

A Race to the Bottom? Exploring County Spending Shortfalls Under Welfare Reform in North Carolina

Maureen Berner, Ph.D.

ABSTRACT

North Carolina's experiment with local control of TANF programs provides a unique example of the budget implications of state to local government policy devolution. County-level expenditure data indicate that after state to local government devolution, only 45 of 100 counties met welfare maintenance of effort (MOE) budget requirements. This article demonstrates that several important factors, including control over program eligibility and benefit levels, were significantly associated with MOE spending variation. Counties given more flexibility spent dramatically less than others. Many failed to meet MOE requirements without penalty, year after year. These issues raise serious questions about decentralization from both the budget and policy perspectives.

INTRODUCTION

One of the most important changes in the history of social welfare policy occurred in 1996, when President Clinton signed legislation replacing the entitlement-based Aid to Families with Dependent Children (AFDC) program with a new block grant program focused on finding work for welfare recipients—Temporary Assistance to Needy Families (TANF). The authorization for TANF expired September 30, 2002. Congress then began its reauthorization of TANF, and in 2004, states began reauthorizing their state programs. As of this writing, Congress has not completed its reauthorization, providing extensions on parts of the program as needed in a piece-meal fashion. As this process proceeds, the need for unbiased, policy relevant information concerning how states and local governments are reacting to TANF is vital.

Welfare reform advocates have argued that state and local levels of government are better positioned than the federal government to design welfare programs. For example, Gramlich suggests the standard argument is that the level of generosity for welfare programs is congruent to state and local desires, and that the centralization or decentralization question boils down to whether the altruism motive that leads to benefit payments in the first place works across the state or nation.¹ But he also noted that this was a question that could not be answered with then available data.

One indicator of commitment to the goals of welfare is level of funding. Now that state and local governments have had more control over these programs for six years, funding data are becoming available, and we can begin to answer Gramlich's question. When you decentralize control over a social policy, in this case, welfare, does local government change its financial support of the program? Is the altruism motive that existed when the program was centralized, as manifest by funding, maintained?

While there has been much research on administrative changes, no substantial work has documented changes in welfare spending at the direct service level. This is especially true of spending at the local government level, where, in many places, key decisions are made about what services are

¹ E. M. Gramlich, "Economists' View of the Welfare System." *American Economic Review* 79 (1989): 191-196.

offered, to whom, and how. In addition, many research efforts have focused on evaluating the impacts of welfare reform on program recipients.² Fewer studies are aimed at measuring how the various levels of government - National, state, and local - have responded to welfare reform legislation.³

The contribution of this analysis is in its local government spending focus in a state which is experimenting with state to local government policy devolution. North Carolina has implemented a pilot project in which 21 counties took full control for designing welfare programs, including establishing eligibility, benefit levels, and time requirements. I describe and offer factors associated with variations in county-level welfare expenditure data for four state fiscal years (SFYs 1997-98 to 2000-01) for 99 of the 100 counties in North Carolina, comparing the pilot project counties to those not participating in the program. County-based expenditures, as opposed to state or federal pass through funds, show the direct level of public support for various welfare program activities. Whether advocates claim that reform is successful (as measured by caseload reduction), or critics claim it is not (as measured by Standard of living of clients), budget data are important to begin understanding *why*.

This analysis is guided by the following questions:

- 1) Are counties meeting state mandated maintenance of effort (MOE) requirements to financially participate in welfare reform efforts? To what extent?
- 2) What factors explain county variations in reaching these MOE requirements?
- 3) What budget implications can be drawn from these findings?

After a brief review of the literature, I provide background information regarding the broader public policy environment in which this analysis takes place, including unique features of welfare reform in North Carolina. Then I describe methods, present findings, and discuss the implications of the results.

² See the following websites for a flavor of existing welfare reform research studies: [<http://ssw.unc.edu/workfirst/reports.html>]; [<http://www.ces.ncsu.edu/depts./fcs/humandev/welfare1.html>]; [<http://www.ncga.state.nc.us/LegLibrary/studies/welfare.htm>]; and [<http://aspe.os.dhhs.gov/hsp/welf-ref-outcomes00/chapter3.htm>].

³Deborah Ellwood and Donald J. Boyd, "Changes in State Spending on Social Services Since the Implementation of Welfare Reform: A Preliminary Report," The Nelson A. Rockefeller Institute of Government (February 2000).

LITERATURE REVIEW

Over the last decade, many scholars of devolution have focused on the circumstances surrounding the initial decentralization of policymaking power by an upper level of government, usually the national government, to a lower level of government, usually the state. A large component of this work is descriptive and focuses on the national government's role in devolving power to the states. For example, Conlan provides a rich historical account of devolution over the past 25 years with a focus on why Nixon, Reagan, and Gingrich gravitated toward the use of decentralization.⁴ Walker highlights the cross-pressures placed on the government to both centralize and decentralize policymaking authority.⁵

The Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) represents one of the most recent and controversial examples of devolution. The research on PRWORA can be generally aligned on a national, state or local perspective. The reforms to the welfare system associated with this legislation were quite noteworthy, with policymaking authority significantly shifted from the national government to the individual states. As a result, the 1996 national welfare reform legislation generated a great deal of research that facilitates an increased understanding of the devolution of responsibilities to the states.⁶ Much of this work, however, focuses primarily on the legislative act of devolving power from the federal government to the states. The political science and policy literature that does explore consequences focuses almost entirely on welfare benefit levels, sanctions, eligibility requirements, and outcomes such as welfare spells, caseload, employment and earnings.⁷ As of January 7, 2002, the Washington, D.C. think tank Center on Budget and Policy Priorities listed over 90 major

⁴ Timothy Conlan, "From New Federalism to Devolution: Twenty-Five Years of Intergovernmental Reform" (Washington, DC: Brookings Institution Press, 1998).

⁵ David B. Walker, "The Rebirth of Federalism" (New York: Seven Bridges Press, 2000).

⁶ Sanford F. Schram, "Introduction to Welfare Reform: A Race to the Bottom." *Publis* 28 (1998): 2-3.

⁷ Paul E. Peterson and Mark Rom, "American Federalism, Welfare Policy, and Residential Choices," *The American Political Science Review* 83 (1989): 711-728; Schram, 1-8; Samuel H. Beer, "Welfare Reform: Revolution or Retrenchment?" *Publis* 28 (1998): 9-16; Irene Lurie, "Watching the Race: Where You Sit Affects What You See," *Publis* 28 (1998): 88-94; Suzanne Mettler, "States' Rights, Women's Obligations: Contemporary Welfare Reform in Historical Perspective," *Women & Politics* 21 (2000): 1-33; Joe Soss et al., "Setting the Terms of Relief: Explaining State Policy Choices in the Devolution Revolution," *American Journal of Political Science* 45 (2001): 378-395; and Bruce A. Weber, Greg J. Duncan, and Leslie A. Whitener, "Welfare Reform in Rural America: What Have We Learned?" *American Journal of Agricultural Economics* 83 (2001): 1282-1292.

studies on the program, the vast majority published just since 2000. In particular, there are many studies examining recent reductions in welfare caseloads, and whether or not welfare reform or the economy or other factors are responsible.⁸

The realization that state and local governments will face new challenges under PRWORA has also resulted in new work focused on lower levels of government. At the state level, Francis' work attempts to look more directly at how officials have responded to devolution and how their responses have impacted public policy.⁹ Francis looks at state variation in welfare reform policies and finds that "states have acted independently to address the needs of their welfare populations".¹⁰ Nathan and Gais study how states respond to decentralization from a different angle.¹¹ They highlight the problems of information systems and management problems associated with the implementation of decentralized welfare policies in the states. Other work by devolution scholars, including Powers, Kincaid, Tannenwald, and Hedge and Scicchitano, focuses on the potential consequences of devolving responsibilities to the states, such as stresses to revenue generation and state management capabilities.¹²

Much of the work in this area warns of threats to local governments as a result of welfare reform. For example, Chernick studied the fiscal behavior of state governments in response to the change from matching aid to block grants under PRWORA.¹³ He predicts that the overall level of redistribution in the United States will almost certainly decrease, and raises the issue of the effect of block grants on state-to-local relations as mayors and county executives fear the accompanying state-to-local devolution of the

⁸James Ziliak et al., "Accounting for the Decline in AFDC Caseloads: Welfare Reform or the Economy?" *The Journal of Human Resources* 35 (2000): 570-585; and Yu Hsing, "Welfare Reform and Caseload Reductions" *International Journal of Social Economics* 28 (2001): 338-343.

⁹Richard M. Francis, "Predictions, Patterns, and Policymaking" A Regional Study of Devolution." in *Welfare Reform: A Race to the Bottom*, eds. Sanford F. Schram and Samuel H. Beer (Washington, DC: Woodrow Wilson Center Press, 1999).

¹⁰*Ibid.*, 178.

¹¹ Richard P. Nathan and Thomas L. Gais, "Implementing the Personal Responsibility Act of 1996: A First Look" (Albany, NY: Rockefeller Institute of Government, 1998).

¹² Elizabeth T. Powers, "Block Granting Welfare: Fiscal Impact on the States," *Economic Development Quarterly* 14 (2000): 323-339; John Kincaid, "The Devolution Tortoise and the Centralization Hare," *New England Economic Review* (May/June 1998): 13-40; Robert Tannenwald, "Come the Devolution, Will States Be Able to Respond?" *New England Economic Review* (May/June 1998): 53-73; and Davie M. Hedge and Michel J. Scicchitano, "Devolving Regulatory Authority: The Federal and State Response," *Policy Studies Review* 11 (Spring 1992).

responsibility for redistribution. Hovey also raises concerns about the potential impact of welfare reform on local governments, including increased fiscal stress and increased benefit disparities.¹⁴ As early as 1997, Margaret Weir from the Brookings Institution suggested that local governments would be key to the welfare reform debate, and lamented that they had not been significantly consulted in the policy change process.

In other pieces related to welfare reform and local government, Connell and Rubin discuss welfare reform's impact on local housing authorities.¹⁵ More recently, Angel writes on the administrative and fiscal challenges facing state and local governments dealing with immigrant population needs under PRWORA.¹⁶ Katz and Allen conducted a series of interviews with local officials on their response to welfare reform.¹⁷ The officials cited fragmented administration of governmental programs as a barrier to effective delivery of services to welfare recipients. In commenting on the difficulty of studying this issue, Katz and Allen state, "With welfare policy, in short, the devil is in the details."¹⁸

PUBLIC POLICY ENVIRONMENT

The Personal Responsibility and Work Opportunity Reconciliation Act (PROWA) of 1996 (P. L. 104-193) "changed welfare as we knew it" in the United States. A major component of welfare reform, in the spirit of devolution, was the establishment of a block grant funding system for each of the 50 states, replacing the traditional Aid to Families with Dependent Children entitlement program. One can argue about the importance of various aspects of TANF, but there are at least two major ramifications of the change. First, by moving the program from an entitlement to a state block grant, recipients are no longer

¹³ Howard Chernick, "Fiscal Effects of Block Grants for the Needy: An Interpretation of the Evidence," *International Tax and Public Finance* 5 (1998): 205-233.

¹⁴ Harold Hovey, *Can the States Afford Devolution? The Fiscal Implications of Shifting Federal Responsibilities to State and Local Government* (New York: The Century Foundation Press, 1999).

¹⁵ Terrence L. Connell, Deborah Devin and Les Rubin, "Welfare Reform: What It Could Mean to LHAs," *Journal of Housing and Community Development* 55 (1998): 34-42.

¹⁶ Jacqueline L. Angel, "Devolution and the Social Welfare of Elderly Immigrants: Who Will Bear the Burden?" *Public Administration Review* 63 (2003): 79-89.

¹⁷ Bruce Katz, and Katherine Allen, "Cities Matter: Shifting the Focus of Welfare Reform," *Brookings Review* (Summer 2001): 31-33.

guaranteed assistance. Second, rather than government treating welfare in a relatively consistent fashion through a single federal program, there are over 50 different state TANF programs, with each state designing its own program, setting benefits and establishing eligibility requirements. States also vary in terms of time limits, work requirements, sanctions, and provision of services rather than direct financial assistance.

In states where local governments are involved, there is even more variation. In “The Policy Context of Second Order Devolution,” the authors present an excellent summary of the cascading nature of this federal to state government shift:

“For 35 American states this first-order devolution in the delivery of welfare assistance marked the end of the formal devolution line. In these states full and total responsibility for administering TANF rests with the state-level welfare agency. But for the remaining American states, including North Carolina, local governments (primarily counties) play significant roles in the administration and local delivery of welfare and other human service programs. In these states first-order devolution resulted in the following query: “How much state-to-local second-order devolution should be permitted or promoted?””¹⁹

North Carolina is one of the states with a second order devolution. The delivery of TANF services is a locally administered, state-supervised process, run under the “Work First” program. To keep this discussion focused, I concentrate on funding rather than program variation. The majority of Work First funding is federal, but funding is based on two other major participants - state and local government contributions are also significant.

First, the amount of each state’s federal block grant is based on the state’s 1994 AFDC spending level. Second, in order to access its total block grant funding, each state must spend 75 percent of its former, state-originated spending level - this mandate is referred to as a state’s maintenance-of-effort (MOE) requirement. Whatever local governments spend on particular welfare program within the state can count toward the state’s total.

¹⁸ Ibid., 33.

Third, just as each state is required to meet a MOE expenditure level to access its entire federal TANF block grant funds, if a county participates in the program, the local government involved may have to reach a MOE. For example, each county in North Carolina is required to reach a pre-determined county-based welfare expenditure level. According to North Carolina state law (G.S. 108A-27.12.), all counties must maintain Work First funding based on their “county funds budgeted in State Fiscal Year 1996-97 for AFDC Administration, JOBS employment and training, and AFDC Emergency Assistance (cash and services).” Counties must reach this MOE requirement to access their total allotted amount of state and national funding.

For illustration purposes, Figure 1 shows the distribution of Work First funding for SFY 2000-01 among the three levels of government.

[Figure 1, about here]

Work first clients receive services that are supported in part by federal, state and local government funds. In SFY 2000-2001, North Carolina counties received approximately \$90.8 million in Work First County Block Grants from Federal and State sources (\$86.3 million federal pass through monies and \$4.5 million in state monies). The counties in turn spent money in two ways: for Work First services and for Work First administration. Figure 2 illustrates what funds went to each area.

[Figure 2, about here]

As the nation devolved the responsibility for welfare to the states, North Carolina initiated a second-order devolution by providing counties with the opportunity to increase their local level of responsibility for designing the program. While all counties are affected by the general state requirements and goals of the Work First program, certain so-called Electing counties “also have the opportunity to

¹⁹ Deil Wright and Kevin FitzGerald, “The Policy Context of Second-Order Devolution” in Christine A. Kelleher and Susan Webb Yackee, ed., *Meeting Challenges: North Carolina Responds to Welfare Reform, 1996-2001*

establish their own eligibility criteria and benefit levels.”²⁰ While all 100 North Carolina counties were eligible to apply for status as an Electing county, only 25 counties applied. Because the pilot program was controversial, in a compromise agreement, the state agreed to allow only up to 15.5 percent of the state-wide caseload to participate in the pilot program. The names of the 25 counties applying for Electing status were placed in a hat, and on the state legislature floor, the Sergeant-of-Arms drew out county names until the 15.5 percent maximum was reached.²¹ Twenty-one counties were included. The counties not chosen or which did not apply in the first place, and therefore which do not have additional program flexibility, are often referred to as Standard counties.

What was the reaction of counties to this devolution? A project in North Carolina studying this issue tracked county officials’ perceptions of devolution. That project, Tracking County Responses to Welfare Reform, gathered data from five officials in each county on the perceived extent and character of devolution and the desire for additional policymaking authority in the counties. A summary of that work was published as part of that project. The editors/authors found that “...from the time welfare reform exploded onto the political agenda in 1997 through the time of our surveys in 2000, its importance in the counties of North Carolina remained high. In fact, the importance of welfare reform in 2000 remained at the same level as it was when the reforms were being pushed through the General Assembly.”²² The report found relatively strong support for securing workforce participation by clients, reducing county expenditures, reducing welfare rolls, and organizational culture change, among other goals. Surprisingly, the strength of the perceptions was relatively equal between Standard and Electing Counties.

The work presented here adds to the earlier analyses by looking at funding outcomes. This study focuses on the county-only spending for Work First programs, for example the \$79.8 million in Work

(Chapel Hill, North Carolina: The Institute of Government, University of North Carolina, 2002), p. 3.

²⁰ North Carolina’s Temporary Assistance for Needy Families State Plan (P.L. 104-193): The Work First Program. North Carolina Department of Health and Human Services, FFY 2002-2003, p. 2.

²¹ Christine A. Kelleher and Susan Webb Yackee, An Analysis of Welfare Reform: Actions, Attitudes, and Assessments in n Christine A. Kelleher and Susan Webb Yackee, ed., Meeting Challenges: North Carolina Responds to Welfare Reform, 1996-2001 (Chapel Hill, North Carolina: The Institute of Government, University of North Carolina, 2002).

²² Ibid., 80.

First services and \$12.8 million in Work First Administration spent in SFY 2000-2001. County welfare expenditures do not include Work First general cash assistance, which is comprised of federal and state dollars only, and which is distributed directly to the client via checks. Overall, this study will examine county-originated Work First funding for four state fiscal years, 1997-2001.

ARE NORTH CAROLINA COUNTIES MEETING THEIR MOE REQUIREMENTS?

Data

To answer this question, data on MOE spending were collected from the Office of the Controller at the North Carolina Department of Health and Human Services (NC DHHS). To control for county differences, MOE spending is examined as the ratio of the county's actual TANF expenditure divided by its required MOE expenditure level. Two former and two present NC DHHS officials have verified the DHHS data as the most reliable local government welfare reform expenditure data available.

Only one county, Graham, was omitted from this otherwise complete population of data because its data were considered unreliable by DHHS officials. It would have presented an extreme outlier in the data. No other major outliers were identified, although one should note there is a smaller number of counties having a large negative value for the percent of MOE above or below the required amount than those with a positive amount.²³

Findings

Despite the statutory requirement, many counties in North Carolina do not reach their required annual MOE levels. Taken together, over the four fiscal years covered in this study, the MOE shortfall

represented over \$33.8 million of combined county funds that could have potentially supported more welfare reform activities at the local level (see Table 1). On the other side of the spectrum, the counties that met or exceeded their MOE requirements contributed only \$3.4 million total above the minimum required outlays over the four years. When these combined shortfalls and surpluses are combined, the net result for the 100 counties was still over \$30 million of required local welfare reform funding that was not spent. As a percentage, this amount may seem somewhat small, but it is significant in terms of absolute dollars.

[Table 1, about here]

In meeting their TANF MOE requirements, state and local governments may count state and local funding that they spend through their state TANF programs and (subject to certain restrictions) state and local funding that they spend for needy families through other social services programs. This makes the inability of county governments to reach the required MOE levels even more interesting.

Work First block grant funding received by counties is not subject to a local "match" requirement in the sense that counties "draw down" federal and state Work First funding on a dollar-for-dollar or other matching formula based on actual county spending for Work First. Instead, counties are simply required to "maintain" a specified percentage of the level of their earlier financial effort in assisting needy families as a condition of receiving federal and state Work First funding. While counties may be subject to potential fiscal sanctions if they fail to do so (withholding federal and state funding on a dollar for dollar basis), the county Work First MOE requirement is qualitatively different from more common financial match requirements for social services programs.

²³ To understand if there is any problem presented by this data, the distribution was examined. It showed some skew to the negative values, but it was not great. Attempts to transform the variable resulted in a greater skew in the opposite direction.

It is also significant to note that the average percentage shortfall decreased over time for the Standard counties, to a relatively minor shortfall, as seen in Figure 3. However, in Electing counties, the shortfalls are significant and continue each year. Standard counties are also more closely clustered in MOE. After an initial Standard deviation of 13 percent, they appear to be settling into a pattern of approximately +/- seven percent Standard deviation. In contrast, the Electing counties have generally exhibited much more variation in MOE.

[Figure 3, about here]

WHAT FACTORS EXPLAIN COUNTY VARIATIONS IN REACHING THESE REQUIREMENTS?

Method

The framework that motivates this model is that freedom fosters change. Given freedom to make funding changes, decision-makers may change spending, either increasing or decreasing it, in line with their political support of a program. Political attitudes toward welfare, the economic situation of the region and government, and social attitudes would be the usual suspects in understanding county spending variations. The factors operationalizing these concepts, and accompanying hypotheses about how they would react to more freedom in local government decision-making, are:

H₁ County fiscal well-being is positively related to percent of MOE reached. The theory behind this hypothesis is that counties with proportionately greater financial resources have more capacity to raise local dollars, allocate it to local welfare programs, and draw down more state and federal dollars than counties with less fiscal well-being. Conversely, those counties under fiscal stress tend to cut spending on social programs.

- H₂* A County's Work First caseload is positively related to percent of MOE reached. The rationale here is that welfare programs will have higher visibility and priority in counties with proportionately larger Work First caseloads
- H₃* More liberal politics are positively related to percent of MOE reached. The theory behind this hypothesis is that counties with greater Democratic support tend to be more ideologically sympathetic to public welfare programs and thus are more willing to commit local resources to such program than are counties with stronger Republican leanings.
- H₄* Standard counties are more likely to have a higher percentage of MOE reached than Electing counties. Electing counties have sought greater local autonomy over public welfare programs. They may have done so in order to increase local programming. However, it may be more likely that they have done so in the belief that local governance could lower costs, either with or without reducing services, and less money has been allocated as a result.
- H₅* All counties will face a learning curve in adapting to the Work First program. Any organization will need to learn in the face of significant policy change, especially the Electing counties. We could expect that even if the intent of counties was to maintain constant programming, the initial change in funding structure that Work First represented would cause a change in spending, but that spending would increase over the four years as counties gain experience.

To test these five hypotheses a multivariate, fixed effect model was specified. The county is the fixed effect, to control for unobserved heterogeneity among counties.²⁴ The dummy variables are county-specific and can change over time. The resulting model is:

²⁴I also ran the model without the fixed effects, and in addition to confirming the other results, these new results showed that certain characteristics of the county are significant, such as per capita income, fund balance, the

$$\text{MOE} = \beta_0 + \beta_1 F + \beta_2 I + \beta_3 D + \beta_4 C + \beta_5 S + \beta_6 P + \beta_7 T + \beta_8 R + \varepsilon$$

where

MOE = amount above or below 100 percent that the ratio of the county's MOE level obtained to its required MOE level is

β_i = parameter estimates (i=0...6)

F = fund balance as a percentage of the county's total general fund expenditures

I = per capita income as a percentage of the state average per capita income

D = number of times in the previous year the county was declared a federal disaster area

C = number of Work First cases as a percentage of the county's total adult population

S = status as Electing or Standard county (Electing = 1; Standard = 0)

P = political orientation (Republican = 1; Democratic = 0)

T = first year of program (1997 = 1, other years = 0)

R = rural nature of county (1 = primarily rural, 0 = primarily urban)

ε = error

This is only one way to model the question of what is affecting local government spending on welfare. In terms of different dependent variables, spending levels directly could measure commitment to welfare, but that would not account for historical spending patterns and culture, as well as the obvious differences in population or caseload. Ideally, in addition to understanding if spending went up or down, one would like to know if counties took advantage of the freedom to change the programs on which the money was spent, changing how services were delivered. At the time of this writing, such research is underway. In terms of independent variables, there are many that could be added in a complete model.

political leanings of the county. Of the original and the additional variables, 1997 carries the largest weight in the model (as measured by Standardized coefficients) at .53, and Electing status is the second largest weight, at .33. Given that the fixed effect model is tending to capture these county level differences, and is the more appropriate

Other indicators of a county's fiscal well-being could be used, such as credit rating. Economic development or decline could be another factor affecting attitudes toward welfare. When other variables were explored for use as independent variables for this model, they were either too vague for use as an appropriate indicator, too similar to a variable already in the model, or not available. I suggest they continue to be considered, however, as this research moves forward.

Measures

For the dependent variable, the percent of MOE reached by each of the 100 counties in each of SFYs 1998-2000 was calculated. One hundred percent was subtracted from these data, giving the amount above or below each county was in terms of reaching its required 100 percent of MOE. The range of values shows that counties fell short by as much as 68 percentage points to spending over by 30 percentage points.

All data for the other variables also covered these four years. There is no evidence of multicollinearity among the variables. There are four observations per county (396 total). Some clustering for these values will occur, and therefore, the observations are not truly completely independent. The results presented below, therefore, should be interpreted with caution.

Fiscal well-being for each county was measured via two independent variables: fund balance and per capita income. Fund balance was taken as a percentage of the county's total general fund expenditures while per capita income was taken as a percentage of the state average per capita income. Both measures were included for their different areas of emphasis: the fund balance ratio is more reflective of a county government's current financial health while the per capita income ratio is more representative of the overall financial health of the entire county. Fund balance information was collected

model specification, and that the other variables in the non-fixed-effect model carry less weight than the two I have focused on, I maintain the preference of the use of the fixed effect model.

from the N.C. Office of the State Treasurer.²⁵ Per capita income figures were collected from the February editions of *Business North Carolina*.

In the past decade, North Carolina local governments have also been under unusual levels of stress due to natural disasters. Hurricanes, flooding, and drought have affected different parts of the state, and a variable was included that accounts for the number of times in the previous year that the county was declared a federal disaster area. This variable captures the high level of fiscal stress brought on by natural disasters. Data for this variable were obtained from Novogradac and Company LLP's Affordable Housing Resource Center.

A county's Work First caseload was calculated as the number of Work First cases (not recipients) as a percentage of the county's total adult population, as measured by annual population estimates as of July of each year as published by the State of North Carolina. As with the fiscal well-being measures, this measure was taken as a percentage measure to ensure proportionality across counties. Caseload data for each county were collected from the NC DHHS.^{26 27}

A county's political orientation was represented in the regression analysis with a dummy variable, with 0 indicating a Democratic majority on the local governing board (Board of County Commissioners) and 1 for a Republican majority. Political orientation data were collected from the North Carolina Association of County Commissioners. Finally, a county's status as a Standard or Electing County was measured via a dummy variable where 1 is used to indicate that a county was an Electing county and a 0 indicates Standard counties.²⁸ County status data were collected from The Tracking Welfare Reform in NC Counties Project.²⁹

²⁵ See website [<http://ncdst-webt.treasurer.state.nc.us/lgc/units/unitlistjs.htm>].

²⁶ See website [<http://www.dhhs.state.nc.us/docs/reportcard.htm>].

²⁷ This variable may be somewhat endogenous. If so, the coefficient estimate will be biased. However, since it is not the variable of interest, we can simply note this potential problem when we interpret the results. Its role in controlling for other factors is preserved.

²⁸ This was a difficult variable to measure. The county's status was easy to trace. However, the larger question is, "What is it about Electing counties?" As a reminder, Electing counties are ones that received freedom to have county-designed welfare programs, including the freedom to adjust county-based welfare spending. In investigating how to probe this issue in more depth, I constructed a separate logistic model to determine what factors affect the probability of applying to be an Electing county.

A counter variable was considered to measure learning over time, but instead a dummy variable for year is used to capture year specific impacts. Initially, a dummy variable is used for each of the four years. When tested in various model specifications, I found 1997 was consistent significant, and the other years were not. In the interests of parsimony, I only keep 1997, the beginning year for the pilot program, in the model.

Results

Overall, the eight independent variables explain approximately 41 percent (adjusted) of the county variation in reaching MOE requirements. The results are presented in Table 2.

[Table 2, about here]

We are left with no strong conclusions regarding our hypotheses for fiscal well-being. Neither fund balance, per capita income gain, or incidence of disaster (and therefore fiscal stress) measured statistical significance. For future research, however, it may be interesting to note that the measures for fund balance and per capita income have opposite signs: the fund balance showing a negative relationship with percent of MOE reached, and per capita income showing a positive one. Based on this, one may

The logistic regression looked at five main characteristics of N.C. counties that I felt would affect whether or not they applied to be an Electing county. (Selection of final participants in the process was random, so looking at the self-selection of the applicants is more appropriate.) The five characteristics were: what region of the state the county is in, whether it is a metropolitan area, the political basis of the board of county commissioners, the county population, and unemployment. The model had relatively good fit, with a percentage predicted=observed at 83.7 percent. The Cox and Snell R^2 was .359; Nagelkerke R^2 was .511. I found that region, political basis of the governing board, and unemployment were all significant. Although these results are interesting, I decided to not change the final regression model for several reasons. Most of the variables significant in the logistic regression are dealt with in some way already in the final model. In addition, using probabilities of applying to be an Electing county in the final model rather than a direct dummy did not garner significant results. Third, I feel the issue is one of appropriate model specification. There is a distinct difference to being an Electing county that does not reflect politics, population or economic forces. Being Electing gave a freedom to the counties to adjust their spending levels, a freedom not granted to other counties. I feel this explicit difference warrants maintaining the use of a dummy variable.

²⁹ See website [<http://www.unc.edu/depts/welfare/chron.pdf>].

wish to keep these variables as discretely different as opposed to uniting them under a more abstract concept.

Although it had the expected sign, Work First caseload was not statistically significant. As in other states, caseloads in North Carolina were decreasing during the study period— a drop of over 60 percent from 1995 to 2002.³⁰ But the pattern of caseload levels does not closely correspond to county funding levels. The model result may be a function of the fact that cash assistance, which is the direct financial benefit received by the Work First clients, is comprised entirely of national and state (not county) dollars.

The variable for politics had an unexpected sign, showing that Republican counties could be expected to be slightly closer to reaching their MOEs, but again, this variable was not statistically significant. The variable for rural or urban status also did not have significance.

The most striking result came from the final variables. A county's status as Electing or Standard is statistically significant, and the parameter estimate is large. Electing counties are far behind Standard counties in terms of percent off MOE reached – around 26 percentage points, in fact. This would support the fourth hypothesis stated above, participating in the pilot plan had the result of lowering county originated welfare spending. For the fifth hypothesis, the dummy for 1997 was also significant, showing that counties did in fact decrease spending significantly, by over 14 percent, in the first year of the program. However, earlier model specifications, with dummies for other years, did not support the concept that spending levels continue to change each year. An adjustment is made, and then spending patterns are more stable. This result is open to interpretation. It may mean there is little learning taking place over time. It may also be that 1997 was the year when politicians, in both Standard and Electing Counties, felt they could most easily make a programmatic shift or funding cut.

³⁰ Sorien Schmidt, *Holding Families Back: Federal Roadblocks to Work First Success* (Raleigh, N.C.: North Carolina Justice and Community Development Center, 2002).

WHAT BUDGET IMPLICATIONS

CAN BE DRAWN FROM THESE FINDINGS?

These findings have implications for state and local governments and individuals in North Carolina. There are also wider implications for other states considering policy devolution. First, counties continue to play a major role in funding welfare in North Carolina. Over these four state fiscal years, the 100 counties have collectively contributed over \$380 million in local funds towards the Work First program. Despite the \$30.4 million shortfall in local funds, counties have played an indispensable role in assisting the State reach its required MOE expenditure level to receive federal matching funds. However, the county shortfall from statutory levels means the State faced an additional burden to reach the state-wide MOE. Even without the county contribution, the state reached its federally required MOE in each of these years. One could consider the state as having substituted its own funding for the counties' shortfall during these years. State government spending met the federal MOE requirement in these years, but in the current times of severe state fiscal stress and deficits, this may not continue to be the case. If the state does not make up the county shortfall, the level of the federal match could become endangered.

Interviews with a former state official familiar with the program suggests the state was aware of the shortfalls, but since state spending was sufficient to reach the federal MOE requirements, the statutory requirement for county spending was not enforced. Counties were not penalized. The counties did not lose state funding as a result of failing to meet their MOE requirements. Will this continue? Will North Carolina, or other states in a similar position, enforce local government mandates? If North Carolina begins to enforce this requirement, counties may have to make difficult policy and funding choices.

Perhaps the more important issue is the fact that counties did not provide over \$30 million dollars in expected and required services to clients. However, it does not confirm the particular motivations or causes of Standard and Electing counties in failing to reach their MOE requirements. While a majority of Electing counties and Standard reported MOE gaps, the combined MOE monetary shortfall of the 21 Electing counties over the four SFYs (\$10.3 million) was one third of the total. Likewise, while most

Standard counties are not reaching their MOEs, after the first year, the majority of these are only short by less than five percent, while Electing Counties report significantly larger gaps.

The implication is that by having reduced spending, client suffered. However, we do not know this. Perhaps Electing counties are able to institute changes that still serve clients but in a more efficient manner. Perhaps Electing counties are using their freedom to reduce unnecessary service provision. While we try to control for caseload, there may be some other reduction in demand for services. This research only confirms that behavior is changing, with a wide disparity of funding resulting, and indicates some possible predictors of that behavior. The results set the stage for the next step in this research. While the significant funding shortfalls in the Electing counties may raise concern, we cannot draw firm conclusions about the positive or negative ramifications of the funding shortfalls until we track precisely what services were provided, how they were provided, and tie those services to client outcomes.

Much of the evaluation of Work First was suspended when the state suffered an economic downturn in the early part of the 2000 decade. Data following individual recipients reveals that Work First case openings did not appear to increase, mainly due to large increase in families being offered cash, usually equal to three months of benefits, as a diversion payment to avoid being added to the Work First rolls. Without these payments, the caseload would have likely climbed dramatically. Recent information on spending on welfare at the county level is sparse, since Medicaid spending burdens have become much more of a concern at the local government level.³¹

What broader implications does the research have? This analysis suggests that decentralization may bring about reduced program spending, confirming some of the fears expressed by several of the authors cited in the literature review. Either Electing or Standard counties, or both, may be experiencing administrative burdens, and not able to spend money as they would like. One former DHHS official interviewed suggested that setting up a new program independent of other social service programs takes

³¹ “What’s Up with Work First?” presentation by Dean Duncan, University of North Carolina at Chapel Hill School of Social Work, April 2, 2004. Accessed at http://ssw.unc.edu/workfirst/reports/LNC%20Presentation_apr04.pdf on September 2, 2005.

time and an information technology infrastructure that is not readily available or easy to implement.

Other welfare specialists in North Carolina confirmed this interpretation.

This study also raises questions regarding the fiscal accountability of inter-governmental block granting. For example, have the MOE requirements that have accompanied the TANF block grant process clarified or confused the issue of funding accountability? Are states striving to maximize the use of local funds when pursuing their MOE requirements? Are local governments taking advantage of ambiguous enforcement measures by states when they have not anted up their required levels of welfare reform funding?

LIMITATIONS

A significant limitation of this study is that it only examines four years of fiscal data. A second limitation concerns the validity and reliability of the dependent variable data. While these data are the most reliable data available it should be noted that this information is reported by each county's Department of Social Services to the NC DHHS. As a result of this reporting structure, it is possible that counties have different understandings in regards to what can be coded as a Work First expenditure. However, other on-going research using the same data suggests they are reliable.³² Another example of a potential limitation of the data is that certain counties may rely on volunteers and faith organizations to provide in-kind Work First Services that are not reflected in the existing reporting forms. Third, as mentioned above, some clustering in the data is possible and the results must be interpreted with caution. Finally, with an adjusted R squared of .409, there are clearly other significant factors or motivations unidentified by this study that can help explain county variations in reaching their MOE requirements.

It is important to point out that while it is necessary to standardize the dependent variable to account for variations in population, budget, and other salient differences between the 100 counties, the effects of this Standardization can be dramatic. For example, in state fiscal year 1999-2000, while

Perquimans County and Cabarrus County reported similar gaps in their MOE requirements, \$58,598 and \$57,485 respectively, this amount represented only a four percent MOE shortfall for Cabarrus, while for Perquimans it amounted to a 31 percent shortfall.

CONCLUSION

Several important factors, including control over program eligibility and benefit levels, were significantly associated with county welfare spending variation. It is clear counties given more flexibility spent dramatically less than others. Many, both Electing and Standard counties, failed to meet MOE requirements without penalty, year after year. These issues raise serious questions about decentralization from both the budget and policy perspectives. Did the counties reduce spending because they were allowed to, were their administrative changes so successful that they did not need the additional funding, or were the structural changes so great the money could not be spent? Would we find similar results if other programs were also devolved to the local level? What role does a penalty play, if it is not enforced? North Carolina has been able to meet its MOE requirement to gain federal funding in the past, but what if it couldn't without the county funds? If the state would enforce the MOE requirements at the county level, would counties increase their funding, or be willing to forgo other funds from the state? Does the lack of enforcement imply a lesser focus on the policy objectives of the Work First program? These are important questions for future research. In addition, we have not explored the impact to the beneficiaries. A brief examination of this issue, using caseload in the following year as a dependent variable, did not provide significant results. More detailed work in this area is needed.

Katz and Allen state that the next step in welfare reform is to focus on cities.³³ While cities are not the drivers of TANF programming in North Carolina, the focus on local government, and I would argue, on social service budget priorities at the local level, is very appropriate. All the aforementioned

³² Christine Kelleher and Susan Webb Yackee, "Sub-National Governments as Laboratories for Innovation: Policy Learning After Devolution" Paper prepared for the Annual Meeting of the American Political Science Association, Chicago, Il (September 2004).

³³ Katz and Allen, 31-33.

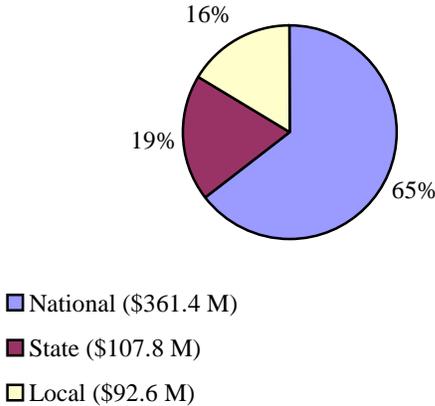
questions and implications that emerge from this study are particularly timely for local, state and federal policymakers who will make key decisions regarding the reauthorization of welfare reform in the coming years. Demetrious Caraley noted recently that there was a danger in trying to evaluate welfare reform on a national basis because it was “now a patchwork of programs with different rules and benefits depending on the state, administered according to the views of sometimes idiosyncratic individuals who happen to be serving in key political roles.”³⁴ This is even more so the case when power over program design and administration is devolved to the local level. However, that patchwork also presents the variation that will be very valuable in trying to understand what mix of services best achieves the goals of moving welfare recipients to work. A key starting point in this process is understanding how funding commitments change after devolution. In highlighting the MOE process in more detail, this paper has offered some insights into the nature of the welfare funding relationship that exist between the state and local governments in North Carolina, with strong questions raised for North Carolina and other state governments as they consider policy and program devolution.

NOTES

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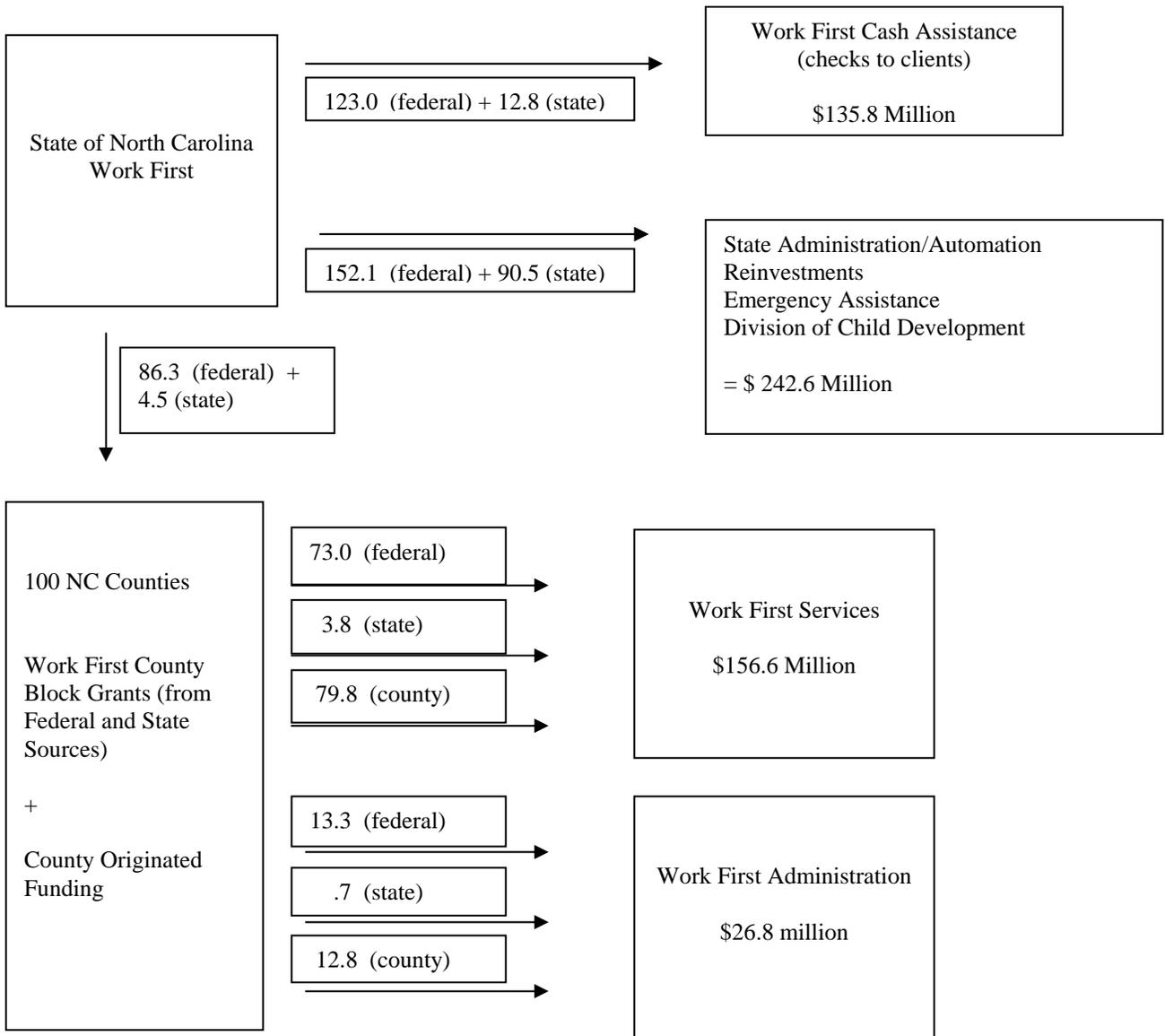
³⁴ Demetrios James Caraley, “Ending Welfare As We Know It: A Reform Still In Progress” *Political Science Quarterly* 116 (2001-2002): 542.

Figure 1: Sources of Total North Carolina Work First Funding, SFY 2000-2001



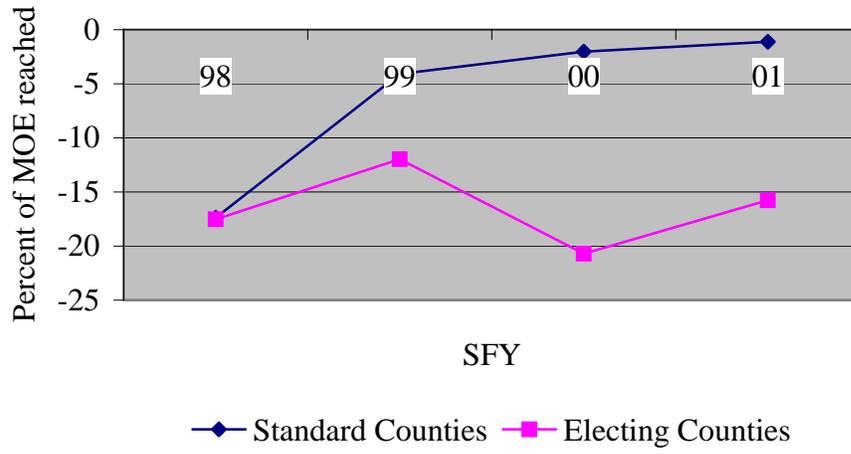
Source: Tracking County Responses to Welfare Reform Project, University of North Carolina at Chapel Hill.

Figure 2: Distribution of N.C. Work First Funding, SFY 2000-2001 (in \$ Millions)



Source: Tracking County Responses to Welfare Reform Project, University of North Carolina at Chapel Hill.

Figure 3. Average Percent of MOE Reached in Standard Versus Electing Counties



Source: Author's calculations.

Table 1. County Variance in Reaching Maintenance of Effort Requirements (in percents)

All counties combined	SFY98	SFY99	SFY00	SFY01
Mean	-17.40	-5.54	-5.74	-4.06
Standard Deviation	12.60	6.82	13.44	12.03
Minimum	-45.52	-27.83	-67.78	-65.12
Maximum	30.14	12.29	23.57	15.24
Standard counties				
Mean	-17.38	-4.10	-2.04	-1.12
Standard Deviation	12.99	6.51	7.80	7.06
Minimum	-45.52	-27.83	-31.19	-31.15
Maximum	30.14	12.29	23.57	15.24
Electing Counties				
Mean	-17.54	-11.96	-20.71	-15.76
Standard Deviation	10.75	4.37	19.05	18.40
Minimum	-33.77	-23.44	-67.78	-65.12
Maximum	9.44	-2.93	4.63	9.49
Total Surplus Funding	\$.166 M	.505 M	.121 M	1.529 M
Total Deficit Funding	\$20.732 M	4.891 M	4.445 M	3.741 M

Source: Author's calculations. Figures are rounded.

Note: The four counties which wished to be electing, but were not chosen, had substantially smaller shortfalls in funding (-15.51, -5.26, 5.70 and 1.28 from SFY1998-SFY2001), when compared to those which were chosen.

Table 2: Model Results

Variable	UnStandardized Coefficients (B)	Standard Error	t-score
Constant	-28.676	17.457	-1.643*
Fund Balance	-.090	.098	-.918
Per Capita Income	.180	.125	1.438
Disasters	1.159	.901	1.287
Work First Case Load	.035	.116	.304
Status as Electing or Standard County Political	-25.900	-7.746	-3.344***
Orientation	-.383	2.527	-.152
First year of Program - 1997	-14.219	1.692	-8.403***
R-squared	.566		
Adjusted R-squared	.409		
F-Value	3.620***		

*p<=.10, **p<=.05; ***p<=.01

Source: Author's calculations.