CBO MEMORANDUM

POLICY CHANGES AFFECTING
MANDATORY SPENDING
FOR LOW-INCOME FAMILIES
NOT RECEIVING CASH WELFARE

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CONGRESSIONAL BUDGET OFFICE
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NOTES

Unless otherwise indicated, all years referred to in this memorandum are fiscal years.

Numbers in the text and tables may not add up to totals because of rounding.

This Congressional Budget Office (CBO) memorandum estimates the amount of federal mandatory spending and tax benefits that have been made available to low-income working families as a result of legislation and other changes in policy since 1984. It focuses on families who do not receive cash welfare payments and thus does not consider changes in the benefits provided to welfare recipients. The memorandum responds to a request from the Chairman of the Subcommittee on Human Resources of the House Committee on Ways and Means.

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CONTENTS

TABLES

INTRODUCTION

Changes in policy since 1984 have greatly increased federal assistance for low-income families with children who do not receive cash welfare payments. The Congressional Budget Office (CBO) estimates that policy changes to mandatory federal programs will add more than $13 billion to spending for Medicaid and children's health insurance, $1 billion to child care, $28 billion to the earned income tax credit, and almost $4 billion to the child tax credit.[1] In total, those increases will amount to $46 billion (see Table 1).

The programs examined in this memorandum are either means-tested or income-tested. Medicaid, Vaccines for Children, State Children's Health Insurance, the Child Care and Development Fund, and Food Stamps are all programs that require beneficiaries to verify that they have low income and few assets. Most of those programs have income and resource limits established by the states under federal guidelines. The Food Stamp program prohibits households without elderly or disabled members from receiving benefits if their gross income exceeds 130 percent of the poverty level or their liquid assets exceed $2,000.

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1. One exception to those expansions is the Food Stamp program. For most nonwelfare families with children, eligibility criteria for that program have not changed substantially since 1984; and for most legal immigrants in families with children, recent changes in the program's rules make them no longer eligible to participate.

TABLE 1. EFFECTS OF POLICY CHANGES ON PROJECTED FEDERAL OUTLAYS FOR LOW-INCOME FAMILIES NOT RECEIVING CASH WELFARE
(In billions of 1999 dollars)

	Projected Federal Spending in 1999		
	Under 1984 Policy[a]	Under 1999 Policy[b]	Increase
Medicaid Benefits	4.0	13.7	9.7
Medicaid Vaccines for Children	0	0.5	0.5
State Children's Health Insurance Program	0	3.2	3.2
Child Care	0	1.0	1.0
Earned Income Tax Credit	1.6	29.8	28.2
Child Credit	0	3.5	3.5
Total	5.6	51.7	46.1

SOURCE: Congressional Budget Office.

a. Policies as they existed before the enactment of the Deficit Reduction Act of 1984.

b. Spending as projected by CBO based on laws in effect on July 1, 1998.

In general, the tax credits examined here have higher income limits than the other benefit programs. The earned income tax credit (EITC) is completely phased out for people with adjusted gross income above $30,735 in 1999. Although the child credit is available to families with much higher income, this analysis focuses only on its effects on people with income below the maximum amount for EITC eligibility.

CBO's estimate of a $46 billion increase in mandatory federal spending for nonwelfare families since 1984 reflects only the growth attributable to policy changes, not the effects of other factors, such as inflation, unemployment, and population growth. In many of the major mandatory spending programs, benefits are defined by federal statutes, and there are virtually no differences in the way the programs operate from state to state. In others, such as Medicaid, significant differences exist because the states can choose to cover optional services or population groups, set reimbursement rates, and seek waivers from the federal government to alter program rules. Consequently, the term "policy changes" is not restricted to federal legislation but also includes the effects of choices made by state and federal decisionmakers.

Besides mandatory spending for nonwelfare families, the federal government also spends significant resources on programs classified as discretionary. Much of that spending—such as federal funding for elementary and secondary education—is distributed to state and local governments under formulas that generally include factors such as poverty rates or median income. Data on the income and welfare status of people who benefit from those programs are typically limited or nonexistent, so CBO did not attempt to allocate discretionary spending to low-income, nonwelfare families. In any event, discretionary outlays for education, training, employment, and social services (budget function 500), health (function 550), and income security (function 600) have grown by more than 50 percent over the 1984-1999 period, adjusting for inflation. As a result, excluding discretionary programs from this analysis is not likely to affect the direction of its conclusions.

MEDICAID

Most Medicaid beneficiaries who are not elderly or disabled also receive cash welfare payments. But recent policy changes have focused on expanding Medicaid benefits for low-income families who do not receive such payments. In 1999, an estimated 15.3 million children and adults whose eligibility is not based on their receipt of cash welfare benefits will get $13.7 billion in federal Medicaid benefits (see Table 2). CBO estimates that if policies had not changed since 1984, 3.2 million such enrollees would have received $4.0 billion in benefits. Most of the increase in enrollment and benefits stems from federal legislation enacted since 1984, and the rest results from decisions by states to expand Medicaid coverage.

Medicaid in 1984

In 1984, most federal Medicaid funding for nondisabled adults and children was spent on people who collected cash benefits through the Aid to Families with Dependent Children (AFDC) program. For instance, federal spending on such

TABLE 2. MEDICAID BENEFITS FOR NONDISABLED CHILDREN AND ADULTS NOT RECEIVING CASH WELFARE, UNDER 1984 AND 1999 POLICIES

	Enrollment (Millions)			Annual Federal Spending (Billions of 1999 dollars)		
	Under 1984 Policy	Under 1999 Policy	Increase	Under 1984 Policy	Under 1999 Policy	Increase
Children	1.8	10.9	9.1	1.7	8.3	6.6
Adults	1.4	4.4	3.0	2.2	5.4	3.2
Total	3.2	15.3	12.1	4.0	13.7	9.7

SOURCE: Congressional Budget Office.

children accounted for about $2.0 billion of the total $2.6 billion that Medicaid spent on children. Children and adults not receiving cash benefits accounted for just $0.6 billion and $0.7 billion, respectively. In terms of numbers of beneficiaries, nearly 8 million children and 4.4 million adults received Medicaid benefits in 1984 because they were in the cash category, whereas only 1.6 million children and 1.2 million adults fell into the noncash category.[2] However, some states provided benefits to other people not receiving cash benefits by using their legal authority to expand Medicaid's income and resource criteria and by establishing medically needy programs, which let states offer Medicaid coverage to beneficiaries with income slightly above the AFDC payment standard as well as to beneficiaries who may have high medical expenses but do not meet the tests for income and resources.

2. Data from the early 1980s counted Medicaid recipients—people who received a service. Current figures (and the numbers in Table 2) count Medicaid enrollees—people who have a Medicaid card—and thus may include individuals who do not get services.

Medicaid in 1999

CBO projects that federal Medicaid spending on nondisabled children and adults will total $27 billion in 1999. In contrast to the situation in 1984, only half of that spending will be for children and adults who receive cash benefits. Spending on other children is projected to total $8.3 billion, and spending on other adults is expected to total $5.4 billion.

One of the principal reasons that spending for noncash beneficiaries has increased as a share of total Medicaid spending is the rapid growth in the number of such beneficiaries. The number of children who are on Medicaid without receiving cash benefits is projected to grow sixfold over the 1984-1999 period—from 1.6 million to 10.9 million—while the number of children with cash benefits will rise by only 40 percent. Likewise, the number of Medicaid adults without cash benefits will more than triple—from 1.2 million to 4.4 million—compared with almost no change in the number of adults with such benefits. As a result, the proportion of nondisabled, nonelderly Medicaid recipients who do not meet AFDC eligibility criteria will rise from less than 20 percent in 1984 to nearly half in 1999.

Most (but not all) of the growth in Medicaid spending for noncash beneficiaries since 1984 stems from changes in federal and state policy. Even without those changes, however, growth in the population and in the cost of health care would have driven up enrollment and costs in the Medicaid program. If the number of Medicaid beneficiaries had increased at the same rate as the overall population since 1984, and if benefits had grown at the same rate as national health expenditures, an estimated 3.2 million noncash beneficiaries would have received $4.0 billion in Medicaid benefits in 1999. Thus, an increase of 12.1 million in Medicaid enrollment and $9.8 billion in spending can be roughly attributed to changes in policy over the past 15 years.

Changes in Eligibility and Benefits

Beginning with the Deficit Reduction Act of 1984, the Congress expanded Medicaid eligibility for low-income pregnant women and children through a series of legislative efforts known collectively as the Medicaid poverty expansions. Those expansions produced the option to cover pregnant women and infants with family income up to 185 percent of the poverty level, which was included in the Omnibus Budget Reconciliation Act of 1987 (OBRA-87); the federal mandate to cover pregnant women and children under age 6 with family income up to 133 percent of the poverty level, included in OBRA-89; and the federal mandate to cover children born after September 30, 1983, with family income below the poverty level, included in OBRA-90.

The Congress also passed the Family Support Act of 1988, which required states to lengthen transitional Medicaid benefits from four months to 12 months for families who lose AFDC because of increased earnings. That act also required states to expand Medicaid coverage for two-parent families whose principal earner is unemployed. The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 continued the provisions for transitional Medicaid benefits until 2001. Although that legislation also decoupled eligibility for Medicaid and AFDC, states must still provide Medicaid benefits to people who meet their eligibility requirements for the former AFDC program as it was in effect on July 16, 1996.

The expansion of Medicaid eligibility during this period resulted partly from those federal legislative changes and partly from actions by the states. When the legislative changes were being made, some states were already covering the newly mandated children and adults under other, optional mechanisms. For example, states had the option to cover so-called Ribicoff children—those under 21 who, if they met the definition of dependent child, would have been eligible for AFDC. The legislative changes opened up other avenues for states to cover those children. Furthermore, while the expansions were taking effect (or being phased in), many states took advantage of other expansion tools. Through the flexibility in determining income and resources allowed under section 1902(r)(2) of the Medicaid law and waivers under section 1115, states expanded coverage to beneficiaries at higher levels than those mandated by the federal government.

Not all of the difference in spending growth between the cash and noncash groups is attributable to increases in enrollment. Expansions for noncash adults focused on pregnant women, who necessarily have high medical costs. Additionally, in OBRA-89, the Congress defined the benefits provided in Medicaid's Early and Periodic Screening, Diagnosis, and Treatment program for children and required that states cover treatment to correct problems identified during screening. (Spending on those benefits is included in the above figures for federal payments for children and adults.)

VACCINES FOR CHILDREN

In OBRA-93, the Congress provided states with funds to cover the cost of vaccinations for Medicaid-eligible and other uninsured children under the Vaccines for Children program. Spending on that program is accounted for separately from Medicaid benefit payments and is estimated to total about $500 million in 1999 for both types of children.

STATE CHILDREN’S HEALTH INSURANCE PROGRAM

The Balanced Budget Act of 1997 established the State Children's Health Insurance Program (CHIP), which provides states with matching funds to develop health insurance programs for children—either by starting their own programs or by expanding Medicaid. Funding for those Medicaid expansions comes from the CHIP grants to states. The program became effective in 1998 and next year is projected to spend approximately $3.2 billion. Half of that will go for Medicaid expansions and half for new state programs.

CHILD CARE

Federal spending on child care for low-income families has increased substantially since the late 1980s. Before then, no program specifically for child care existed, and federal funding was limited to other programs (such as the Social Services Block Grant) that permitted some resources to be used for that purpose. In 1988 and 1990, four child care programs were created—one for people on AFDC, and three for low-income families with children who did not receive cash welfare payments. Those three programs were the At-Risk Child Care program (for people at risk of becoming welfare recipients if they did not receive child care assistance), the Transitional Child Care program (for people who had just left welfare), and the Child Care and

Development Block Grant (primarily, although not exclusively, targeted toward low-income families). Except for the block grant, those were mandatory programs.

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA) consolidated the three mandatory programs into one funding stream: the Child Care and Development Fund (CCDF). States are entitled to receive a part of those funds based on their previous spending; the rest go to states spending more on child care than their historical level.

PRWORA gave states considerable flexibility in using this new consolidated child care funding stream, allowing the money to go to families with income up to 85 percent of the state's median income. How much federal child care funding is going to welfare families versus nonwelfare, low-income working families is not yet known. The CCDF program requires states to report those figures in the future, but data are not yet available. Under the CCDF, states must use 70 percent of their mandatory and matching funds on welfare recipients, people leaving welfare, and people at risk of going on welfare and 30 percent on low-income working families. However, nonwelfare families could fall into either funding category.

In 1996, the year before PRWORA took effect (and the last year for which data are available), states spent 44 percent of their federal child care money on nonwelfare families. If they spent the same share in 1999, total federal mandatory spending on child care for nonwelfare families would be about $960 million. However, states could spend a higher proportion of their money on nonwelfare families, since PRWORA permits them to do so.

TAX CREDITS

Two credits to the federal income tax benefit low-income families with children. The earned income tax credit is projected to provide a maximum credit of about $2,300 in 1999 for a working family with one child and $3,800 for a working family with two or more children. The credit has been expanded since 1984 to provide larger amounts and to extend coverage to families with higher income. The Taxpayer Relief Act of 1997 created a separate credit for families with children (except those with the highest income) that equals $400 per child in 1998 and $500 per child in later years. Unlike the EITC, however, that credit cannot exceed a family's income tax liability, except in special circumstances. Consequently, low-income families may not be able to claim the full amount of the credit.

Earned Income Tax Credit

In 1984, the EITC gave families with children a refundable credit equal to 10 percent of their earnings, up to a maximum credit of $500. The credit was reduced by 12.5 cents for each dollar of adjusted gross income (AGI) or earnings above $6,000. As a result, the credit phased out completely for families with income above $10,000. The parameters of the credit were the same for all families, regardless of the number of children they had.

Since 1984, the Congress has expanded the EITC to include taxpayers without children, to provide larger credits to families with two or more children, to increase the size of the credit, to expand eligibility to taxpayers with higher income, and to index the credit's dollar parameters for inflation. Based on the inflation projection in its January 1998 economic forecast, CBO estimates that the maximum credit for families with two or more children will be $3,836 in 1999. For those families, the credit will equal 40 percent of their first $9,590 of earnings, reduced by 21.06 cents for each dollar of earnings or AGI over $12,520. Families with two or more children and AGI of at least $30,735 will not qualify for the credit.

Families with one child will be able to claim a maximum credit of $2,322 in 1999. The credit will equal 34 percent of their first $6,830 of earnings, reduced by

15.98 cents for each dollar of earnings or AGI over $12,520. One-child families with earnings or AGI above $27,052 will not qualify for the credit.

The various expansions of the EITC between 1984 and 1999 will more than triple the number of eligible families—from 5.0 million to 15.8 million (see Table 3). Total credits will increase more than 18-fold, from $1.6 billion under 1984 law to a projected $29.8 billion in 1999. The average credit per eligible family will be almost six times larger—$1,886 compared with $320—as a result of the legislative changes.

TABLE 3. TAX BENEFITS FOR LOW-INCOME FAMILIES WITH CHILDREN UNDER 1984 AND 1999 TAX LAWS

	Under 1984 Law	Under 1999 Law	Increase
Earned Income Tax Credit			
Eligible Families (Millions)	5.0	15.8	10.8
Total Credits (Billions of 1999 dollars)	1.6	29.8	28.2
Average Credit per Eligible Family (1999 dollars)	320	1,886	1,566
Child Credit			
Eligible Families (Millions)	0	5.8	5.8
Total Credits (Billions of 1999 dollars)	0	3.5	3.5
Average Credit per Eligible Family (1999 dollars)	0	603	603

SOURCE: Congressional Budget Office.

NOTE: Low-income families are those with income below the maximum income for receipt of the earned income tax credit. In 1984, that limit was $10,000. In 1999, it is projected to be $30,735.

Child Credit

The Taxpayer Relief Act created a new tax credit for families with children equal to $400 per child in 1998 and $500 per child in subsequent years. The credit is reduced by $50 for each $1,000 of modified AGI over $75,000 (or over $110,000 for couples filing joint tax returns).[3] For families with one or two children, the credit is not refundable. Families with three or more children may receive a refundable credit if their combined income and payroll tax liability exceeds zero. For those families, the maximum credit equals the sum of their net income tax liability plus the share of Social Security and Medicare taxes they pay directly. CBO projects that 5.8 million low-income families will qualify for a total of $3.5 billion in child credits in 1999.[4] The average low-income family claiming the credit will receive a tax reduction of just over $600.

FOOD STAMPS

Unlike the other mandatory programs discussed in this analysis, the Food Stamp program has not changed substantially between the mid-1980s and the late 1990s for

3. Modified AGI equals AGI plus income earned outside the United States that is otherwise excluded from adjusted gross income.

4. For this analysis, low-income families are ones with income below $30,735, the level above which families with two or more children will be ineligible to receive the EITC in 1999.

most nonwelfare families with children. The major exception is that most legal immigrant noncitizens in families with children would have been eligible for food stamps in 1984, but many are not eligible under the program's 1999 rules.

During that period, legislation has adjusted a few of the program's parameters in ways that affect the benefits of families with children, most notably:

- o Families with costs for shelter or dependent care will receive slightly higher benefits in 1999 than they would have under 1984 law.

- o Families with earnings can deduct 20 percent rather than 18 percent of those earnings from their countable income, allowing for marginally higher benefits.

- o The standard deduction will be lower in 1999 than it was in 1984 in real terms (adjusting for inflation), which results in lower benefits for recipients with income.

- o Although the asset limit was raised from $1,500 to $2,000 in 1985 for families with no elderly members, it will nonetheless be lower in real terms in 1999 than it was in 1984, which means that some families with assets who would have qualified for food stamps in 1984 will not qualify in 1999.

- o Although the vehicle allowance was raised from $4,500 to $4,600, its real value has declined by 35 percent over the period, thereby becoming a larger impediment for Food Stamp applicants.

Those changes would make some families marginally better off, and others worse off, under the Food Stamp program's 1999 rules than under its 1984 rules, but for most families with children, the program has not changed substantially since 1984. To the extent that it has changed, some aspects are more generous and others less generous, making the average net effect for all families negligible.

Of course, that is not the case for noncitizen families with children. In 1984, most legal immigrants were eligible for food stamps on the same basis as citizens after they had been in the United States for three years. The 1986 Immigration Reform and Control Act (IRCA) extended legal status to people who entered the country illegally in the mid-1980s, although it required them to wait five years before applying for social welfare programs. Thus, the act increased the number of legal immigrant families eligible for food stamps.

In 1996, however, PRWORA eliminated Food Stamp eligibility for legal immigrants unless they were refugees living in the United States for less than five years, had a work history of 40 or more quarters of employment covered by Social Security, or were veterans or active-duty members of the U.S. military. The recently enacted Agricultural Research, Extension, and Education Reform Act of 1998 restores eligibility for children who were in the United States in August 1996, but many adult legal immigrants in families with children and aliens in families with children who entered the country after August 1996 remain ineligible. Many would have been eligible under the Food Stamp program's 1984 rules. Although the net impact of Food Stamp legislation during the mid-1990s was to reduce spending by about $300 million, whether that legislation will offset the additional benefits that resulted from IRCA is uncertain.