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REDESIGNING THE TANF CONTINGENCY FUND TO MAKE IT MORE EFFECTIVE

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Overview

When Congress created the TANF block grant in 1996, it created the TANF Contingency Fund for states to draw upon during periods of economic distress. This fund was intended to address some of the risks and hardships states would face as a result of the conversion of the former Aid to Families with Dependent Children program — an entitlement whose funding rose automatically in recessions — to a block grant with a fixed federal funding level. The Contingency Fund has since been depleted, and the President's budget proposal for fiscal year 2012 includes $612 million in new funding. Replenishing the fund would provide much-needed assistance to states as they respond to the heightened demand for assistance that results from the continued weak economy, but the additional resources could be used more effectively if the Contingency Fund were redesigned.

Over one-third of the states relied on the Contingency Fund during the current economic downturn. A handful of states began drawing on it in 2008, and 21 states and the District of Columbia used it for one or more years in 2009, 2010, or 2011. The original $2 billion that Congress allocated to the fund in 1996 was used up by December 2009. Congress added (and then partially pulled back and redirected) funding for fiscal year 2011; the additional $334 million in funds available for this year were depleted by December 2010.

Recognizing the severity of the recent recession, Congress included a new $5 billion Emergency Contingency Fund (often referred to as the TANF Emergency Fund) for 2009 and 2010, as part of the 2009 Recovery Act; this fund expired on September 30, 2010. Every state except Wyoming drew on the Emergency Fund to cover increased state costs of providing basic assistance, subsidized employment, and non-recurrent short-term benefits during the severe economic downturn, eventually spending the full $5 billion appropriation.

With the expiration of the Emergency Fund in September 2010 and the subsequent depletion of the Contingency Fund by December, *no* additional resources to states are available from the federal government for the first time since TANF's creation in 1996 despite today's hard economic times. The continuing need for a Contingency Fund is evident: unemployment remains at about 9 percent and is expected to remain above 8 percent for the foreseeable future. Not surprisingly, TANF caseloads are higher than at the start of the recession, and while they have started to decline in some states, they are continuing to remain high in others. We know from previous recessions that poverty remains at high levels for a considerable period of time after the economy begins to recover. In addition, states are facing significant budget shortfalls that are likely to continue for several more years.

The recent recession exposed flaws in the design of the Contingency Fund, which is unnecessarily complicated and poorly targeted to achieve its purpose. A redesigned fund could better fulfill the intended goal of temporarily providing states with extra federal help to meet increased need in hard economic times.

We recommend redesigning and simplifying the fund, drawing on the lessons and state experiences under both the Contingency Fund and the Emergency Fund. To avoid some of the confusion that resulted from two similarly-named funds, we suggest renaming the redesigned fund. In this memo, we call it the "Needy States Fund"; other names could also be considered. The key goals of a redesign are to make the fund more accessible to states and to ensure that states use the funds to provide additional assistance or services to help families meet their needs in tough economic times, either through subsidized jobs or cash benefits to families.

Our recommended design has the following features:

- **A simpler, updated economic hardship trigger to qualify a state for funds.** We propose replacing the current triggers with a simple measure: an unemployment rate at or above 6.5 percent. The current triggers are increased SNAP (food stamp) caseload relative to the mid-1990s or increased unemployment relative to recent prior years; the former is outdated and the latter could penalize a state that experiences a prolonged period of high (but not increasing) unemployment. We also propose allowing a state that hits the trigger to receive extra funds for that calendar quarter and three additional quarters, which would allow states to maximize their use of the additional funds without worrying about whether they will lose their eligibility in the next month or two.

- **More narrowly targeted funding.** Building on the Emergency Fund's targeting provisions, we propose limiting the use of extra funds to two or three categories: (1) subsidized employment, (2) basic assistance, and perhaps also including (3) emergency aid to meet basic needs. Currently, states can use Contingency Funds for any TANF purpose, many of which have no direct relationship to helping families meet needs in hard economic times.

- **Requirement that a state increase its help to needy families.** We recommend basing the amount of extra help for which a state is eligible on the amount by which it has increased its spending above a base year in the targeted categories. This is similar to the approach used for the TANF Emergency Fund. It ensures that a state receives additional funds only for *increased* expenditures and cannot simply use the funds to replace existing expenditures. The Contingency Fund's maintenance-of-effort (MOE) provisions are complex and can hinder otherwise-eligible states from accessing the fund. Moreover, they do not require a state to actually increase spending to help families meet needs in hard economic times.

Current Contingency Fund Design Limits Fund's Effectiveness

Under current law, a state can access the TANF Contingency Fund if it meets a monthly economic hardship (or "needy state") trigger *and* an annual Contingency Fund 100 percent maintenance-of-effort requirement, both of which are described below. A state that qualifies for an entire year can receive an amount equal to up to 20 percent of its annual block grant. Once a state receives Contingency Funds, it can spend them for any TANF purpose but must spend the funds during the fiscal year for which they are awarded.

Understanding the Contingency Fund's performance during this recession provides important guidance on why and how the fund should be redesigned.

Economic Hardship Triggers Should Be Updated and Simplified

The 1996 law defined a "needy state" as one whose increased food stamp caseloads (relative to 1994-1995 levels) or high unemployment triggered eligibility for the Contingency Fund.[1] The "needy state" triggers are out of date, unnecessarily complicated, and somewhat arbitrary. The SNAP caseload increase as compared to a state's caseload level over 15 years ago may no longer be a reasonable measure of state economic hardship. Over the years, more and more states have met the trigger based on SNAP caseload increases, although until recently these increases reflected changes in the SNAP program and procedures more than a state's economic conditions. (In the last few years, state SNAP increases have reflected economic circumstances.)

During this recent recession, more states also have met the trigger based on the state's unemployment rates. However, the design of the high unemployment trigger is problematic. Because the unemployment rate must continue to be higher than in the prior two years, a state with a prolonged period of high but steady unemployment could stop meeting the trigger. In the next few months, some states would no longer meet this trigger and might not meet it again for many years. For example, to meet the trigger in June 2011, California would need a 12.4 percent unemployment rate, an *increase* of four-tenths of a percentage point from its 12.0 percent rate in March 2011.

Under current law, a state can qualify for Contingency Funds in the month that it meets the "needy state" trigger and the subsequent month.[2] In some cases, once a state meets the trigger, it is likely to continue to meet it for many months to come, due either to unemployment levels or SNAP caseload. In other cases, a state's status could fluctuate from month to month. States cannot necessarily rely on their continued eligibility over a period of time, making it difficult for them to plan.

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[1] Specifically, to qualify for contingency funds, states must meet one of the following eligibility triggers for at least one month: an unemployment rate for a 3-month period that is at least 6.5 percent and at least 110 percent of the rate for the corresponding 3-month period in either of the two preceding calendar years, or a Food Stamp caseload that is 10 percent over the FY 1994-1995 level, adjusted for the impact of the 1996 welfare bill's immigrant and Food Stamp provisions on the Food Stamp caseload. (The unemployment trigger is based on one of the triggers for Extended Benefits under the unemployment insurance program.)

[2] A state may receive a provisional allocation of up to 1/12 of 20 percent of its annual block grant for each month that it qualifies as an "eligible state." A state that meets the triggers in just one month would be considered an "eligible state" for two months, and can receive up to 1/6 of 20 percent, or 3.3 percent of its block grant.

MOE Requirement and Reconciliation Limit Access to Fund

Even when all states met the "needy state" economic hardship trigger, fewer than half drew on the Contingency Fund. This is because states must also meet special Contingency Fund maintenance-of-effort and reconciliation requirements, which are complicated and daunting.

First, states need to meet a special 100 percent MOE standard for the Contingency Fund; this requires a higher level of state spending than the regular TANF MOE requirement, which is 75 or 80 percent of historic spending (depending on whether a state is meeting its Work Participation Rate target for the year). Moreover, the Contingency Fund MOE test uses a somewhat different measurement of state spending than the regular TANF MOE requirement; some spending that counts for TANF purposes — notably child care — does not counting for Contingency Fund purposes. (See Appendix I for details.)

A state must not only meet the 100 percent MOE standard but *exceed* it sufficiently to match the Contingency Funds received, or the state may need to repay some of the funds. (See Appendix I for details of this reconciliation calculation.) When queried on why they were not accessing the Contingency Fund, a number of states indicated an inability or unwillingness to take funding that they might need to repay. The complexity, risk, and arbitrariness of these requirements have resulted in uneven access to the fund.

Moreover, while it is reasonable to require states that receive extra federal funding to maintain at least their past level of effort, the current formula does not actually require states to spend at least the same amount of money. Instead, a state can be more aggressive about identifying funding that can count toward the MOE requirement — whether state or local government spending or spending made by nongovernmental organizations — while actually *reducing* state spending in programs that provide benefits and services to needy families. For example, Washington State recently worked with consultants to identify third-party spending in local communities and other spending that significantly exceeded the 100 percent MOE standard for the state in 2009. Knowing that it could identify significant MOE resources outside of its TANF program, the state later adopted cuts that reduced TANF benefits and terminated thousands of families from TANF in the same year in which it received Contingency Funds.[3]

Thus, the states that qualify for Contingency Funds are likely to be those that have been more resourceful at navigating the funding requirements rather than those that have invested resources in maintaining or increasing benefits and services to needy families during the economic downturn. A redesign could address this by including a more reasonable and meaningful measure of state contributions.

States Can Use Contingency Funds for Fiscal Relief Rather Than to Meet Increased Need

At the same time that the Contingency Fund's design limits "needy states" from accessing the fund, it also fails to ensure that the states that receive funds use them to maintain or increase services to meet increased need in hard economic times. Once a state qualifies for Contingency

[3] Washington State received Contingency Funds for FY 2008, 2009, and 2011. In 2011, it instituted significant TANF cuts, including a 15 percent benefit reduction and time limit policy changes that terminated about 10 percent of the state's TANF caseload.

Funds under the "needy state" trigger and MOE requirements, it can use the funds for any TANF purpose, as long as it spends them in the fiscal year for which they are awarded. The funds can help states meet increased TANF program costs in response to increased need, but states can also use them for existing (or even reduced) TANF program costs. States also may withdraw an equivalent amount of funds from the TANF program to pay for eligible activities elsewhere in their budgets. (And as discussed above, a state can meet the 100 percent MOE requirement by becoming more aggressive in identifying other existing state or third-party spending that it can count toward the MOE.)

Thus, a state can receive Contingency Funds and actually *cut* benefits or eligibility at the same time, as Arizona did for each of the last three years and Washington State did this year.[4] A state could also qualify to receive Contingency Funds and use the extra money to build up TANF reserves for future years rather than to increase services in the current year. While a state must spend Contingency Funds in the year it receives them, a state could simply spend the Contingency Fund money first (instead of TANF block grant funds) and carry over an equivalent amount of block grant funds to future years.

The bottom line is that the original goal of the Contingency Fund is not being carried out. A redesign could address this deficiency by targeting the extra federal funds more narrowly and appropriately to the areas of TANF spending that directly address increased need or higher unemployment during recessions.

Recovery Act's TANF Emergency Fund Provides Lessons for Redesign

The 2009 Recovery Act created a temporary $5 billion TANF Emergency Fund for states in fiscal years 2009 and 2010. Its purpose was to provide benefits, emergency help, or subsidized jobs to families during the recession. Every state except Wyoming received these funds and used them to provide emergency relief, such as payments to avert utility shutoffs, and/or to place low-income adults and youth in subsidized jobs. Nationally, more than 250,000 people were placed in such jobs.

A state could receive TANF Emergency Funds for 80 percent of its increased TANF and MOE spending in three categories: basic assistance (provided a state's caseload had increased), subsidized employment, and non-recurrent, short-term benefits (such as emergency payments to avoid eviction and homelessness). The increased spending in each of these three categories was measured relative to a base year (either 2007 or 2008). The maximum amount that any state could receive in Emergency Funds over the two-year period was 50 percent of one year's TANF block grant amount for the state. (The 50 percent cap applied to the combined amount a state received under the Emergency Fund and the regular TANF Contingency Fund.)

Technically, there was a difference between how a state could *qualify* for Emergency Funds and how a state could *use* the money once it received it. To qualify for funding, a state needed to

[4] Arizona received Contingency Funds for FY 2008 through 2011 and has made a series of TANF cuts over the last several years. In 2009, Arizona cut benefit levels. In 2010, the state made a number of changes to time limits and other policies that resulted in a 44 percent reduction in caseload in the first nine months of implementation. In 2011, Arizona instituted further time limit changes expected to terminate another 3,500 families, or about 20 percent of the remaining caseload. See the previous footnote for details on cuts in Washington State.

increase its spending in at least one of three Emergency Fund categories (relative to its spending for the category in the base year). The state could receive 80 percent of the increase, up to the cap on the amount of Emergency Fund money the state could get. Once a state qualified for the money, it could use it in any way permissible under TANF (except transfers to SSBG or CCDBG). In practice, most states used the funds in the ways the Recovery Act had contemplated.

The design of the Emergency Fund targeted the additional federal resources toward direct help to families, whether in the form of regular cash assistance, emergency assistance, or a wage-paying subsidized job. States could only qualify for funding based on increased spending in one of those categories. Consequently, they expanded their efforts to address the increased needs of unemployed families. Many of these efforts served a broader group of low-income families and were not limited to families that received cash assistance.

State Initiatives Under the TANF Emergency Fund

Design differences between the Contingency Fund and the Emergency Fund prompted states to take very different approaches in using Emergency Fund money. An examination of state initiatives under the Emergency Fund provides useful guidance for a Contingency Fund redesign. For example:

- **Subsidized employment:** Some 39 states and the District of Columbia received $1.3 billion of the TANF Emergency Fund to place about 260,000 low-income individuals in subsidized jobs. Most of these state subsidized employment programs did not start until late in calendar year 2009 or early 2010, so these impressive results were achieved in less than two years. The placements were split almost equally between year-round programs that served mostly adults and summer and year-round programs that served youth (up to age 24). California, Illinois, Pennsylvania, and Texas each placed more than 20,000 individuals in subsidized jobs. Illinois operated the largest year-round program, placing almost 30,000 adults in subsidized jobs in less than six months. California and Texas operated the largest summer youth programs, placing about 27,000 and 22,000 youth in jobs, respectively. Pennsylvania's placements were almost equally split between adults (14,000) and youth (13,000).[5]

- **Non-recurrent, short-term benefits:** Over 40 states received funding based on increased spending for emergency assistance. The extra federal dollars available under the TANF Emergency Fund spurred at least 20 of these states to create new initiatives to help families facing hard times (these initiatives generally ended when the funding expired). In all, states received over $2 billion in Emergency Fund reimbursements for increased spending on short-term, non-recurrent initiatives. Some of the new or expanded initiatives helped families with housing and utility expenses. For example, Georgia (in collaboration with the United Way and other local partner agencies) created a highly successful program that helped 23,000 families catch up on past-due housing-related debts, including rent, mortgage, and utility bills. Maine (in collaboration with three utility companies) created a program to pay off utility arrearages,

[5] For additional detail, see LaDonna Pavetti *et al.*, "Creating Subsidized Employment Opportunities for Low-Income Parents: The Legacy of the TANF Emergency Fund," CBPP and CLASP, February 16, 2011, http://www.cbpp.org/files/2-16-11tanf.pdf.

preventing shut-offs to about 7,000 low-income families. A number of states, including Texas and Oklahoma, also used TANF Emergency Funds to provide food to needy families.

- **Basic assistance:** All but a handful of states received Emergency Funds for increased spending on TANF basic assistance. While TANF caseloads were much less responsive to the recession than those in SNAP (food stamps), they increased modestly in many states and significantly in a few. Importantly, the fact that states were getting additional federal help for increased basic assistance costs helped protect these benefits from widespread and deep cutbacks in most states. A few states cut cash assistance benefits or eligibility during 2009 or 2010, but such moves generally brought little in state savings (since they resulted in smaller Emergency Fund grants). Once the Emergency Fund expired, however, TANF basic assistance benefits became particularly vulnerable to cuts. Since the fund expired at the end of September, 2010, at least four states — Delaware, New Mexico, South Carolina, and Washington — plus the District of Columbia have cut TANF benefit levels. In addition, California has enacted reductions that will take effect in July. TANF *eligibility* changes also have been adopted in a number of states. Taken together, these changes will result in termination or reduction of benefits for hundreds of thousands of poor families. These cuts in benefits are occurring at a time when more families are in need and the depth of need is greater than it has been in the past.

Design of TANF Emergency Fund Directly Shaped State Initiatives

In creating the TANF Emergency Fund, Congress deliberately sought to boost job creation and assist needy families. The results demonstrate that the fund succeeded. This success contrasts with states' use of Contingency Fund dollars, which had no requirement that states actually use the extra help to support needy families or create jobs. Despite some complexities and barriers in the Emergency Fund design, its success demonstrates the role that Congress can play in shaping additional assistance to states during hard times.

The Emergency Fund was targeted, and it required increased state effort. The targeting was achieved by limiting spending that would qualify a state to receive funds to three categories — subsidized jobs, basic assistance, and short-term, non-recurrent assistance. To show their increased efforts, states were required to boost TANF and MOE spending *within the category*, and the amount of their federal assistance was based on that increase. The success of the Emergency Fund is directly tied to these requirements. Without them, the additional federal help would have helped fill state budget holes but would not necessarily have translated into jobs or help for needy families and communities.

The Emergency Fund also limited reimbursement to 80 percent (rather than 100 percent) of increased spending in a category. This provision proved to be an obstacle to many states. In times of tight budgets, many states were unable to start or continue initiatives that required increased state expenditures. When states understood the extent to which they could use third-party funds to help cover the remaining 20 percent, many of them launched new initiatives and subsidized employment programs, and many indicated they could have done much more with more time. Ultimately, the 80 percent provision did not further the targeted, increased effort. Instead, it added complexity and delay, somewhat limiting access to the funds.

The Emergency Fund also ended too soon. While the recession was technically over when the fund ended on September 30, 2010, unemployment remained very high and demand for continued job assistance and emergency help remained strong. Historically, declines in unemployment rates and TANF caseloads have lagged behind a recovery. Consequently, the additional federal funding should have been extended. Moreover, for subsidized employment in particular, both states and employers need some assurance that additional funds will be available for a sufficient period before they will commit to establishing a program. Under the Emergency Fund, some states were hesitant to start new initiatives in 2010 when they were not sure if the fund would be extended, and ultimately it was not. States would have benefitted from more time and greater certainty that the money would be available for a somewhat longer period of time.

Proposed Redesign of a "Needy States" Fund

An examination of states' experiences under both the regular TANF Contingency Fund and the Recovery Act's Emergency Fund reveals some important lessons for shaping a redesigned fund for hard economic times.

- **Simplicity and certainty where possible:** Many aspects of the current Contingency Fund are unduly complicated and prevent states from accessing the fund even in hard times. While some complexity may be inevitable, design improvements can make this work better.

- **Targeting increased federal help to specific types of spending:** The TANF Emergency Fund's success in creating 260,000 subsidized jobs demonstrates that explicit conditions for additional federal help directly shape states' spending decisions. Given the broad and diffuse permissible uses of TANF funds, Congress should prescribe that this money be used to provide jobs or financial help to families to meet their basic expenses during an economic downturn rather than to plug state budget holes.

- **Meaningful and workable MOE requirements:** The 100 percent Contingency Fund MOE and reconciliation/repayment requirements are arbitrary. They exclude some otherwise-eligible states from seeking the funds while enabling other states to receive the money simply because they do a better job of identifying funding elsewhere to count toward the MOE requirement. A meaningful approach should require increased or maintained state expenditures in the specific target categories.

Based on these concepts, we propose a redesigned (and renamed) Needy States Fund. As described more fully below, the additional federal funding would be targeted and could only be used for specific categories of expenditure. To ensure that states do not simply supplant their prior spending in these areas with the additional federal funds, states could receive Needy State Funds only to the extent that their expenditures in a target category exceed their prior expenditures in that category.

While states would have a great deal of flexibility on how to spend their TANF and MOE funds, a state that seeks additional federal funding in times of economic hardship would have to comply with greater federal directives on the use of the additional funds. The money should be used to respond to increased needs in the weak economy, not to fill holes in the state budget.

Change Definition of Economic Hardship Trigger

A simple, single factor should be used to define a "needy state," rather than the complicated criteria of SNAP caseload growth or increased unemployment. We suggest a trigger based only on unemployment rates or some other measure of high unemployment. An alternate could be the percentage of the working-age population that is not employed (that is, the inverse of the employment-to-population ratio). We recommend looking at a single measure for a period of time such as a calendar quarter, rather than a measure that compares data in one period to data in a recent comparative period; this would avoid the problem that can arise under the current trigger when a state stops meeting the trigger because its unemployment rate, while quite high, is no longer increasing. We suggest that a state unemployment rate of 6.5 percent be the trigger and thus "needy state" status would be triggered when the average unemployment rate for a quarter exceeds 6.5 percent.[6]

All states *currently* meet the "needy state" trigger and did so for each month in fiscal year 2010. If the trigger were changed to a simple 6.5 percent (seasonally adjusted) unemployment rate, 40 states and the District of Columbia — rather than all — would have met that trigger based on the average monthly unemployment rate for the first quarter of 2011. This change in the trigger would ensure that the funds are targeted to states with high unemployment.

We also recommend lengthening the period for which a state that meets the trigger is considered eligible for additional federal funds. "Needy state" should be defined to include the quarter in which a state meets the trigger plus the three subsequent quarters. In other words, once a state no longer meets the trigger (that is, the unemployment rate has dropped below the trigger levels), the state would still be a "needy state" for the next three quarters. In this way, a state will know that it will continue to qualify for at least three additional quarters and can safely undertake an initiative such as launching or expanding a subsidized jobs program. To the extent that a state is hovering just above or below the unemployment trigger, this would enable the state to rely on an ongoing period of eligibility until it is consistently below the unemployment trigger. This approach, which recognizes that improvements in poverty rates and TANF caseloads typically lag well behind the economy as a whole, would provide stability for state budget and program planning.

Target Spending to Areas Related to Supporting Needy Families in Hard Times

We recommend building on the approach of the TANF Emergency Fund which targeted funding to specific purposes. The first priority for such targeted funding should be to provide families with basic income support — either connecting them to a subsidized job or providing cash assistance to help them meet basic needs if they are unemployed. These two categories from the TANF Emergency Fund were central to helping states meet the needs of families during the recession. By providing subsidized jobs, states were able to provide work opportunities to low-income individuals who would otherwise have been unemployed. However, states did not have sufficient funding to provide subsidized jobs to all families in need. By allowing states to use these funds to provide both subsidized jobs and cash grants, states will be able to maintain a focus on work while containing program costs.

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[6] Alternately, the trigger could be met for a quarter once when the average unemployment rate for a three-month period (which includes a month in the quarter) exceeds 6.5 percent. This approach would address possible disparities of meeting the trigger depending upon when high unemployment months fell with respect to calendar quarters.

Depending on the amount of funding available, we suggest considering a third category that would be a modified version of the Emergency Fund's category of short-term, non-recurrent benefits category. If this third category is included, we suggest narrowing it to emergency aid to meet basic needs. Some of the services and benefits that were included in the short-term nonrecurrent benefit category, while worthy services and benefits, did not fall within a more narrow definition of emergency aid for basic needs. Given the limited funding that is likely to be available to states, we suggest either omitting this third category altogether or more narrowly focusing the aid on meeting families basic needs by helping to avert or address homelessness, address utility shut-offs, or providing emergency food aid.[7]

State Obligation to Maintain or Increase Effort

A central question is how to ensure that the additional federal help is conditioned on states' maintaining or increasing their expenditures in the targeted expenditure categories. What obligations should a state have to participate in the cost of any increase in expenditures? And how can states be prevented from "supplanting"— spending the Needy State Funds in the targeted category while withdrawing an equivalent amount of other federal TANF or state MOE funds to use elsewhere?

The Contingency Fund and the Emergency Fund both had mechanisms to address these issues. But the 100 percent MOE Contingency Fund requirement and the related reconciliation and repayment provisions have been neither reasonable nor effective in preventing states from supplanting. The Emergency Fund measure of increased funding relative to a base period had some complexity, but much of that was due to third-party MOE funds, which were not counted as part of state expenditures in the base period. This factor was added largely because only 80 percent of increased spending was reimbursed, and many cash-strapped states needed to find an outside source for the other 20 percent.

Recent experience suggests that states are not in a position to step up their TANF spending in hard economic times. Still, at a minimum, a state should not be able to accept additional federal funding and then remove or supplant prior TANF or MOE spending. Federal funds should be conditioned on some maintenance-of-effort and/or non-supplantation provisions. This approach will necessarily involve some complexity in identifying comparison periods and relevant adjustments. Any non-supplantation measure should seek specifically to maintain spending *within the targeted categories*, as opposed to overall TANF or MOE spending. We have learned that states can appear to be maintaining and even increasing overall spending levels when they really are simply counting other state or third-party spending more aggressively than in the past — and may actually be withdrawing funds from core TANF-related programs.

[7] Many of the short-term nonrecurrent state initiatives under the TANF Emergency Fund involved partnerships with third-party non-governmental organizations and these were among the most complicated aspects of the TANF Emergency Fund. As outlined in the next section, our recommended approach does not count third-party spending toward non-supplantation or maintenance-of-effort requirements. Under the TANF Emergency Fund, at least two states claimed increased third-party spending for short-term nonrecurrent benefits that would have occurred anyway and then retained all or part of the Emergency Funds received as reimbursement for state fiscal relief and without re-investing these funds in any increased services. This is another reason for restricting third-party MOE in the redesigned fund.

Under our proposal, which differs from prior approaches, *each state could receive Needy State Funds to spend in the targeted categories to the extent that its TANF or MOE spending in the category exceeded its spending in that category in the base period* (up to the state's annual maximum amount of Needy State funding). This is similar to the Emergency Fund approach, except that it provides 100 percent federal matching funding and dispenses with the 20 percent state matching requirement. At the same time, our proposal restricts states' ability to claim third-party spending as MOE, which is how many states responded to the match requirement under the Emergency Fund. In other words, we drop one requirement that, in many cases, was met simply through more aggressive accounting practices and another that, in some cases, prevented a state from receiving funds that it could have put to good use.

In measuring increased TANF and MOE expenditures under our proposal, states would count expenditures of federal funds from the TANF block grant, TANF supplemental grants, or the Needy States Fund.[8] For this measure, MOE expenditures would include state or local government expenditures but would not include third-party expenditures by non-governmental organizations. We suggest excluding non-governmental expenditures because of the complexity they add and because counting them can lead to significant withdrawal of state effort. We suggest that a state be able to qualify for Needy State Funds for a targeted expenditure category based on increased spending in that category. Thus, as with the Emergency Fund, a state could have increased spending in one category (for example, subsidized employment) and receive additional federal funds for those increased expenditures. A state could qualify in either or all of the categories. Other technical issues, which we address in Appendix II, include defining the base period that would be used in the spending comparison and any adjustments that might be needed for individual states.

For any given year, the amount of Needy State Funds that a state could receive should not exceed 20 percent of its TANF block grant allocation for that year plus any TANF supplemental grant amounts. This annual allocation should be disbursed uniformly each quarter to ensure that all eligible states receive an equitable share of available funds. We recommend that for any given quarter, the amount of Needy State Funds not exceed 5 percent of the annual block grant plus any annual supplemental grant amount. The federal Needy State Funds would have to be spent in these categories in the fiscal year for which they are awarded.

Conclusion

Congress created the Contingency Fund alongside the basic TANF block grant that replaced the old AFDC program because it recognized that states would need additional federal funding when the economy faltered. The Contingency Fund as originally designed, however, has proven to be of limited effectiveness. It often was not available to the neediest states. In addition, there was no guarantee that funds that were distributed would be used to help families to weather hard economic times. We recommend replacing the Contingency Fund with a redesigned fund, which could be

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[8] Increased spending looks to all federal TANF spending, including the additional funds provided from the Needy States Fund, because in some instances a state may be spending the funds it received for reimbursement for increased spending in a prior quarter and in other instances a state may be claiming the increased spending prospectively based on projected increased spending. The TANF Emergency Fund allowed state to submit for funding based on projected increased spending in an upcoming quarter and this approach was essentially to the funding of subsidized employment in most states.

called the Needy States Fund and which would eliminate the deficient features of the Contingency Fund and build on successful elements of the TANF Emergency Fund.

The TANF block grant expires on September 30, 2011. Congress will need to reauthorize the block grant or to extend it until it can be fully reauthorized. This new Needy States Fund should be created now, even if that means including it in a TANF extension bill. Without it, we are likely to see more reductions in TANF benefits and more program changes that make fewer needy families eligible for assistance in finding employment or meeting basic household needs. Unemployment remains high, and it will take time for the economy to more fully recover. What we need now is more help for vulnerable families provided in a well-targeted, efficient, and effective manner — rather than further cutbacks in such assistance.

Appendix I: Current Contingency Fund MOE and Reconciliation Requirements

There are two state spending requirements related to the current Contingency Fund: the 100 percent MOE requirement and the additional reconciliation-related requirement that the state either spend sufficiently in excess of the 100 percent MOE to match the Contingency Funds received or subsequently repay all or part of the federal funds.

1. Contingency Fund MOE Requirement

As a condition of the TANF block grant, states are required to meet an annual state maintenance-of-effort (MOE) requirement, which is 80 percent of a state's historical spending, as defined as its 1994 contribution to AFDC and related work programs. A state's MOE requirement is reduced to 75 percent in any year in which a state meets its TANF Work Participation Requirement.

For Contingency Fund purposes, a state must meet a *100 percent of historic state spending* MOE requirement. Certain state spending that otherwise would count toward the regular TANF MOE requirement does *not* count for purposes of the Contingency Fund requirement. Specifically, states cannot count child care spending, which is about 15 percent of MOE spending nationwide (and a significantly larger share of MOE spending in some states) toward the Contingency Fund requirement.[9] For example, 65 percent of Illinois's 2009 MOE spending and 60 percent of Pennsylvania's 2009 MOE spending was for child care, making it impossible for these states to meet the Contingency Fund MOE requirement.

In addition, MOE spending in separate state programs (SSP) cannot count toward the 100 percent MOE requirement. States can spend MOE funds within a program that also receives TANF funds or in a separate state program (SSP) that receives no TANF funds (or both). Since some TANF requirements (for example, child support assignment and retention provisions) do not apply to MOE-funded SSPs, it makes sense for certain types of state MOE spending to be structured in that manner. While spending in separate state programs is not a large share of MOE overall, it represents a significant share for some states. For example, in 2009, Connecticut spent 38 percent of its MOE in SSPs and New Jersey spent 57 percent.

2. Requirement to Spend an Amount in Excess of 100 Percent MOE to Keep Federal Contingency Funds

The Contingency Fund matching requirement is implemented through a "reconciliation" process. To keep Contingency Funds that they receive, states must spend beyond their required 100 percent Contingency Fund MOE level. A state may keep only the money that matches state MOE expenditures (excluding SSP and child care expenditures) made in excess of the state's 100 percent Contingency Fund MOE level. If the state qualifies for and receives contingency funds for the full

[9] The portion of state spending for child care in 1994 under AFDC is backed out of historic state spending in setting the 100 percent Contingency Fund MOE level, but the historic spending on child care is small relative to the increased child care spending under TANF. See amounts backed out in the Table at the end of Program Instruction on Federal TANF Contingency Funds, TANF-ACF-PI-2008-04, May 6, 2008, http://www.acf.hhs.gov/programs/ofa/policy/pi-ofa/2008/200804/pi200804.htm.

fiscal year, such expenditures are multiplied by the state's Medicaid match rate in order to determine the amount that the state may keep.

In a Program Instruction, HHS explains this reconciliation process with an example as follows:

> Assume a State is eligible for Contingency Funds in each month during the fiscal year. The State has a 50 percent FMAP rate. The State requests and receives [a total of] $10 million in Contingency Funds [over the] 12 months. Because the FMAP rate is 50 percent, the State must spend a combined $20 million over its Contingency Fund MOE by the end of the fiscal year to keep the $10 million. This $20 million would consist of the $10 million Contingency Funds (Federal share) plus $10 million in excess qualified State expenditures (not counting SSP expenditures and child care expenditures).[10]

However, if the state is eligible for less than the full year, the match rate is reduced by the fraction of the year for which the state qualified. The required reduction in the federal match increases the excess MOE expenditures a state must make to keep all of its Contingency Funds for the fiscal year. Hence, the fewer months for which a state receives Contingency Funds, the smaller the federal share (i.e., the contingency payment) and the larger the state share of total reimbursable expenditures to retain all of the Contingency Funds.

HHS illustrates the impact by continuing with the same example in the Program Instruction:

> Now assume the State receives Contingency Funds for only part of the fiscal year. Assume the State's FMAP rate is still 50 percent; the State received Contingency Funds of $5 million for a 6 month period (6/12th of the full-year contingency amount of $10 million); the State's 100 percent Contingency Fund MOE level is $95 million; and qualified State expenditures for the year (minus SSP expenditures and child care expenditures) equal $105 million. Assume the State spent the entire $5 million contingency payment. Also assume excess State TANF expenditures total $10 million ($105 million minus $95 million), the same as in the 12 month example above where the State would have had to spend $10 million in State funds to retain $10 million in Contingency Funds.
>
> However, because the State will receive Contingency Funds for only part of the fiscal year, we must also commensurately reduce the Federal match by 1/12th times the number of months during the fiscal year for which we made a contingency payment to the State. To calculate reimbursable State expenditures for Contingency Fund reconciliation purposes, add the $5 million Contingency Fund expenditures to the $10 million in excess State TANF expenditures for a total of $15 million. To determine the State match requirement to retain the money, multiply the Federal match rate of 50 percent by 0.5 (1/12th times 6 months) to arrive at 25 percent (the adjusted FMAP rate for the State). Then, multiply this rate by the $15 million in reimbursable expenditures to determine how much the State may retain. This results in a Federal share of $3.75 million. In this case, the State did not meet its spending requirement since it received $5 million in Contingency Funds and may only retain $3.75 million and must remit $1.25 million to ACF. To retain the full $5 million in Contingency Funds the State received for the six-month period, reimbursable expenditures would have

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[10] Program Instruction on Federal TANF Contingency Funds, TANF-ACF-PI-2008-04, May 6, 2008, http://www.acf.hhs.gov/programs/ofa/policy/pi-ofa/2008/200804/pi200804.htm.

> had to equal $20 million ($5 million in Federal Contingency Funds and $15 million in excess State TANF expenditures above the State's Contingency Fund MOE level). . . .[11]

Apart from the complexity of these rules, a state that is hovering near the "needy state" trigger may not know how many months it will qualify for Contingency Funds, and, thus, what matching rate will apply in setting this level as part of the reconciliation determination. This makes it considerably harder for states to plan their expenditures.

[11] Program Instruction on Federal TANF Contingency Funds, TANF-ACF-PI-2008-04, May 6, 2008, http://www.acf.hhs.gov/programs/ofa/policy/pi-ofa/2008/200804/pi200804.htm.

Appendix II: Strategies for Addressing Issues that Arise in Measuring Increased Spending

Ensuring that the Needy States Fund is used to increase state expenditures in the targeted expenditure categories, rather than to supplant existing expenditures will necessarily involve some detailed decisions on how to measure increases in expenditures. Some of the issues include:

What is the base period for comparison?

Generally, one would want states to be able to compare current year spending to a period before the high unemployment levels were reached. Thus, when a state becomes a "needy state," its base period for comparison could be the fiscal year prior to the year in which the state first became a needy state. Alternatively, the four quarters prior to the quarter — or the first four of the eight quarters prior to the quarter — in which the state became a needy state could be the comparison period. Using the immediately prior four quarters could provide a more closely tailored period prior to the rise in unemployment, while going back another four quarters could provide a base period prior to any gradual worsening of the economy.

However, a different base period measure may be needed to transition to this new approach, given both the change in the trigger and the fact that all states are already needy states under the definition in the current law. Some states have met the current needy state trigger for a number of years. Consequently, the pre-trigger period could be a long time ago. Therefore, it makes sense to set a fixed recent period in time as an alternate comparison base period, at least for states that were already needy states prior to the change in law.

We suggest either 2007 or 2008 could be a good fixed comparison period; the law could set either one of these as a base year option or give states the option to choose either one. (ARRA set the base year for the TANF Emergency Fund as 2007 or 2008, whichever year had lower spending in the relevant category.) These years represent a time when TANF caseloads were not yet increasing significantly in most states — and were still declining in many states — and prior to state receipt of any TANF Emergency Funds. Because state caseloads shifted at different times, we suggest that states have the option to choose between 2007 or 2008.

Under this proposal, the comparison base period would never be earlier than 2007 or 2008, no matter when a state first met needy state status. All states that are needy states at the time of the change in law would use this alternate measure. A state would remain in needy state status until the end of three quarters after the quarter in which the unemployment rate drops below the trigger. As time passes and the economy improves, states may cease to become needy states for a substantial period of time before becoming a needy state again at some point in the future. In these circumstances, the transitional base period option of 2007 or 2008 would cease to apply and the base period would be the year (or four quarter-period) prior the trigger being reached again.

What is the length of the relevant comparison periods?

A key design question is whether this is a year-to-year comparison or a quarter-to-corresponding-quarter comparison. In other words, must a state have increased spending for the entire year in the targeted category (and if so, can it draw down funds based on quarterly estimates)? Or, can a state qualify for funds for each quarter to the extent that its spending in the category for the quarter exceeds the spending in the comparable quarter in the base year? There are some good reasons to support either approach, but on balance, we suggest a quarter-to-quarter comparison. (This is similar to the approach taken for the TANF Emergency Fund.)

Using only an annual period for measuring whether supplantation has occurred could prove to be a deterrent to states using the fund. One of the drawbacks of the design of the Contingency Fund was the reconciliation and repayment provision, which led to reluctance of some state agencies to take funds when they were not sure what their annual spending levels would be.

A quarter-to-quarter comparison allows a state to draw on funds (and count on keeping them) when it can rely on meeting the non-supplantation requirement for a quarter. This allows a state to draw on and use the funds in times of need. If a state does withdraw spending from a category for a given quarter of a fiscal year, it would not qualify for Needy State Funds for that quarter in the relevant category. But, because the funds are doled out at a rate of not more than 5 percent of the state's basic TANF block grant per quarter, a state would not be able to have maxed out its allotment early in the year and then withdraw funding later in the year. (It would be possible for a state to receive its maximum allotment because of increased spending in one category even if it reduced spending in the other target category for the last quarter of the year; that is consistent with the choice to allow a state to qualify for Needy State Funds based on increased spending in a single category.) As with the TANF Emergency Fund, we suggest that a state receive Needy State Funds prospectively for an upcoming quarter in order to be able to use these funds to increase its effort in that category.

The base period would be the year (or, a four-quarter period) with the lower overall spending in the category (as with the TANF Emergency Fund). Once the base period is set for a category of spending, then each request quarter for Needy State Funds would be compared to the corresponding quarter in the base period.

What adjustment authority might be needed to ensure an "apples-to-apples" comparison?

Finally, the law should include authority for HHS to make adjustments in the amount of spending reported for a category in order to ensure that comparisons between base year periods and current year request periods reflect real maintenance of, and increase in, effort and are not simply an artifact of funding shifts. The TANF Emergency Fund had a similar provision in order to fairly measure state spending relative to periods in which the funding may have been configured differently. For example, a state that served families in a solely state-funded program (outside of the TANF and MOE structure) may have discontinued that structure in tight budget times and brought those families back into the TANF-funded program. This should not be viewed as increased spending if it is merely a funding shift and not increased effort. Similarly, a state that moves some families into a solely state-funded program should not be penalized with respect to the Needy States Fund. Such adjustments in measuring state expenditures for basic assistance proved relatively straightforward under the TANF Emergency Fund, and continuing that approach should be feasible. Adjustments could be made, if needed, for the subsidized employment category as well. For example, in measuring increases in expenditures for subsidized employment programs in 2009 or 2010 under the Emergency Fund, an adjustment would be appropriate to back out any employer supervision and training claimed as third-party MOE in the base period since third-party spending would not count as MOE under the proposed redesign.