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The Structure of the TANF Block Grant

Executive Summary

One of the major changes in the sweeping welfare reform legislation of 1996 was replacing the federal guarantee of cash welfare to all qualified families—the Aid to Families with Dependent Children (AFDC) program—with a block grant that provides a fixed and guaranteed level of funding to states. The new block grant, called Temporary Assistance for Needy Families (TANF), gives states great flexibility in spending their funds as long as they are pursuing one or more of the goals of the block grant. Several questions about the block grant need to be addressed during the debate on TANF reauthorization, which must be completed by October 1, 2002. These include the size of the block grant and the formula for allocating it among states, whether additional funds should be provided to states during recessions, and whether the TANF performance bonuses should be revised or dropped. This brief outlines several policy options for addressing these issues.

The 1996 welfare reform legislation replaced the Aid to Families with Dependent Children (AFDC) program with a new Temporary Assistance for Needy Families (TANF) block grant that is very different than its predecessor. In the old AFDC program, funds were used almost entirely to provide and administer cash assistance to low-income—usually single-parent—families. The federal government matched state expenditures, with poorer states' expenditures matched at a much higher rate than wealthier states. AFDC caseloads tended to go up during recessions and down during good economic times (although the linkage was not nearly as close as with the Food Stamp Program), so federal expenditures on TANF also showed some cyclical variation.

In the new TANF program, by contrast, federal expenditures are, with a few modest exceptions, fixed at \$16.5 billion dollars a year

for fiscal years 1997-2002. Thus they neither adjust for inflation nor rise and fall with economic cycles or the size of the caseload. Individual states' share of the total block grant is based on the amount they received from the AFDC program in the mid-1990s (states could choose the most advantageous from three alternative base periods). And unlike AFDC, in which federal expenditures matched state expenditures at a fixed rate, under TANF states are required to spend 75 percent of the amount they spent from state funds in 1994 (80 percent if they fail to meet federal work participation rate targets).

During the reauthorization debate, Congress and the administration will face six major issues concerning TANF block grants. First, how much money should the federal government spend on TANF? Second, should an inflation adjustment be built into the TANF block grant to keep its real value from being eroded over time? Third, should the current

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allocation of TANF funds across states—which gives much more money per low-income child to wealthier states than to poor ones—be revised? Fourth, should the TANF block grant include a counter-cyclical element so that states get more money during recessions, when need rises and state budgets are extremely tight? Fifth, should the “maintenance of effort” requirement that states spend at least 75 percent of the amount spent in 1994 be revised? Finally, should the structure of the performance bonuses associated with the TANF block grant be revised?

This debate will occur in an environment of tight fiscal constraints. The rosy budget forecasts of recent years have changed dramatically. Because of the recession, the tax cut of 2001, and increased spending on defense and homeland security, the federal government now faces a future of red ink. The states are facing large budget shortfalls themselves, and almost all of them have constitutional requirements to balance their budgets. They will be looking to Washington for fiscal relief, or at least to avoid cutbacks in the flow of funds from Washington.

The Size of the Block Grant

Perhaps the most fundamental question that Congress will face this year concerns the overall size of the block grant. Current annual funding of \$16.5 billion expires at the end of fiscal year 2002. Congress must act—if only to pass a continuing resolution embodying current law and funding levels—to sustain the flow of funds to the states beyond September 30. But state governments would prefer more than a temporary extension of TANF: they want the stability of a multi-year funding stream to be able to make their own programmatic commitments for the new array of services being offered under TANF.

Some critics argue that funding levels in the block grant ought to be reduced. They note that current levels were set when TANF caseloads were more than twice the level they are today. Moreover, a number of states have

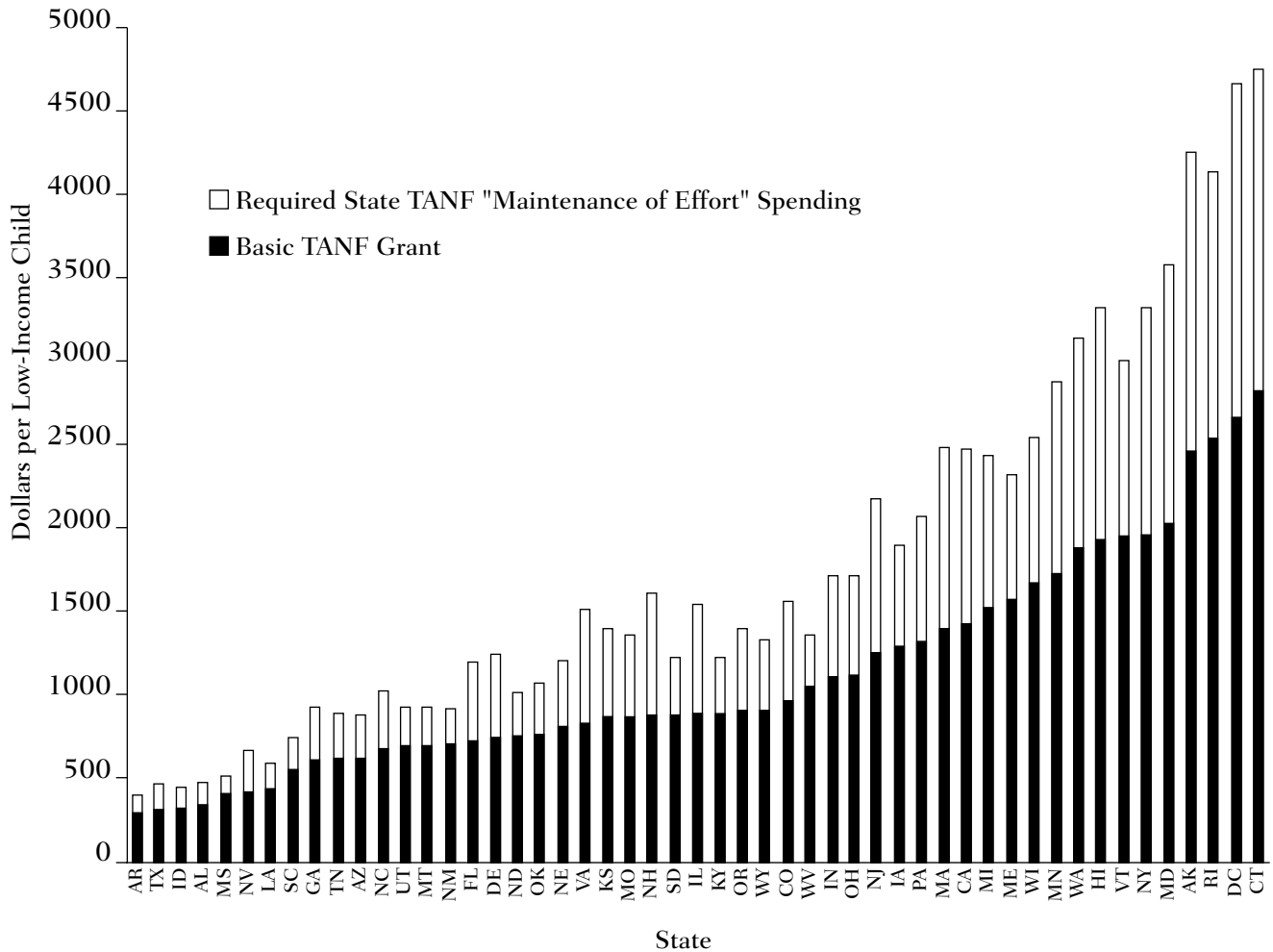
not spent their full block grant allocations, especially in the early years of the TANF program. By 2001, however, most states were spending almost all of their current TANF allotments, and many had begun to draw on reserves from past years. Indeed, data from the U.S. Treasury Department show that for the first time in 2001, states actually spent more than the annual TANF allocation of \$16.5 billion.

Defenders of current or even increased funding levels pose several counterarguments. First, because the TANF block grant has no built-in inflation adjustment, it has been declining in real terms for six years—roughly 12 percent between 1997 and 2002. More importantly, they argue that the caseload number is no longer a meaningful indicator of states’ funding commitments under TANF. States spend less than half of their TANF funds on cash benefits to those officially on the TANF caseload; the rest is spent primarily on child care, transportation, job search, and other work supports for the working poor and the hard-to-employ who may or may not be on the TANF caseload. Thus, states need the entire block grant amount because they are now running two programs—a cash welfare program and an employment program—with the same amount of money they had under AFDC.

Inflation Adjustment for the Block Grant

The decline in real purchasing power of the TANF block grant will continue, and is projected to be around 22 percent lower in 2007 than it was in 1997, if TANF funding remains at \$16.5 billion. As a result of the decline in real dollars, states that have increased their spending on work supports in recent years will face difficult trade-offs between cutting cash benefits, cutting work supports, or increasing their own spending on TANF-financed programs. To avoid this financial squeeze on states, Congress can increase the TANF basic funding level to account for past inflation,

Figure 1
Federal TANF Grant Amount and State TANF Spending per Low-Income Child by State



Note: TANF = Temporary Assistance for Needy Families
 Source: U.S. Department of Health and Human Services

build an inflation mechanism into TANF to take account of future inflation, or both. If Congress enacts a five-year extension of TANF, about \$18 billion in extra funding over the 2003-2007 period would be required to account for inflation between 1996 and 2007; about \$6.5 billion would be required over that period to account only for anticipated future inflation between 2002 and 2007.

Allocation of TANF Funds Across States

As noted above, TANF block grant allocations are based on states' historical spending levels under the AFDC program. Even though

poor states enjoyed a much more advantageous match rate than wealthier states, their benefits were generally much lower, so the flow of federal funds per low-income child was much lower. This pattern carried over to the TANF block grant, as shown in figure 1. The lower part of each bar graph shows the TANF block grant dollars received per child living in a low-income family for each state in fiscal year 2002. As the figure clearly shows, there are immense disparities across states in the block grants received per low-income child. In the ten states receiving the least generous federal grant, the TANF block grant provides only \$429 per low-income child,

while in the ten states receiving the most federal dollars, TANF provides around five times as much. The disparities in TANF block grant funding are exacerbated by the fact that states that receive higher federal allocations also are required to spend more of their own money to meet federal “maintenance of effort” requirements. Thus, the actual funding disparities across states, shown by adding the upper and lower sections of the bars in figure 1, are actually much greater—more than a six-to-one disparity between the highest and lowest ten states.

There is little justification for the dramatically uneven levels of funding per low-income child, especially because the federal government provides fewer dollars to poorer states. However, it is much more difficult to come up with an acceptable resolution of the problem. Defenders of the status quo argue that reopening the allocation formula could destroy political consensus on TANF and lead to lower overall funding levels. Indeed, a formula fight helped to delay Senate consideration of welfare reform legislation in 1995. The reallocation fight would be particularly intense if it involved a zero-sum game in which richer states lost money so that poorer states could get more. The simplest change in allocation would be to gradually adjust the funding formula to give more money to states with low federal funding per low-income child. But even with a lengthy phase-in, such zero-sum funding changes would be opposed by large and powerful states that would lose money.

In short, changing the current allocation would be problematic unless all states are at least protected against a drop in the nominal value of their current allocation. But in a time of tight budgets, a major increase in funds is also difficult. The most likely candidate for increased funding is restoration of the TANF supplemental grant which gives increased funding to about one-third of the states with historically low AFDC grants per low-income person and/or fast-growing populations. The supplemental funding pot was only \$319

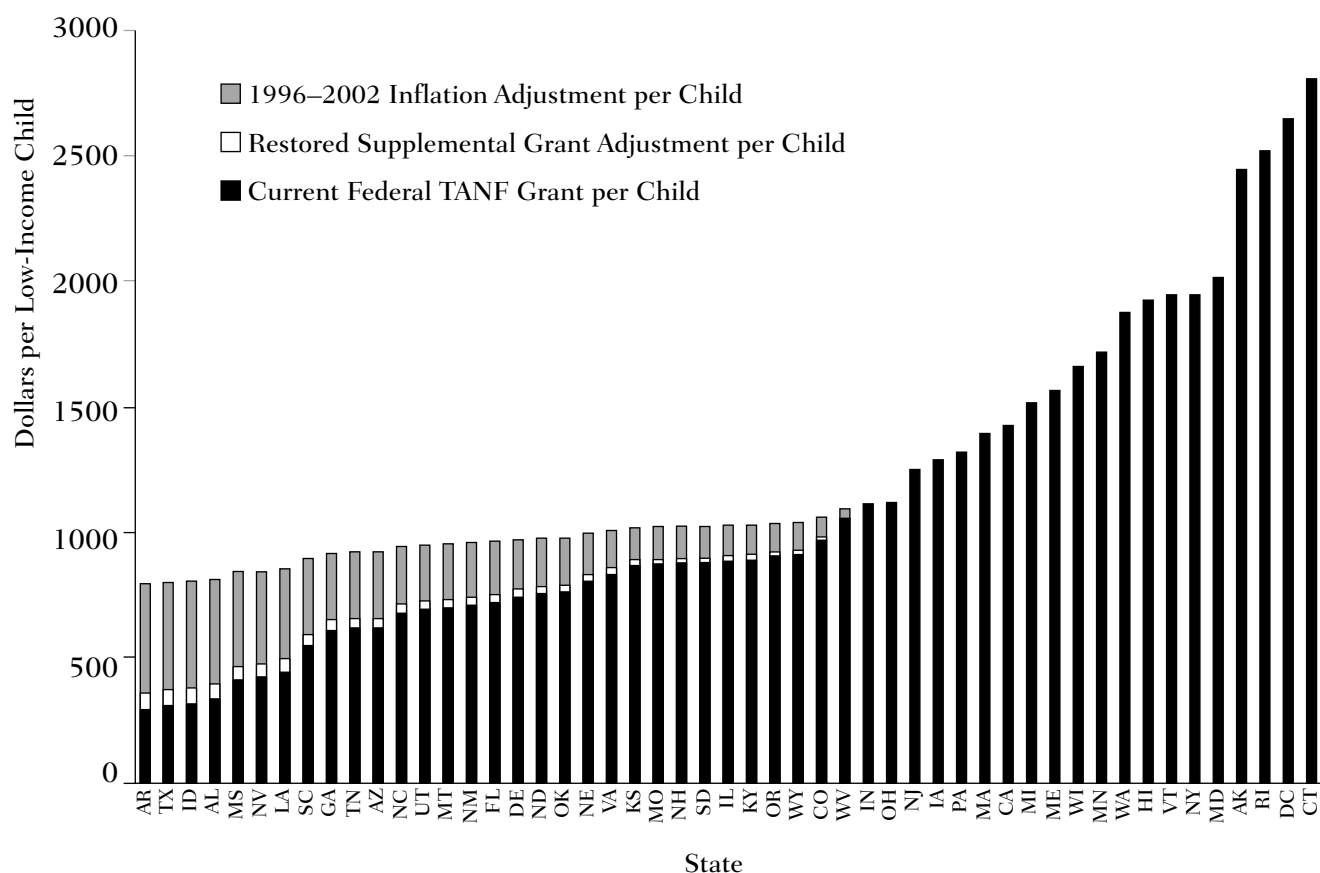
million in 2001. Because the supplemental grant is not assumed to be included in the budget baseline, renewing it for 2003 and beyond will require offsetting savings or new revenues. The middle parts of the bars on figure 2 show the very modest impact on state grant levels of restoring the supplemental grant and reallocating it so that each state getting a grant below the national average of \$1,114 per low-income child would have an equal percentage of the gap filled between its current level and the national average. Because the funding gap is so large—it would take \$4.1 billion in 2002 to bring all states up to the current national average—the supplemental grant would make only a modest dent in achieving this goal, filling about eight percent of the gap.

Far more effective in filling the gap would be increasing the current TANF block grant for inflation since 1996, on top of restoring supplemental grant funding and devoting the entire amount to increasing benefits in low-grant states. These two steps together would permit filling 60 percent of the gap needed to bring below-average states up to the national average (top portion of bar graphs in figure 2), but would cost \$2.5 billion in 2002 or \$12.5 billion over five years.

A less expensive strategy for partially equalizing revenues across states would be to preserve nominal grant levels for richer states, while using future inflation adjustments to the TANF block grant (if Congress enacts them) primarily to bring grants for low-grant states closer to the national median or average. However, so long as inflation rates remain low, it would take many years for inflation adjustments alone to make a substantial impact on low-grant states. Moreover, it is unlikely that the entirety of an inflation adjustment could be used in this way for more than a few years.

Even if additional funding can be found for states with low TANF grants, additional problems exist. Two in particular are notable. First, any approach to filling the gap between

Figure 2
Effects of Adding New Funds to State TANF Allocations



Note: TANF = Temporary Assistance for Needy Families
 Source: U.S. Department of Health and Human Services

low-grant and high-grant states will give almost one-third of the money to Texas, a very large state with a very low TANF grant. Concentrating such a high percentage of the gains on one state might be politically problematic.

Second, Congress would have to decide whether states receiving the funding boost would be required to increase their own spending levels to qualify for the money. Legislators from richer states would undoubtedly argue that it is not fair that they have to maintain their spending efforts at relatively high levels while poorer states get more money with no additional

effort over their already very low spending levels. But it is not clear that low-grant states would be willing to spend more of their own money. After all, the reason that TANF grants are so low now in these states is that under the AFDC program, they were very reluctant to spend their own funds on poor families.

Politicians will be tempted to simply ignore the TANF allocation formula or reinstate the supplemental grant in its old form to avoid these political problems. Given the magnitude of the funding disparities, and the limitations they impose on the capacity of low-income states to provide adequate benefits and

employment services to their citizens, retaining the current formula would be an unfortunate outcome.

Adjusting TANF for Recessions

Unlike the old AFDC program, the TANF block grant is a fixed funding stream to the states that does not respond to economic conditions. Nevertheless the law includes several provisions that are intended to help states that run into problems during recessions. First, states can carry over unspent TANF funds to future years. Second, states can borrow up to a total of \$1.7 billion from the federal government, repayable at market rates of interest. Third, the 1996 law created a federal contingency fund of \$2 billion that states could draw upon when they had substantial increases in unemployment or food stamp use; however, the increases necessary to trigger benefits from the fund were so stringent that states could not access these funds except in a very deep recession. Moreover, to qualify for contingency funds, states have to boost their own spending from 75 percent to 100 percent of the 1994 level, despite the fact that states often cannot find such additional funds during a recession.

Critics of these arrangements argue that states will have difficulty maintaining both increased cash assistance and needed work support commitments during a recession. While a number of states have carried over TANF funds from the good economic times of the late 1990s, they have been reluctant to carry over too much because of signals from Congress that they would lose the funds if they did not use them. Moreover, states are unlikely to borrow funds from the federal government when facing a budget squeeze. One option currently under discussion for dealing with a recession is improvement of the contingency fund, with changes in eligibility criteria and the state spending requirement to make it more accessible for states. Other options include giving states increased control of carry-over funds so that they do not fear the

funds will be lost if they are not spent, and making the TANF block grant explicitly counter-cyclical by, for example, tying grant levels to the unemployment rate (see *Welfare Reform & Beyond Policy Brief #7*, by Rebecca M. Blank for an extended discussion of options for dealing with recessions).

Requirements for State Spending

The old AFDC program required states to contribute their own funds to finance cash benefits. About 45 percent of the total costs of AFDC were paid by states. The TANF program continued this tradition by requiring states to spend 75 percent of the amount they spent on AFDC and related programs in 1994 (80 percent if the state failed to meet required work participation rates). This provision was a subject of great controversy during the 1995-96 welfare reform debate. Some states lobbied to drop all requirements on state spending. Child advocates argued that if there was to be no individual entitlement, the TANF program should at least guarantee that a specific amount of money be available for a cash safety net program and for welfare-to-work activities.

There have been no prominent proposals during the debate on TANF reauthorization to reduce state maintenance of effort spending. But the intense budget pressure faced by Congress could lead members of the congressional budget committees to look for cuts in the \$16.5 billion TANF block grant. Cuts of this sort would lead, in turn, to a call from the states to allow them to reduce their own spending. The most likely outcome, however, is that both the federal block grant amount and the state 75 percent “maintenance of effort” requirement will be retained.

Changing Performance Bonuses

In addition to the basic TANF block grant, the federal government offers two sets of bonus grants to states that have achieved superior performance on goals defined by the federal government. One bonus offers a total of \$100

million per year to up to five states that have achieved the highest reductions in the ratio of non-marital births to total births in the past year while reducing abortions. The second bonus offers \$200 million per year to states that have met at least one of several performance criteria established by the Department of Health and Human Services. In its original form, the second bonus was awarded for job entry, job retention, and wage progression by TANF recipients. Starting in 2002, bonuses are scheduled to be added to reward states for success in enrolling eligible low-income families in food stamps and Medicaid or the State Children's Health Insurance Program, as well as for child care affordability, accessibility and quality, and for increases in the number of low-income children living in two-parent families.

In order for a bonus system to have the intended effect of boosting a state's effort to perform well, states must believe that their efforts can actually have a direct impact on the particular outcomes measured by the bonus system. But in the case of the illegitimacy bonus, high performance in reducing illegitimacy rates appears to have resulted largely from demographic factors that are not under state control rather than from any new state effort. Moreover, the underlying rationale of a bonus system is that it can encourage states to mount new programs to achieve the desired improvement in performance. New programs generally cost money. As we have seen, there is a wide discrepancy between states in the amount of money they

receive from the basic TANF grant. Thus, wealthy states have an advantage in mounting new programs aimed at winning bonus payments simply because they have more money to invest.

The illegitimacy bonus appears to enjoy only weak support in Congress primarily because it is difficult to identify a clear relationship between states that have actually won the bonus and the efforts those states put forth to win the bonus. By contrast, there is considerable support for the performance bonus. To date, the performance bonuses have been awarded based on state success in placing and keeping recipients in jobs. Most observers believe that states can obtain reliable measures of job placements and job retention and that state programs seem to have an impact on state performance.

In a year in which money is tight, it might be expected that proposals to use bonus money for other purposes will be forthcoming. In fact, the Bush administration has already proposed to end the illegitimacy bonus and part of the performance bonus in order to use the money to provide funds for a marriage initiative. The bill introduced by Representative Benjamin Cardin, the ranking Democrat on the Ways and Means subcommittee responsible for welfare, would also eliminate the illegitimacy bonus. The illegitimacy bonus seems unlikely to survive; what happens to the performance bonus remains to be determined.

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Additional Reading

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