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ABSTRACT

This General Accounting Office (GAO) report addresses the concern raised by Senator Thad Cochran that revising counts of people in poverty (by adjusting the official poverty line for geographic differences in the cost of living) could significantly alter the allocation of federal aid to state and local governments. A concern is that a cost-of-living adjustment in counting people in poverty could divert federal assistance from states that already must make an above-average effort to fund needed public services. The following are problems presented by the proposed cost-of-living adjustment: (1) It raises fairness issues in allocating federal aid; (2) it would improve only one dimension of state funding needs; (3) states differ in the cost of providing services; and (4) states differ in their ability to fund services for the poor. The report describes how the Chapter 1 program formula is an excellent example of how increased fairness in the allocation process could be achieved. The report concludes that if adjusting poverty counts to reflect differences in the cost of living prove feasible, it would enhance the federal government's ability to target federal assistance to places with the greatest needs. However, such a change should not be implemented in federal allocation formulas without first assessing the impact of the change on the fairness with which federal funding is allocated to states and localities. One figure is included. (LMI)

United States General Accounting Office

GAO

Report to the Ranking Minority Member, Subcommittee on Regulation and Government Information, Committee on Governmental Affairs, U.S. Senate

May 1994

FEDERAL AID

Revising Poverty Statistics Affects Fairness of Allocation Formulas

GAO/HEHS-94-165

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United States
General Accounting Office
Washington, D.C. 20548

Health, Education, and
Human Services Division

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May 20, 1994

The Honorable Thad Cochran
Ranking Minority Member, Subcommittee on
Regulation and Government Information
Committee on Governmental Affairs
United States Senate

Dear Senator Cochran:

In your request you expressed a concern that revising counts of people in poverty by adjusting the official poverty line for geographic differences in the cost of living could significantly alter the allocation of federal aid to state and local governments. You asked us to provide our views on how such a revision could affect the fairness of the distribution of federal formula grants if such an adjustment were made. Our analysis is drawn from several reports we have issued in the last decade that address the issue of fairness in allocating federal aid to state and local governments.[1]

Results in Brief

Achieving fairness, in the sense that state and local governments undertaking comparable financial burdens should be able to provide comparable benefits for citizens in need of such services, requires that grant allocation formulas reflect three dimensions of state funding needs: (1) the number of people potentially eligible for services, (2) the cost of providing those services, and (3) the ability of state and local taxpayers to fund services from state and local revenue sources.

A better count of poverty, appropriately adjusted to reflect cost-of-living differences, would enable policymakers to target scarce federal aid where poor people have a greater need of services. However, adjusting poverty counts would improve only one dimension of state funding needs. Achieving fairness in the distribution of formula grants also requires that differences in states' own funding capabilities and differences in the cost of services also be taken into account to ensure that all three dimensions of states' funding needs are reflected in the distribution of federal assistance.

With a formula that lacks an indicator of a state's funding capabilities, a cost-of-living adjustment in counting people in poverty could redistribute federal assistance away from states that already must make an above

[1]See Related GAO Products at the end of this report for a listing of these reports.

average effort to fund needed public services.[2] Such a change could therefore add to the burden of those states already faced with a relatively high burden in funding the needs of the poor.

Background

Many experts agree that several problems exist in the measurement of poverty statistics. One of the most significant is that differences in the cost of living in different geographic areas are not taken into account. To address these issues, the National Academy of Sciences has formed a panel of experts to address the measurement of poverty, and it is in the process of studying the pertinent issues and of forming recommendations to address these measurement problems. Adjusting the poverty thresholds for variation in the cost of living raises technical issues of statistical reliability as well as concerns about how this one adjustment might interact with other recommended adjustments the Academy might recommend. Because we have not studied the current problems of measuring poverty in depth, at this time we cannot address the feasibility of making a cost-of-living adjustment in funding formulas.

Revising Poverty Counts Raises Fairness Issues in Allocating Federal Aid

Revising poverty counts to reflect cost-of-living differences could have significant repercussions if implemented in federal program formulas used to target federal grants that address the needs of the poor and disadvantaged. For fiscal year 1993, we identified 19 formula-based grants using poverty counts as the basis for distributing federal assistance to state and local governments in the Catalogue of Federal Domestic Assistance (see app. I). These 19 programs distributed $22 billion that year. The potential impact could be much larger if revised poverty counts were to be implemented in programs that use per capita income where a direct measure of poverty would be more appropriate. The Medicaid and the Aid to Families with Dependent Children programs are two cases in point. They alone allocated an estimated $91.8 billion in fiscal year 1993.

Given the size and importance of these programs, adjusting poverty counts could redistribute a sizable portion of the federal aid earmarked for domestic needs.[3] Such an adjustment naturally raises fairness questions in allocating federal resources. And the design and structure of grant

[2]This is because the cost of living tends to be lower in low-income states.

[3]See our report, Medicaid: Alternatives for the Distribution of Funds to States (GAO/HRD-93-112FS, Aug. 20, 1993), for estimates of how Medicaid funding would be redistributed if per capita income were replaced with poverty counts in that formula.

allocation formulas are the means by which fairness—or the lack of it—is realized.

A Common Principle of Fairness Is That States Undertaking Comparable Tax Burdens Should Be Able to Fund Comparable Benefits

An equitable allocation of federal assistance to state and local governments requires that grant formulas reflect three dimensions of need:

- the number of people potentially eligible for services under a given grant program,
- the cost of providing such services, and
- the ability of state and local taxpayers to support the nonfederal share of financing such services.

Funding formulas that reflect these three dimensions would promote an equitable allocation of federal resources in the sense that if all states imposed taxes at comparable rates, they would be able to provide comparable services for those in need.[4] This principle of fairness does not mean that all states must provide the same services and tax themselves at the same levels. But if states were to do so, they should be able to provide services roughly comparable to one another.

This notion of fairness is quite common. States have applied this notion of fairness with varying degrees of success in financing education since the 1920s. Today it is, to some degree, embodied in school aid formulas in most states. In addition, since the late 1940s when the Hill-Burton Hospital Construction program was passed, federal programs have compensated those states with more limited revenue raising capacity by providing them with larger grants than those to wealthier states. The fairness principle is reflected in such federal programs as Aid to Families with Dependent Children and Medicaid and the Vocational Education and Alcohol, Drug Abuse and Mental Health block grants. However, it is not reflected in the formula for allocating grants under the Chapter 1 program for the educationally disadvantaged even though the legislative history recognizes that low-income school districts lacked the financial means to adequately fund compensatory education when the program was authorized in 1965.

[4]Fairness, as defined here, is not the only possible criterion for designing allocation formulas. In addition to needs, as reflected by people in need, costs, and funding capacity, policymakers may also wish to reward grantees that undertake a greater financial effort to fund program needs or to provide incentives for grantees to be innovative and try new ways of delivering services that produce more cost effective outcomes.

Adjusting Poverty Counts Would Improve Only One Dimension of State Funding Needs

Adjusting poverty counts for differences in the cost of living would improve the measurement of potentially eligible recipients in programs intended to benefit low-income people. However, it does not address issues related to differences in the cost of providing services, nor does it compensate for the relatively wide disparities in states' abilities to fund program services from state and local resources. Consequently, using a revised poverty count that reflects cost-of-living differences without considering the cost of services or the funding capabilities of states and localities could adversely affect the fairness with which federal funds are allocated.

States Differ in the Cost of Providing Services

States differ not only in their concentration of people in poverty but also in terms of the costs of providing similar services. While it would be inappropriate to compensate state or local governments that have high costs because they are not vigilant in keeping costs as low as possible, it is appropriate to recognize cost differences that exist largely beyond the influence of the governments receiving aid. Ignoring these differences would result in all states being treated differently because federal aid would purchase more services in low-cost states than in high-cost states.

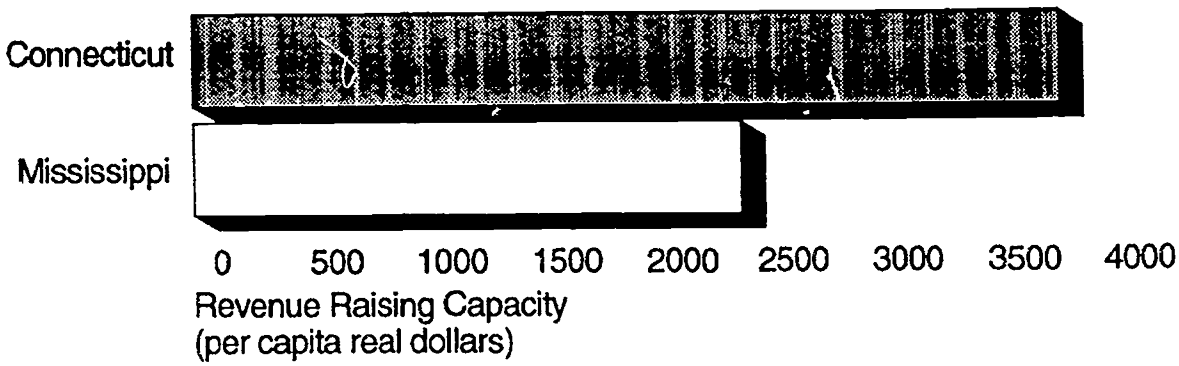
Cost differences is the factor most often neglected in grant formulas because of the difficulty in developing cost indicators for specific programs. Further, the methodological difficulties often result in controversy regarding their efficacy.

States Differ Significantly in Their Ability to Fund Services for the Poor

Our October 1993 report on the fiscal condition of state and local governments concluded that substantial differences exist in the states' abilities to fund public services needs.[5] For example, Mississippi and Connecticut, the home states of the Chairman and Ranking Minority Member of this Subcommittee, respectively, provide a contrast of states at each extreme. We estimate that if Mississippi and Connecticut were to tax themselves at the national average rate, Mississippi would generate approximately $2,267 in per capita revenues while Connecticut would generate more than $3,627 per person (see fig. 1).

[5] State and Local Finances: Some Jurisdictions Confronted by Short- and Long-Term Problems (GAO/HRD-94-1, Oct. 6, 1993).

Figure 1: Connecticut's Revenue Raising Capacity Is Greater Than Mississippi's



In making this comparison, we have adjusted these figures so that they reflect dollars of comparable purchasing power based on Bureau of the Census data on private sector wage rates.[6] We also adjusted these data to reflect interstate differences in high-need populations that include differences in the level of poverty.[7] Thus, even with a cost adjustment and an adjustment for the number of people in need, Connecticut's ability to raise revenues to finance public services exceeds that of Mississippi's by approximately 60 percent. The important point here is that improving our measures of people in need without also taking into account differences in real revenue raising abilities could create more funding inequities rather than fewer.

[6]State wage rates were adjusted to control for differences in the composition of each state's labor force. Specifically, adjustments were made to account for state differences in the age structure, gender composition, and educational levels of their respective workforces.

[7]In counting people in poverty we also made a crude adjustment to reflect cost-of-living differences so as not to overstate Connecticut's funding capacity or understate Mississippi's. While we believe the adjustment we made is reasonable for the purposes of making the above comparison we would not advocate its use to adjust poverty counts in grant formulas.

Allocating Chapter 1 Grants for the Educationally Disadvantaged Illustrates How Formulas Could Improve Fairness

The Chapter 1 program formula, which was used to distribute about $6.9 billion in federal funds in fiscal year 1994 to local educational agencies, is an excellent example of how increased fairness in the allocation process could be achieved. The Chapter 1 program currently allocates federal assistance on the basis of the number of children living in poverty (the formula's measure of people in need) and state per pupil educational spending (a crude proxy for interstate differences in the cost of educating students).

In our July 1992 report on the Chapter 1 funding formula[8] we analyzed the relationship between poverty counts and student performance on standardized tests and found that among schools with high concentrations of poverty, there were disproportionately more low achievers in large compared to smaller schools. We found that for each 10 poor children in large high-poverty schools there were approximately 5 low achievers, while small high-poverty schools had only 3 low achievers.[9] This difference might have occurred because the decennial census undercounted poor children in high-cost urban areas and overcounted them in lower cost rural areas.[10] As a consequence, the current Chapter 1 formula underfunds high-need urban schools. Thus, a measure of poverty that could adjust for cost-of-living differences would improve the federal government's ability to target Chapter 1 funds to schools with high concentrations of educationally disadvantaged children.

In addition to improving targeting based on need for services, our report also recommended that the formula's current cost factor (per pupil expenditures) be modified to eliminate a bias that favors higher income states.[11] Our report recommended that per capita income also be included in the Chapter 1 formula to reflect the more limited funding capability of low-income rural and urban schools.

[8] Remedial Education: Modifying Chapter 1 Formula Would Target More Funds to Those Most in Need (GAO/HRD-92-16, July 28, 1992).

[9] Small schools were defined as those with fewer than 50 students in poverty and larger schools were schools with more than 126 students in poverty.

[10] This difference could also be partly explained by having large numbers of poor children concentrated in larger schools, resulting in a peer group effect that results in poorer performance. We were unable to distinguish between these two possible causes for the high poverty/low achievement relationship we found.

[11] The report identified three reasons, which are unrelated to cost differences, why higher income states may spend more per pupil. In this regard, higher income states may spend more per pupil because they (1) have greater funding capabilities, (2) choose to procure more expensive education instruction, or (3) give education a relatively higher funding priority.

As mentioned earlier, the legislative history of the Chapter 1 program justifies the need for the program partly on the grounds that high-poverty areas have a lesser ability to finance compensatory education programs. However, a measure of local funding capacity is not now part of the Chapter 1 allocation formula. Instead, the formula uses state per pupil educational spending, which has the effect of channeling more Chapter 1 funds to states with greater, rather than lesser, funding capacities. Consequently, adjusting poverty counts for cost-of-living differences could mean greater funding inequities by allocating disproportionately more aid to high-cost areas with relatively large tax bases and a greater ability to fund these needs with relatively modest local tax burdens.

Conclusions

While we are unable to comment on the measurement issues associated with poverty, if adjusting poverty counts to reflect differences in the cost of living prove feasible, we believe this would enhance the federal government's ability to target federal assistance to places with the greatest needs. We also believe that such a change should not be implemented in federal allocation formulas without first assessing the impact of the change on the fairness with which federal funding is allocated to states and localities. In a formula lacking an indicator of states' own funding capabilities, such a change by itself could increase inequities. In formulas that already adequately reflect states' funding capabilities, such a change would improve fairness.

We did not obtain agency comments on this report because we were not evaluating agency functions or going beyond the audit work reported in previous GAO reports.

We are sending copies of this report to appropriate congressional committees and other interested parties. If you have any questions about this report, please call me on (202) 512-7215 or contact Jerry Fastrup, Assistant Director, on (202) 512-7211. Other major contributors to this report are listed in appendix II.

Sincerely yours,

Joseph F. Delfico

Joseph F. Delfico
Director, Income Security Issues

Grant Programs to State and Local Governments That Use Poverty Data in Allocation of Funds

Program	FY 1993 obligation
School Breakfast Program	$891,163,000
National School Lunch Program	4,131,424,000
Special Milk Program for Children	20,023,000
Child and Adult Care Food Program	1,273,160,000
Emergency Food Assistance Program (Administrative Costs)	45,000,000
Community Development Block Grants/Entitlement Grants	2,725,450,000
Community Development Block Grants/State's Program	1,118,300,000
Community Development Block Grants/Small Cities Program	49,750,000
Emergency Shelter Grants Program	52,364,000
Senior Community Service Employment Program	390,060,000
Migrant and Seasonal Farmworkers	78,293,000
Weatherization Assistance for Low-Income Persons	185,393,000
Federal Emergency Management Food and Shelter Program	129,000,000
Chapter 1 Programs/Local Educational Agencies	6,130,580,000
Supplementary State Grants for Facilities, Equipment, and Other Program Improvement Activities	9,950,000
Low-Income Home Energy Assistance	1,437,908,000
Head Start	2,776,285,604
Developmental Disabilities Basic Support and Advocacy Grants	89,878,176
Maternal and Child Health Services Block Grant to the States	557,938,640
Total	**$22,091,920,420**

Source: Catalogue of Federal Domestic Assistance, U.S. General Services Administration, Washington, D.C. (1993).

Major Contributors to This Report

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Related GAO Products

Older Americans Act: Funding Formula Could Better Reflect State Needs (GAO/HEHS-94-41, May 12, 1994).

State and Local Finances: Some Jurisdictions Confronted by Short-and Long-Term Problems (GAO/HRD-94-1, Oct. 6, 1993).

Remedial Education: Modifying Chapter 1 Formula Would Target More Funds to Those Most in Need (GAO/HRD-92-16, July 28, 1992).

Maternal and Child Health: Block Grant Funds Should Be Distributed More Equitably (GAO/HRD-92-5, Apr. 2, 1992).

Substance Abuse Funding: High Urban Weight Not Justified by Urban-Rural Differences in Need (GAO/T-HRD-91-38, June 25, 1991).

Medicaid Formula: Fairness Could Be Improved (GAO/T-HRD-91-5, Dec. 7, 1990).

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Highway Funding: Federal Distribution Formulas Should Be Changed (GAO/RCED-86-114, Mar. 31, 1986).

Changing Medicaid Formula Can Improve Distribution of Funds to States (GAO/GGD-83-27, Mar. 9, 1983).

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