Improving Low-Income Policies in *tight* Fiscal Times

by Iris Lav and John Springer

The authors represent the Center on Budget and Policy Priorities, a nonpartisan research organization and policy institute. As always, articles in *Communities & Banking* reflect the views of the authors, not the Federal Reserve Bank of Boston.

Like the rest of the nation, the New England states have been scrambling in recent months to repair the budgetary damage associated with the economic downturn. State budgets have been thrown out of balance as revenue collections have fallen substantially below expectations. The National Association of State Budget Officers estimates that 40 states face a combined budget shortfall of $40 billion for fiscal year 2002, and large additional gaps are expected for fiscal year 2003. In response, states are using up reserve funds, raising revenues, and cutting spending — including spending on programs aimed at low-income families and other vulnerable individuals.

Massachusetts' situation is one of the region's most serious. To close a shortfall that exceeded $2 billion during fiscal year 2002, the state used up more than $800 million in reserves and made a number of spending cuts, including nearly $50 million in cuts in various social service programs. Further cuts are planned for fiscal year 2003, even if the substantial tax increase now under consideration is enacted.

Other New England states are in better shape, but they too have been making cutbacks. For example, Rhode Island's governor raised considerable controversy by proposing to eliminate funding for the state's first-ever affordable housing program. Rhode Island is, however, planning to delete a long-standing program that provides small "weatherization bonus grants" to families receiving cash assistance.

Despite recent economic indicators suggesting the downturn has bottomed out, the state budget situation is unlikely to improve soon. State budgets usually don't recover from a downturn until a year or more after the economic recovery begins, in part because unemployment usually keeps rising for a number of months after the economic recovery technically starts.

As a result, the competition for state resources will remain intense for at least the next year. In this competition, groups representing corporations and higher-income families generally have an edge over groups representing low-income families in such areas as funding and organization. One sign of this imbalance is that states have made their tax systems increasingly regressive over the past decade: State tax hikes during the recession of the early 1990s hit both lower- and upper-income families, while state tax relief during the prosperous period from 1994 to early 2001 was largely targeted on upper-income families. The danger exists that some states will close their current budget gaps primarily through tax hikes and spending cuts that hurt low-income families.

To help groups concerned about low-income families participate more effectively in state policy debates, this article briefly describes a few concrete steps states can take – at modest cost and using federal funds wherever possible – to help low-income families harmed by the downturn.

Welfare

One area where states can revise their policies to help low-income families is in the Temporary Assistance to Needy Families (TANF) program, commonly known as welfare. The 1996 welfare reform law gave states considerable power to design their own welfare programs, subject to a few federal requirements. One such requirement is that states may not use federal TANF funds to provide assistance to families with an

adult for more than 60 months of the adult's lifetime. States that want to provide assistance beyond this point must pay for it entirely with state funds.

States also can impose their own time limits that are shorter than 60 months, and 20 states have done so. Among New England states, Vermont has no time limit; Maine, New Hampshire, and Rhode Island have a 60-month time limit; and Massachusetts has a 24-month time limit for assistance within any five-year period. Connecticut's time limit is the region's shortest: 21 months over an individual's lifetime. While this limit may be extended by up to 18 months for certain families, the state has tightened the restrictions on extensions, largely limiting them to cases of domestic violence.

Time limits were intended to encourage work and prevent long-term dependence on welfare. However, in many states, families are reaching time limits at a time of rising unemployment, when moving from welfare to work is especially difficult. In Maine and New Hampshire, for example, the first families reached time limits late last year.

There are several reasons why states may want to revisit their time-limit policies. First, a significant number of parents who recently moved from welfare to work are losing jobs (or are being forced to work reduced hours) and cannot return to welfare because they already have reached their time limit. Many of them aren't receiving unemployment insurance benefits either.

Second, many families have not reached time limits and are still receiving assistance but have not yet found employment. Compared to families that left welfare for employment, these families are more likely to have problems that can keep them from finding or holding a job, such as low skill levels or emotional or physical difficulties. Having failed to find jobs during the strong economy of recent years, these families will have even more trouble doing so in today's more competitive labor market.

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Third, about one-third of families receiving welfare are working but are earning so little that they are still eligible for assistance. Many of these families will not be able to increase their earnings enough to leave assistance during a recession and are at risk of exhausting their months of cash assistance.

States can respond by providing working TANF recipients with exemptions from time limits, under which the months of assistance they receive while working do not count toward their time limit. (This is known as "stopping the clock" for working families.) This enables working families with very low incomes to receive the extra help they need to get by without using up their months of welfare eligibility, which would make them ineligible for help should they become unemployed in the future. Currently, five states, including Rhode Island, stop the clock for families that are working.

States also can provide working TANF recipients with extensions of time limits, under which they continue to receive aid even after reaching their time limit. For example, if a parent worked a certain number of hours during 10 of the months she was receiving assistance, she could qualify for 10 extra months of assistance. This would enable families that have lost jobs to return to assistance even if they have already reached their time limit. A few states have adopted extension policies, but none in New England.

Food Stamps

While states have less flexibility over food stamp rules than welfare rules, in the past few years the federal government has approved several new options that states can use to make the food stamp program more accessible, especially to working families. Food stamp participation by eligible families has fallen dramatically in recent years, a trend states should be particularly eager to reverse since food stamp benefits (unlike welfare benefits) are entirely federally funded.

One new option simplifies the reporting requirements for families receiving food stamps. Traditionally, these families have been required either to inform the food stamp office of even minor changes in their income within 10 days or to mail in a report of their circumstances every month even if there were no changes. In addition, many states have required families to reapply for food stamps in person every three months. For low-income working families, whose income may change from week to week and who may have trouble taking time off from work to go to the food stamp office every few months, policies like these are a powerful deterrent to participating in the program.

Now, however, states have the option of allowing working families to stay on food stamps for six months at a time with no reporting requirements during that period. Twenty states have adopted this option, but none in New England. Adopting the option not only can help boost food stamp participation, but also can make the program easier for states to administer, since it reduces the amount of information that state food stamp offices must process.

Another area of state flexibility over food stamps isn't new, but it isn't being fully exploited either. Under the 1996 welfare law, unemployed individuals aged 18 through 49 who

are childless and not disabled can receive food stamps for only three months out of each three-year period. Generally these individuals aren't eligible for any other benefit program, so the three-month limit on food stamps is especially harsh.

States can request waivers from the federal government to exempt from this time limit any area of the state that has insufficient jobs. Each year, most states receive waivers for at least part of the state. While three of the six New England states are doing all they can in this area, Vermont and New Hampshire could apply for waivers for more areas than they do, and Massachusetts doesn't apply for waivers at all. Since food stamp benefits are entirely federally funded, providing additional months of food stamps to these individuals would entail only minimal (administrative) costs for states.

Health Insurance

A third area where state low-income policies can be improved is health insurance. The number of uninsured families is likely to rise in the coming year, in part because of the economic slowdown. Many workers will lose private health insurance when they become unemployed, and the high cost of coverage under the COBRA program makes it unaffordable for most jobless workers. Rising health care costs, which are causing some firms to drop or reduce health coverage for their employees or increase the amount that workers must pay for coverage, will also contribute to the number of uninsured families this year.

Almost all children who live in families with incomes below 200 percent of the poverty line (or about $30,000 for a family of three in 2002) are eligible for publicly funded health coverage under Medicaid or the State Children's Health Insurance Program (SCHIP). Coverage is much more limited for the adults in these families, however. In more than half of the states, a working parent with two children can receive Medicaid only if she earns less than about $10,000 a year.

The New England states do a better job than many others in providing publicly funded health insurance. Five of the 17 states nationally that provide coverage to working parents with incomes at the poverty line or higher are in New England. In New Hampshire, by contrast, working parents are ineligible for coverage if their income exceeds two-thirds of the poverty line. Moreover, New Hampshire has considerable unspent federal SCHIP funds it could use to help pay for expanding health coverage for parents. Connecticut too has plenty of unspent SCHIP funds and could use them to help pay for expanding parents' coverage beyond the current limit.

Groups concerned about low-income families need to explain that low-income programs not only provide relief to those most in need, but also promote economic growth in the state by bolstering spending among low-income families.

Making the Case for Improved Low-Income Policies

While federal funding is available for several of the policies outlined above, assisting low-income families generally requires state funds as well. As noted above, finding these funds is particularly difficult now because of states' current budget squeeze.

Two recent federal tax cuts could make that squeeze even worse by costing states considerable revenue. (Because of the linkages between federal and state tax codes, federal tax changes often affect state taxes as well.) First, the repeal of the federal estate tax, contained in last year's major tax legislation, effectively repeals most state estate taxes. States will lose between $19 billion and $23 billion in estate tax revenue between fiscal years 2003 and 2007 unless they act to "decouple" their estate taxes from the federal estate tax.

Three New England states — Rhode Island, Vermont, and Maine (for one year) — already have decoupled their estate taxes from the federal estate tax. Massachusetts, which at this writing appears poised to decouple, stands to lose more than $830 million in 2003-2007 from estate tax repeal if it does not act.

Second, the "bonus depreciation" provision of the recent economic stimulus legislation, which allows a business to claim an immediate federal tax deduction on purchases of new equipment, threatened to reduce state income tax collections by close to $14 billion between now and 2004 (when it expires). As with the estate tax, some states have averted this loss of revenue by decoupling their tax depreciation rules from the federal rules. Nearly every state in New England has decoupled fully from the depreciation provision.

But even if states act to protect their budgets from the effects of these federal tax cuts, as they would be wise to do, convincing state policymakers to make the policy improvements outlined above will not be easy. Groups concerned about low-income families need to explain that low-income programs not only provide relief to those most in need, but also promote economic growth in the state by bolstering spending among low-income families. These families (as opposed to high-income families) tend to spend a higher share of any extra income they receive, thereby injecting money into the economy. They also are more likely than higher-income families to do their spending within the state.

An equally strong argument can be made on the basis of fairness. During the late 1990s, when states were flush and felt free to cut taxes, lower-income families received few of the benefits. Now that states are in trouble, these families surely shouldn't be made to bear the brunt of any necessary sacrifices. And if there are ways states can provide extra help to these families at modest cost, they should do so.

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