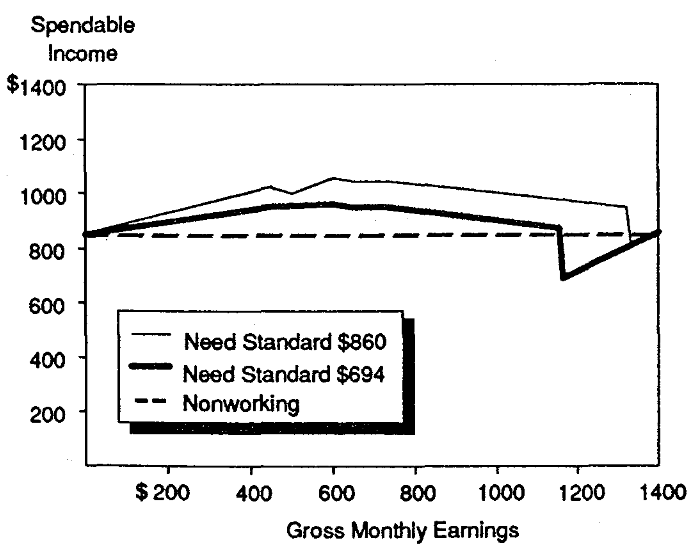
Fiscal Effect of Increasing the Need Standard Above the MAP

The immediate fiscal effect of increasing the need standard would be to *increase* AFDC costs. This is because the increase in the need standard would enable some families, whose income from work currently disqualifies them from receiving a grant, to qualify for a grant. In the near term, these costs could be offset, for instance, by coupling the increase in the need standard with a *reduction* in the MAP.

In the long run, however, increasing the need standard could result in net savings, to the extent it increases the incentive to work enough to encourage currently nonworking recipients to work their way off welfare. At present, we have no way of estimating the behavioral response that this option would elicit.

Figure 12

**Option 2:
Impact Of Increased Need Standard On AFDC-FG Recipients[a]**



[a] Assumes a household of three with child care expenses.

OPTION 3—Improve Medical Coverage for the Working Poor

As discussed above, the high cost of medical coverage for the working poor (and the related value of such coverage provided to AFDC recipients) has probably contributed to the growth in AFDC-FG caseloads. The Legislature has been considering proposals that would expand medical coverage for all workers. How best to accomplish this end is a complex issue that is beyond the scope of this analysis. It is important to note, however, that if medical coverage were extended to all workers, this could have the effect of reducing the current disincentive for potential AFDC-FG recipients to work.

OPTION 4—Expand Participation in the GAIN Program

The GAIN Program seeks to reduce welfare costs by moving AFDC recipients into the labor force. Participation in the GAIN

Program is mandatory for all AFDC recipients who have children over the age of three, with specified exceptions. Failure to participate can result in the loss of benefits.

Rather than relying on direct financial incentives to encourage recipients to work, the GAIN Program relies on education, training, and helping recipients to find jobs. Based on information presented in Figure 9, GAIN would probably be most successful when it prepares recipients for jobs paying more than $1,400 per month. At this income level and above, the individual is no longer on aid and there is a positive and rising net benefit from working. (This income level would vary with the worker's family size. Figure 9 relates to the situation of a family of three.)

The effectiveness of the GAIN Program has not yet been determined. Thus, its potential for reducing AFDC costs is unknown. The GAIN legislation required the Department of Social Services (DSS) to contract for a comprehensive evaluation. This evaluation will determine whether the benefits of the GAIN Program (reduced welfare dependency and increased earnings) exceed its costs. It should also shed light on whether making GAIN more "job" oriented, rather than as "education" oriented as it has been to date, would increase its cost-effectiveness. The study is scheduled for completion in November 1992, although preliminary results should be available in October 1991.

The current funding level for the GAIN Program does not allow all eligible recipients to participate. Under the Governor's proposed 1991-92 budget, the program will serve an estimated 208,000 AFDC-FG & U cases, out of about 276,000 who would be served under full funding. One strategy for reducing caseloads and welfare dependency in the long run would be to expand funding for the GAIN Program providing that it is found to be effective. The DSS advises that fully funding the program in 1991-92 so that it could serve all 276,000 potential participants would cost $488 million ($188 million General Fund). This is $159 million ($50 million General Fund) more than is proposed in the budget.

Until the evaluation of the GAIN Program is available, it will not be possible to determine whether increasing program participation would result in long-term savings. Nevertheless, it is important to note that the program is currently the state's only major strategy for reducing long-term welfare dependency.

CONCLUSION

Our analysis of the AFDC program indicates that recipients have relatively little incentive to work. In considering options to control the program's costs, we note that the Legislature's options to alter the work incentives are limited, not only because of fiscal constraints but also because many of the program's grant determination and eligibility rules are set by federal law. There are, however, some state options that would have some effect on increasing the work incentive.

In reviewing the legislative options for controlling AFDC costs and reducing welfare dependency, we find that each has advantages and disadvantages. Generally, efforts to induce welfare recipients to work and nonrecipients to remain off welfare will result in state costs, at least in the short run, or—as in the case of the Governor's proposal—will have an adverse impact on recipients who are unable to find employment in order to compensate for the reductions in their grants.

While it is possible to estimate some of the immediate costs or savings of implementing specific policies based on the options presented in this analysis, we are unable to quantify all of the potential long-term fiscal effects. Information is not available, for example, to project the ability of AFDC recipients to obtain employment or the degree to which they will respond to changes in the work incentive. As a result, we do not have an analytical basis—from a cost-benefit perspective—to recommend that the Legislature adopt any one of these options. We have, however, been able to show how the different options would operate to affect the incentive for AFDC recipients to work. Hopefully, this provides some insight into the potential that these policies have for controlling the program's costs in the long run.

Reviewing these options also may assist the Legislature in evaluating the Governor's budget proposal to reduce the maximum grant below the AFDC need standard—Option 1 in our analysis. We have shown that this proposal would result in immediate savings and, by reducing the grant, would increase the incentive for AFDC recipients to work. As noted above, however, the work incentive itself is very modest, and those recipients who are unable or unwilling to find employment would experience a loss of income.

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