



# Budget and Policy Implications: California Meets Federal Work Participation Rates for CalWORKs in 1998

## Background

The federal welfare reform legislation of 1996 requires states to have specified percentages of their caseload working or engaged in some other work-related activity. For federal fiscal year (FFY) 1997—October 1996 through September 1997—California met the work participation rate for all families but did not meet the higher rate for two-parent families. This failure could result in a penalty of \$7 million.

In contrast to FFY 1997, California met the federal work participation requirements for all families and for two-parent families in FFY 1998. Recent caseload reductions helped California to meet the federal work participation rates for FFY 1998. This was due, in large part, to the way in which federal regulations defined the two-parent caseload.

## LAO Findings

There are two important consequences for California if it meets federal work participation requirements in the future.

- ❖ The penalty for noncompliance during FFY 1997 will be waived. In this regard, it is not clear whether the state will be in overall compliance in FFY 1999. However, for FFY 2000, compliance is likely because the State Department of Social Services is planning to reorganize all two-parent families into a separate state program which would not be subject to federal work participation requirements.
- ❖ The state could reduce its maintenance-of-effort spending for the California Work Opportunity and Responsibility to Kids (CalWORKs) program from 80 percent of FFY 1994 spending to 75 percent. This could result in potential General Fund savings of up to \$176 million annually.



# THE FEDERAL WORK PARTICIPATION REQUIREMENT

The federal welfare reform legislation of 1996 replaced the Aid to Families with Dependent Children (AFDC) program with the Temporary Assistance for Needy Families (TANF) block grant program. Under the TANF program, states receive a federal block grant but must meet various performance measures, including work participation. Specifically, states that fail to have specified percentages of their caseload engaged in work or some other type of work-related education, job training, or job search activity shall be penalized by reductions in their federal TANF block grant.

The required rate of participation for each FFY is based on two elements: (1) a statutory base participation rate and (2) a caseload reduction factor. Figure 1 shows the specified base participation rates for both the overall caseload and the two-parent caseload before adjusting for the respective caseload reduction factors.

**Meeting the Federal Work Requirement.** Federal law specifies that the rates shown in Figure 1 shall be adjusted downward to reflect the percentage reduction in the respective caseloads since FFY 1995. Thus, states can meet the work participation requirements through a combination of caseload reduction and/or increased work

participation. States with higher caseload reductions will need to achieve lower levels of work participation than states with only modest caseload reductions.

**Caseload Reduction Factor.** The final TANF regulations, released by the U.S. Department of Health and Human Services (DHHS) in April 1999, established a framework for states to determine their caseload reduction factors. This framework (1) requires states to use previously reported figures and definitions for establishing the 1995 base year, and (2) uses a different definition of two-parent cases for purposes of estimating the caseloads in all years following the base year. The caseload reduction factors are calculated for the year prior to the year in which work participation is being monitored by DHHS. For example, the work participation calculation for FFY 1998 would employ the caseload reduction through the prior

**Figure 1**

**TANF Work Participation Rates Prior to Applying the Caseload Reduction Factor**

Federal Fiscal Year	Overall Caseload	Two-Parent Caseload
1997	25%	75%
1998	30	75
1999	35	90
2000	40	90
2001	45	90
2002 and thereafter	50	90

year, FFY 1997. As we discuss later, the framework has the effect of permitting states to “maximize” the amount of their caseload reductions.

**Amount of Penalty.** The penalty for failing to meet the specified work participation rates is up to 5 percent of the federal block grant, increasing 2 percent for each year of successive failure, to a maximum of 21 percent. California’s block grant is \$3.7 billion, so 1 percent is equal to \$37 million. A federal penalty results in a reduction in TANF funds and a corresponding increase in a state’s maintenance-of-effort spending requirement.

The DHHS has discretionary authority to reduce penalties based on the degree of noncompliance.

**The CalWORKs Program.** In response to the federal welfare reform legislation, the California Legislature created the CalWORKs program in 1997. This program, which replaced the AFDC program, provides cash grants and welfare-to-work services to families with children whose incomes are not adequate to meet their basic needs. The program requires able-bodied adult recipients to work or engage in some type of work-related education or training activity.

## CALIFORNIA’S PERFORMANCE WITH RESPECT TO WORK PARTICIPATION RATES

To date, the DHHS has evaluated states with respect to work participation compliance in FFY 1997 and FFY 1998. Below, we review California’s performance.

### FFY 1997 RESULTS

For FFY 1997, California met the participation rate for all families but failed to meet the higher rate for two-parent families.

**Overall Performance.** With respect to the overall rate, California attained a caseload reduction of 5.5 percent. Thus, California needed to have 19.5 percent (the 25 percent statutory base rate less the 5.5 percent caseload reduction factor) of its entire caseload engaged in work or some other work-related activity. For the entire

caseload, California achieved a 20.6 percent participation rate (therefore exceeding the threshold).

**Two-Parent Performance.** For the two-parent caseload, California attained a caseload reduction of 7 percent. Thus, the state needed to have 68 percent (the 75 percent statutory base rate less the 7 percent caseload reduction factor) of its two-parent caseload engaged in work or some other work-related activity. For this caseload, California achieved a 24.5 percent participation rate—well below the 68 percent required rate.

**Penalty for 1997.** On December 30, 1998, the DHHS notified California that it was assessing a penalty of \$6,964,321, based on the finding that the state failed to meet the work participation rate for two-parent families in FFY 1997. The amount



of the penalty was determined as follows: according to federal law, California became subject to the work participation requirement effective July 1, 1997. So, with respect to FFY 1997 (October 1996 through September 1997), California was subject to the requirement for just one quarter of the year.

The DHHS calculated the penalty by applying the penalty rate of 5 percent to one quarter of the state's block grant (\$3.7 billion). The DHHS then used its discretionary authority to *reduce* the penalty based on the "degree of noncompliance" by multiplying the gross penalty by 17.7 percent (the proportion of two-parent cases in our caseload).

**California's Response.** In February 1999, California responded to the federal penalty notification. The response (1) presented a case for "reasonable cause" for noncompliance, (2) requested a waiver of the penalty on the basis of reasonable cause, and (3) included a corrective compliance plan in the event that the DHHS did not accept the reasonable cause explanation. In July 1999, the DHHS notified California that it had accepted California's corrective compliance plan. Thus, the penalty was deferred pending the outcome of this plan. In brief, the corrective compliance plan is full implementation of the CalWORKs program, which did not begin until January 1998. Under this plan, DHHS will not impose the penalty if California is in compliance by September 2000.

## FFY 1998 RESULTS

In contrast to FFY 1997, California met *both* work participation rates in FFY 1998 and is now in

compliance with the federal work requirements. As discussed below, the key to meeting the higher two-parent rate was the magnitude of the caseload reduction factor.

**Overall Performance.** With respect to the overall participation rate, California attained a caseload reduction of 12.3 percent, thus California needed to have 17.7 percent (the 30 percent statutory base rate less the 12.3 percent caseload reduction factor) of its entire caseload engaged in work or some other work-related activity. For the entire caseload, California achieved a 36.6 percent participation rate (therefore exceeding the threshold by nearly 20 percentage points).

**Two-Parent Performance.** For the two-parent caseload, California attained a caseload reduction of 42.3 percent. Thus the state needed to have 32.7 percent (the 75 percent statutory base rate less the 42.3 percent caseload reduction factor) of its two-parent caseload engaged in work or some other work-related activity. For this caseload, California achieved a 36.2 percent participation rate—3.5 percentage points above the required rate.

**The Importance of Caseload Reduction.** The key to meeting the two-parent participation rate was the caseload reduction factor of 42.3 percent. California's participation rate of 36.2 percent was well below the base participation requirement of 75 percent. As discussed in the inset box on page 5, the specific federal framework for calculating the caseload reduction factor significantly benefited California.

## CALCULATING THE TWO-PARENT CASELOAD REDUCTION FACTOR

The underlying caseload reduction in two-parent CalWORKs cases from FFY 1995 to FFY 1997 was approximately 18 percent (estimated). How then did California achieve a caseload reduction factor of 42.3 percent? The answer lies in the specifics of the TANF regulations.

***Establishing the 1995 Base Year Caseload for Two-Parent Families.*** For the base year of 1995, the federal regulations require states to include all cases in the AFDC “Unemployed Parent” caseload (consisting of two-parent families) as reported on the federal ACF-3637 statistical report. The regulations further specify that this amount shall automatically be adjusted upward, based on quality control data, to reflect any other two-parent AFDC cases (in the “Family Group” component of the program). For California, the 1995 base was 182,393 cases. It is important to note that this base includes many cases that *do not* have two *aided* adults. For example, many citizen children of undocumented parents were served in the former AFDC Unemployed Parent program because they were part of “intact” families. Although the parents in these cases were not aided, they were counted as AFDC Unemployed Parent cases.

***Calculating the Two-Parent Caseload in Subsequent Years.*** With respect to calculating the caseload in FFY 1997 and beyond, the federal regulations state that the two-parent caseload consists of “all families with two natural or adoptive parents (of the same minor child) receiving assistance and living in the household.” Thus, for these years, the two-parent caseload *only includes cases that have two aided adults*. Based on the regulations, California’s two-parent caseload for FFY 1997 was 105,165. When compared to the base year caseload of 182,393, this represents a reduction of 77,223 cases, or 42.3 percent. Most of this reduction, however, results from the federal framework for calculating the reduction, which includes many cases without two aided parents in the 1995 base year, while excluding such cases in subsequent years.



## COMPARISON TO OTHER STATES

For FFY 1998, all 50 states and the District of Columbia met the work participation rate for all families. Twenty-eight of the 41 states subject to the two-parent work participation requirement (including California) achieved their required two-parent rates. (Some states are not subject to the two-parent participation requirement because they (1) have no two-parent cases, (2) fund their two-parent cases in a separate state [non-TANF] program, or (3) have pre-welfare reform waivers in effect.) Figure 2 shows the performance of the eight largest states subject to the two-parent work participation rate. Among

**Figure 2**

### TANF Work Participation Compliance for Two-Parent Families Among Ten Largest States

*Federal Fiscal Year 1998*

State	Caseload Reduction Credit	Adjusted Participation Requirement	Participation Rate Achieved	Achieved Required Rate?
Illinois	30.0%	45.0%	77.7%	yes
Michigan	36.6	38.4	63.9	yes
New York	36.5	38.5	58.8	yes
Ohio	25.8	49.2	51.5	yes
Texas	27.1	47.9	44.3	no
California	42.3	32.7	36.2	yes
North Carolina	20.0	55.0	30.9	no
Pennsylvania	48.7	26.3	21.8	no
Florida <sup>a</sup>	—	—	—	—
New Jersey <sup>a</sup>	—	—	—	—

<sup>a</sup> No federal requirement because two-parent cases are in separate state (non-TANF) program.

these large states, California had the second highest caseload reduction factor but the sixth highest two-parent participation rate.

## BUDGET AND POLICY IMPLICATIONS

Meeting the federal work participation rates for FFY 1998 has significant budget and policy implications for California. These are discussed below.

### WILL CALIFORNIA CONTINUE TO MEET THE WORK PARTICIPATION RATES?

***Meeting the Overall Participation Requirement in 1999.*** In FFY 1998, California exceeded

the required work participation threshold for all families by nearly 20 percentage points. Although, the base participation rate for all families increases from 30 percent to 35 percent in FFY 1999, this increase should be more than offset by an increase in the caseload reduction factor. Accordingly, it is very likely that California will meet the work participation rate for all families in FFY 1999.

**Meeting the Two-Parent Participation Requirement in 1999.** For FFY 1999, the *base* participation rate for two-parent families increases from 75 percent to 90 percent. This increase will be partially offset by an increase in the caseload reduction factor. California's ability to meet the two-parent participation rate will depend on (1) the magnitude of the caseload reduction factor and (2) the impact of the CalWORKs program on increasing work participation among recipients. Our analysis of available data suggests that California's participation rate in FFY 1999 will be close to the required level for two-parent families. At this time, however, we cannot say with certainty that California will be in compliance with the federal requirements.

If California were unable to meet the two-parent work participation rate in FFY 1999, the first-year penalty would be approximately \$28 million (based on the current DHHS methodology) because it would be based on a full year, rather than just one quarter of the fiscal year as was the case in FFY 1997. In subsequent years, if California were unable to meet the work participation requirements, the penalty would increase by about \$11 million annually for each successive year of failure.

**Meeting the Work Participation Requirement in FFY 2000 and Beyond.** Some states have reorganized their two-parent caseload into a separate state-funded program, in which case they are not subject to the federal work participation requirements for two-parent families. In California, the State Department of Social Services has issued

a county directive indicating that it will follow this practice, effective FFY 2000 (beginning October 1999). Reorganizing the two-parent cases into this separate state-funded program is budget neutral because it is achieved by a fund shift (of state and federal monies) between the two-parent and one-parent components of the CalWORKs program.

Since the two-parent cases will be served in a nonfederal program, the only work participation requirement applicable to California will be the rate for all families. Given that in 1998 California exceeded the required rate of participation for all families by nearly 20 percentage points, we believe it is likely that the state will comply with this federal work requirement in FFY 2000 and beyond. We note, however, that a recession could have two distinct negative impacts on work participation. First, the caseload would tend to increase, resulting in an increase in the participation threshold. Second, clients are likely to experience more difficulties in finding work, which could reduce the rate of work participation for purposes of meeting the federal requirement.

### **MAINTENANCE-OF-EFFORT (MOE)**

To receive the annual federal TANF block grant (\$3.7 billion for California), states must meet an MOE requirement that state spending on welfare for needy families be at least 80 percent of the FFY 1994 expenditure level, which is \$2.9 billion for California. The MOE requirement drops to 75 percent if a state meets the applicable work participation rates.



To date, California's CalWORKs budgets have assumed that it would be very difficult for the state to achieve the two-parent work participation rate and have therefore been based on a target of spending at the 80 percent MOE level. If California can continue to be in compliance with federal work participation requirements, it has the option of reducing state spending on CalWORKs to the 75 percent MOE level. Potentially, this could result in General Fund savings of up to \$176 million. Actual savings will depend on caseloads, program costs, available federal TANF funds, and budget decisions by the Governor and Legislature concerning the CalWORKs program.

## CONCLUSION

If California can continue to meet the federal work participation rates, the state will have greater flexibility in determining the General Fund budget for CalWORKs. Specifically, the state would be

able to reduce General Fund spending to the 75 percent MOE level, resulting in a *potential* savings of about \$176 million. This could be an issue for the Legislature when considering the 2000-01 budget.

The ability to achieve these savings will depend on various factors that affect future decisions on the size of the CalWORKs program. We note, for example, that to remain in compliance, California will need to continue to meet work participation rates for all families in subsequent years. Thus, it may be necessary for the state to continue to fully fund employment services for CalWORKs recipients in order to remain in compliance with federal work requirements. On the other hand, it is possible that future caseload declines may sufficiently reduce CalWORKs program costs, enabling the state to realize these General Fund savings while fully funding the program.

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