New England

Fiscal Facts

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New England AFDC Caseloads Remain High Despite the Recovery

Many state legislators want to cut the costs and caseloads of Aid to Families with Dependent Children (AFDC), the largest welfare program in the nation. Their efforts are likely to be hindered, however, by changes in the structure of the economy and in the composition of needy families, in particular, the growing number of families headed by women who have never married.

AFDC provides cash grants to needy children (and their caretakers) when at least one parent is absent, incapacitated, or unemployed. Over two-thirds of all AFDC recipients are children, and the overwhelming majority live with a single parent, usually the mother. States voluntarily participate in AFDC, sharing costs with the federal government, which pays 50 percent to 62 percent of the region's benefit costs, depending on a state's per capita income, and half of state administrative costs.

The New England states now spend a smaller portion of their budgets on AFDC than in the past, contrary to conventional wisdom. In fiscal year 1993 (FY93), state-by-state percentages of general fund spending allocated to AFDC ranged from 2 percent to 4 percent of total general fund expenditures within New England. The comparable range in FY86 was 5 percent to 10 percent. AFDC shares have declined primarily because states have increased other outlays, notably for Medicaid, and not because they have sharply cut inflation-adjusted AFDC spending.

Caseload Trends: 1975 to 1991

Business cycles, demographic trends, and changes in welfare policy have influenced the region's AFDC caseloads (See chart, top p. 2).[1] From 1975 to 1979, AFDC rolls expanded largely because of the rising number of divorced women, as the U.S. divorce rate reached an all-time high in the late seventies. Between 1981 and 1982, despite the recession, caseloads dropped sharply because of legislation passed by the U.S. Congress. The Omnibus Budget Reconciliation Act of 1981 lowered the amount of income an AFDC recipient could earn while collecting welfare, thereby disqualifying many recipients and cutting the New England caseload by 14 percent. New England caseloads continued to decline gradually until 1988, in part because of the region's rapid economic growth. The region's economy began to contract the following year, bringing a sharp rise in AFDC caseloads that has continued into the 1990s.

Caseload Trends: 1992 to 1994

Despite the steady decline in the region's unemployment rate since mid-1992, most states' caseloads have continued to climb. Two years after the trough of the recession, caseloads have dwindled appreciably only in Massachusetts and Maine (See charts p. 3). AFDC

Fiscal Facts

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The views expressed in this publication do not necessarily reflect official positions of the Federal Reserve Bank of Boston or the Federal Reserve System. This publication is available without charge. We welcome your ideas and comments; contact Jeannette Hargroves at 617/973-3096. Send requests to be placed on our mailing list to Federal Reserve Bank of Boston, T-8, Attn: *Fiscal Facts*, P.O. Box 2076, Boston, MA 02106-2076.

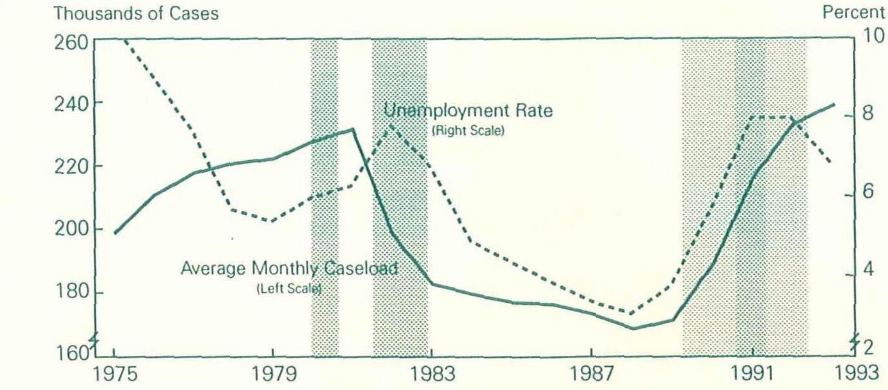
State Budget Timetable

Annual Budgets
Massachusetts
Rhode Island
Vermont
FY95: July 1, 1994 to June 30, 1995

Biennial Budgets
Connecticut
Maine
New Hampshire
FY94-95: July 1, 1993 to June 30, 1995

Business Cycles Influence AFDC Caseloads

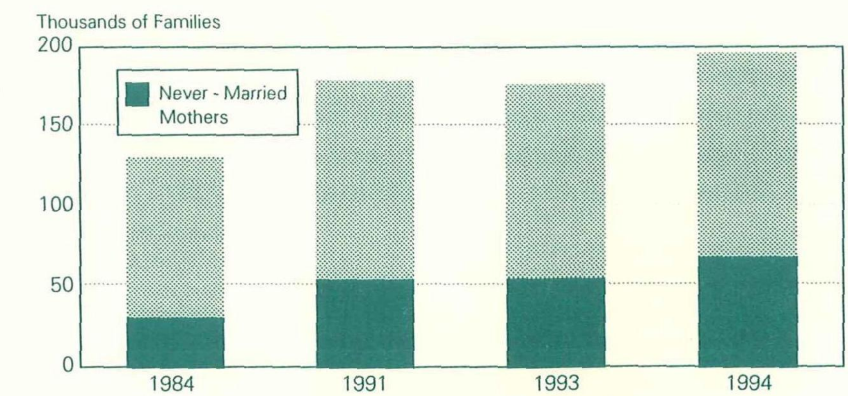
New England Caseloads and Unemployment Rate



Source: U.S. Department of Health and Human Services, Administration for Children and Families; U.S. Bureau of Labor Statistics.

The Number of Mothers Who Have Never Married is Growing Rapidly

Needy Families Headed by Women in New England



Source: U.S. Bureau of the Census, Current Population Survey, March 1984, March 1991, March 1993, and March 1994.

rolls in Vermont, Rhode Island, and New Hampshire did not start to level off until the third quarter of 1994. And in Connecticut, the number of AFDC families continued to grow slowly as of September 1994.

A secular decline in the demand for so-called "female" low-skill occupations may partially explain the persistence of high caseload levels, despite almost three years of increasing employment. Competition and the resulting pressure to reduce costs may have induced many businesses to become more capital intensive. Firms may have increased their reliance on computers, instruments, and other machinery to perform functions formerly carried out by salespersons, clerks, machine operators, and other administrative helpers. Women traditionally have filled a disproportionately large share of these increasingly obsolescent low-skilled positions.[2]

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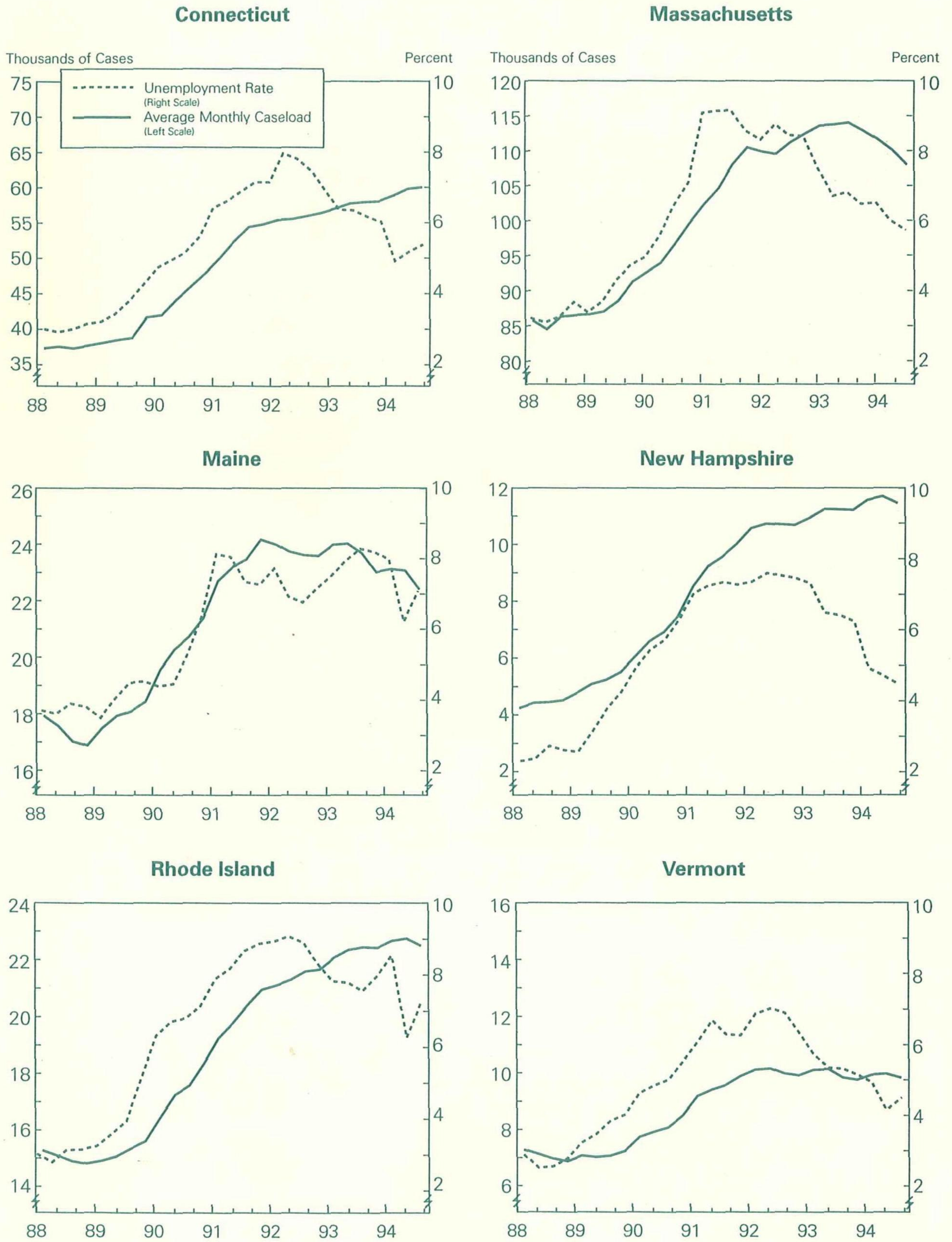
Since 1992 Caseloads Remain High

AFDC Caseload and Unemployment Rate



Source: U.S. Department of Health and Human Services, Administration for Children and Families, Boston Regional Office, September 1994; U.S. Bureau of Labor Statistics.

Across *the* Region

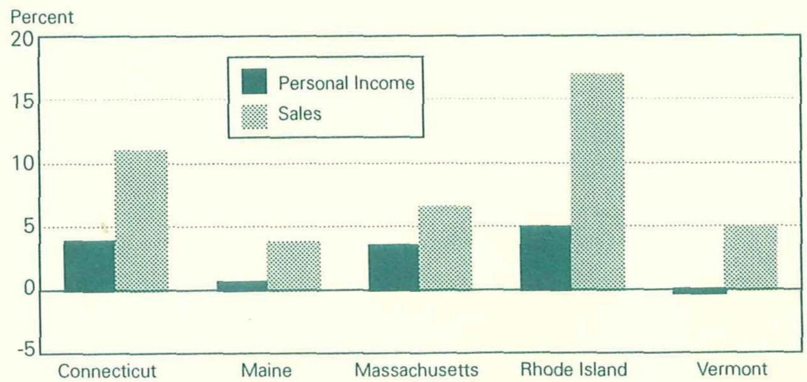
Legislative action slowed this fall as governors and lawmakers turned their attention to the elections. In January, however, legislators will have their hands full, as newly elected and second-term governors take up their tough and potentially contentious agendas. Connecticut's new Governor John Rowland has pledged to repeal the state's income tax over the next five years. Re-elected Governor Howard Dean will hand Vermont's lawmakers a tax reform bill in January and also will propose new health care reform legislation. Massachusetts' re-elected Governor William Weld has already resumed the debate over welfare reform.

Two newly elected Governors, Angus King of Maine and Lincoln Almond of Rhode Island, along with re-elected Governor Stephen Merrill of New Hampshire, could face budget deficits in this fiscal year or the next. Potential shortfalls in New Hampshire and Rhode Island are in large part due to shrinking federal Medicaid dollars.

While the region's governors tackle long-term issues, they can probably rely on modest revenue growth for the remainder of fiscal year 1995 (FY95). Most receipts for the first four months have met or exceeded their targets, with collections from consumption taxes and corporate excise taxes particularly strong. In the second half of this fiscal year, officials' primary concern will be income tax revenues, which show signs of lagging in Maine, Massachusetts, and particularly Vermont (See the chart below.)

Income Tax Revenues Show Signs of Lagging

Change in Personal Income and Sales Tax Revenues
July to October, FY94 to FY95



Note: Rhode Island's sales tax growth is distorted by a change in the tax law. Vermont's sales and income tax growth are official estimates that adjust for tax changes.
Source: Official budget documents, state financial statements, and conversations with state budget officials.

Six-State Review

Connecticut

Four months into FY95, Connecticut appeared to be in reasonably good financial shape. Total revenues were running 13 percent above year-ago levels, slightly ahead of projections. Year-to-date receipts from the three major state taxes contributed to the positive outlook: both the income tax, up nearly 4 percent from last year, and the sales tax, up over 10 percent from last year, were on target for the current fiscal year, and collections from the corporate income tax, up 15 percent from FY94, were running ahead of projections. With no major sources of revenue coming in below expectations, the Comptroller's Office is forecasting a small general fund surplus of less than 1 percent ($20 million) for FY95.

Connecticut's budget could look significantly different, however, if Governor Rowland is successful in carrying out his campaign pledge to phase out the state income tax over the next five years. The eventual repeal of the income tax would dramatically alter the revenue side of the state's budget, as the tax provides about one-fourth of all revenue. His first proposed reduction, a 1-percentage-point decrease in the tax rate effective January 1, 1995, would cost the state at least $200 million in FY95. While the governor has proposed some measures to make up for the loss in revenues, they fall well short of the full $200 million. Further compounding the situation for the current fiscal year is his support of arbitrated pay raises for state employees, which could add $100 million to the state's expenditures. Still another complication arises from a recent federal court ruling striking down the state's scheme for financing uncompensated care at private hospitals, which may jeopardize $150 million in federal Medicaid grants to the state. (See *Fiscal Facts*, Fall 1994.)

Like many other states, Connecticut has been active on the welfare reform front. However, in contrast to the restrictive nature of most reform proposals, Connecticut has implemented a program that extends the reach of public assistance, in order to keep families intact. "Family Strength," which began November 1, increases benefit eligibility for two-parent families and continues to provide child care and medical benefits after the household leaves the welfare rolls.

Maine

Maine's general fund collections for the first four months of FY95 lagged somewhat behind projections, leaving the state slightly in the red. Although sales tax collections were on target, income tax receipts were level with those of one year ago and have been below target since July. For the biennium that begins July 1, 1995, preliminary estimates suggest a $100 million to $300 million budget gap. The problem stems mainly from future costs of recently enacted legislation and the fact that one-time savings and revenue sources, used to close the FY94-95 budget gap, will not be available in the next biennium.

Maine officials remain opposed to large-scale gambling operations; however, they are keeping a close watch on related developments in the region and they are gearing up for an expected lawsuit by the Passamaquoddy tribe. Earlier this year, Maine's lawmakers rejected legislation to legalize an Indian casino in Calais. The tribe has since asked the state to negotiate a compact, but the state has taken no action to date. According to the Indian Gaming Regulatory Act, states have 180 days to negotiate after receiving such a request. Once that time has expired, tribes can take legal action.

Massachusetts

Massachusetts deposited its $60 million surplus for FY94 into the Commonwealth's Stabilization Fund, raising the Fund's balance to $360 million (2 percent of total FY95 appropriations). Massachusetts' revenues for the first four months of FY95 were close to 5 percent above their year-ago level, at the mid-point of the state's recently revised predicted range. (In late summer, officials revised revenue estimates downward slightly, after somewhat disappointing tax collections in previous months.) Receipts from the sales tax and corporate excise tax have been particularly strong, growing by almost 7 percent and 28 percent, respectively, compared to year-ago levels. The collections from income taxes, however, lagged behind their first quarter benchmark and showed a modest gain of only 3.5 percent over their year-ago level.

Governor Weld and the state legislature have yet to resolve their conflict over a welfare reform proposal embedded in the FY95 budget. The governor signed the FY95 budget in late June, but vetoed the welfare reform component. The House overrode the governor's veto, and the Senate has threatened to do likewise. In early December, the governor and two members of the Senate filed a compromise welfare reform bill requiring recipients under 25 years of age to work 25 hours a week, but the bill allows half of that population to spend 15 of the 25 hours in education or training. (The governor's original proposal required a minimum of 25 hours per week of work for all 50,000 "able-bodied" welfare recipients.) The debate is far from settled and will likely continue well into the 1995 legislative session.

Massachusetts voters turned down several tax-related referenda on the November ballot. One, proposing a graduated income tax, was defeated by a wide margin.

New Hampshire

At first glance, New Hampshire's fiscal condition for the first four months of FY95 looks strong. Total revenues were up 4 percent from last year and running close to 6 percent above original estimates. Receipts from the meals and rooms tax, the state's largest revenue source, were 10 percent higher than expected; the business profits tax, despite a rate reduction from 7.5 percent to 7 percent in July, outpaced both FY94's year-to-date collections and this year's projected revenues. The overall strength of the New Hampshire economy was further underscored by Governor Stephen Merrill's announcement that the state's unemployment insurance tax will be cut next quarter, reducing the average firm's liability by 25 percent.

Yet even with the strong performance of these major revenue sources, New Hampshire faces the prospect of a deficit in FY95 because of a loss in Medicaid funding. Over the past several years, New Hampshire has taken advantage of federal Medicaid regulations that, in effect, have permitted states to channel federal Medicaid dollars into their general funds. (See *Fiscal Facts*, Fall 1994 and Winter 1994.) Recently, the federal government severely curtailed this fiscal option, a policy change that New Hampshire did not anticipate when it passed its FY94-95 budget in the spring of 1993. The resulting revenue loss for FY95 has been estimated at $20 million to $24 million, just under 3 percent of total general fund appropriations.

Faced with this loss of funds and higher than anticipated spending, the state's budget director has forecast a FY95 budget deficit of $45 million. To redress this imbalance, Governor Merrill has asked for $24 million in spending cuts. He believes that improvement in the economy will alleviate the need for further belt-tightening for FY95. Anticipating much larger losses in Medicaid funding during the FY96-97 biennium due to further tightening of federal rules (as large as $100 million in FY96 alone), he has ordered all departments to cut their spending requests for FY96 and FY97 by 8 percent and 6 percent, respectively.

Rhode Island

Rhode Island's revenues for the first four months of FY95 ran slightly ahead of expectations. However, officials expect a $15 million to $30 million deficit in the current fiscal year, due mostly to higher-than-anticipated outlays. Spending was 1 percent over budget at the end of October, with health and welfare expenditures accounting for nearly half of the cost overruns. Also contributing to the shortfall is Governor Bruce Sundlun's decision not to proceed with his highly controversial plan to refinance the state's pension fund debt, which would have raised $15 million for education.

The prospects for FY96 are even grimmer. Tightening of federal regulations that provided Rhode Island with tens of millions of federal dollars for hospital care for the indigent, and the expiration next year of the two-year-old nursing home tax and the one-year-old licensing fee will translate into a $42 million revenue loss. At the same time, the state will face a potential $44 million increase in spending in order to keep state operations functioning at current service levels.

In November, Rhode Island residents voted to put the brake on new gambling developments in their state. Voters soundly rejected proposals for casinos in five communities and approved a constitutional amendment requiring both local and statewide referenda for any new or expanded gambling facilities in Rhode Island. Nevertheless, the state's battle with the Narragansett Tribe over a casino planned for their Charlestown reservation wages on. In late summer, the Narragansetts signed a compact with Governor Sundlun allowing them to build a casino either in West Greenwich, if approved by voters, or on their reservation in Charlestown. But Governor Almond has pledged to pursue every avenue to block or limit an Indian casino in Rhode Island. Attorney General Jeffrey Pine has already filed a lawsuit in Superior Court alleging that Governor Sundlun exceeded his constitutional authority in signing a compact with the Narragansetts. He contends that the compact illegally changes or ignores state laws and that the governor appropriated powers reserved for the General Assembly. The lawsuit asks that the court release the state from the agreement unless and until it is authorized by the General Assembly.

Vermont

Vermont began its new fiscal year in the black for the first time in four years. Receipts from most revenue sources in the first four months of FY95 confirmed the state's stable fiscal position, with collections from consumption taxes and corporate taxes particularly strong. Transportation fund revenues were up almost 9 percent over year-ago levels, 13 percent ahead of projections. Lagging income tax revenues, however, have raised official concerns about the adequacy of total revenues for the remainder of the fiscal year. Income tax collections, after adjustment for changes in tax policy, fell slightly below the anticipated target of 1 to 2 percent growth.

In early January, Governor Howard Dean will hand lawmakers a plan designed to reduce average income and property tax burdens and relieve budgetary stress on Vermont's most fiscally strapped cities and towns. The plan would, among other things, reduce the personal income tax rate from 25 percent to 24 percent of federal tax liability; it would also increase the income tax credit by $100 for low-income residents, providing further tax relief to the state's poorest 23,000 households. The plan would retain the current 5 percent sales tax, scheduled to drop by 1 percentage point in FY96, and dedicate 20 percent of the tax's revenues to state aid to education. The property tax rebate program would continue and growth in annual education spending in most towns would be capped at 3 percent (4 percent to 6 percent in those towns where current spending is low), thereby reducing instances of large increases in property taxation. The governor's plan would also modify the education aid formula in favor of communities whose residents earn relatively low incomes.

In addition to tax reform, the governor will ask lawmakers to resume discussions on health care reform, treating it as a multi-year, incremental process. This year, he will focus on extending coverage to uninsured children and to some workers who do not have benefits through employment, as well as expanding pharmacy benefits to some low-income elderly residents.

Continued from p. 2

The rising population of never-married mothers could also be contributing to the region's stubbornly high AFDC caseload. Between 1984 and 1994, poor families headed by never-married mothers rose from one-third to over one-half of all poor families headed by women (See second chart on p. 2). A mother who has never married is more likely to collect AFDC than a divorced woman, since she is less likely to receive support from her child's father, and generally being young, she is not apt to have work experience. A national study reported that one-half of all mothers under age 20 who had never married received AFDC benefits within 12 months of giving birth and three-quarters received AFDC sometime during their first five years of motherhood.[3]

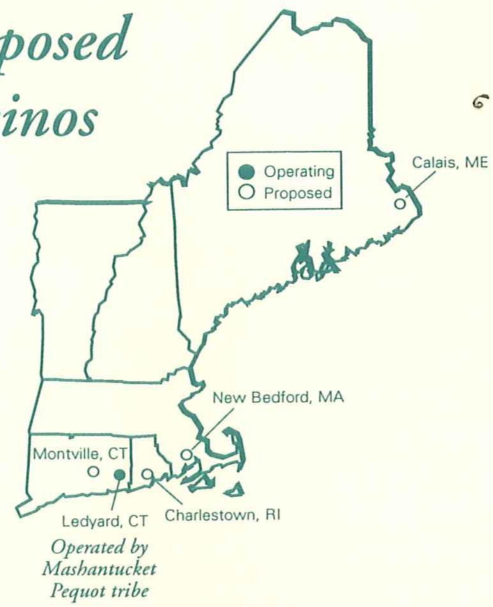
Over time, New England's improved economy may help some AFDC recipients, but not all. Given the restructuring in labor markets and the rising incidence of mothers who have never married, AFDC caseloads and costs are likely to remain high in the foreseeable future.

[1] The analytical framework for this report relies heavily on a study by the Congressional Budget Office, *Forecasting AFDC Caseloads, with an Emphasis on Economic Factors.* Washington: Government Printing Office, 1993.

[2] Evidence of the shrinking opportunities within New England for individuals in these occupations can be found in Katharine Bradbury, "New England Job Changes during the Recession: The Role of Self-Employment," *New England Economic Review*, September/October 1994, Table 3, p. 50. Further indirect evidence can be gleaned from recent trends in employment in wholesale and retail trade, a large sector of the economy that historically relied heavily on women in these occupations. In 1993, even though New England was well into a recovery, employment in wholesale and retail trade was still 11 percent below its level in 1989, its most recent peak.

[3] Congressional Budget Office. *Sources of Support for Adolescent Mothers.* Washington: Government Printing Office, 1990, pp. 53-56.

Note on:
Proposed Casinos



Connecticut:

Mohegan tribe, Montville
State and federal approvals have been granted; the casino could be operational by the fall of 1995.

Rhode Island:

Narragansett tribe, Charlestown
Governor Almond has pledged to block or limit the casino, although the U.S. Supreme Court has ruled that the tribe may build a casino on its reservation. (See page 7.)

Massachusetts:

Wampanoag tribe, New Bedford
Governor Weld has signed a "memorandum of understanding" and plans to approve a formal compact in 1995.

Maine:

Passamaquoddy tribe, Calais
In 1994 legislators defeated a bill proposing a casino; however, the tribe plans to challenge the state's decision. (See page 5.)

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