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THE WHITE HOUSE
WASHINGTON

Date 4-4-97

To: The Vice President

From: The Staff Secretary

The President has asked that the attached document be forwarded to you per your discussion.

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THE PRESIDENT HAS SEEN
4-3-97

THE WHITE HOUSE
WASHINGTON

March 27, 1996

MR. PRESIDENT:

The attached memo from Bruce Reed and Elena Kagan outlines two issues: 1) whether states can privatize certain administrative functions of the Food Stamp and Medicaid programs; and 2) whether worker protection laws -- particularly the minimum wage -- apply to work programs under the new welfare law.

These issues are not being presented for your decision now, so this memo should be considered strictly informational. But Bruce and Elena thought you should know the current state of thinking in advance of your meeting with Sweeney, McAntee et al tomorrow.

On privatization, you will be presented with a decision shortly. Therefore, you should probably not give any indication in your meeting how we will come out. On worker protection, you can give the labor leaders some indication that our interpretation of the law is consistent with their thinking. Given that this issue is essentially a legal interpretation, it may not rise to the level where a decision is required from you.

Phil Caplan Phil

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THE PRESIDENT HAS SEEN
4-3-97

THE WHITE HOUSE

WASHINGTON

'97 MAR 27 PM 7:12

March 27, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: BRUCE REED
ELENA KAGAN

SUBJECT: WELFARE REFORM -- PRIVATIZATION AND MINIMUM WAGE

We must soon provide guidance on two welfare reform issues of importance both to States and labor unions: (1) whether states can privatize certain administrative functions of the Food Stamp and Medicaid programs and (2) whether worker protection laws -- particularly the minimum wage (Fair Labor Standards Act) -- apply to work programs under the new welfare law. This memorandum outlines recommended approaches to dealing with these issues. The recommendation on privatization will give states part of what they want while angering unions; the recommendation on worker protection laws will please the unions while angering states.

Privatizing Food Stamp and Medicaid Administration

The new welfare law explicitly allows states to contract with private entities to administer Temporary Assistance to Needy Families (TANF). The Administration now must decide how to respond to two requests to privatize administration of other federally funded benefit programs. Texas wants to contract out, on a statewide basis, administration of both the Food Stamps and Medicaid programs; Wisconsin wants to privatize administration of the Food Stamps program in a number of counties, though the need for an administrative decision on this plan is not as pressing. Federal approval of these requests will establish a policy for other states as well.

States that want to privatize believe that a competitive contracting process will result in greater program efficiencies while adequately protecting program recipients. (Because Medicaid and Food Stamps remain federal entitlements, private contractors determining eligibility for the programs would have to follow federal eligibility rules.) Organized labor is concerned that privatizing government functions will displace state and local government workers (with a resulting loss of union membership). They also charge that privatization will harm recipients because contractors will "cut corners" in determining eligibility for benefits.

All the relevant agencies and White House offices (HHS, USDA, OMB, DPC, and NEC) believe that allowing some privatization makes sense: the question is how much. Below, after some additional background information, we outline a consensus recommendation.

Background

Federal agencies and the state of Texas have been negotiating since June 1996 over the

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state's proposal to privatize the administration of TANF, Medicaid, Food Stamps, and certain other federally-funded nutrition programs. The state legislature passed the plan with bipartisan support, with endorsements from Lt. Gov. Bob Bullock and other leading Democrats. Under the Texas plan, private contractors would collect information about applicants (including by conducting interviews) and make eligibility determinations. The State would retain control over the appeals and quality control processes. An estimated 15,000 state jobs would be eliminated or transferred to the private sector. The state would require bidders to comment on whether they plan to hire displaced government workers. Such companies as Lockheed, EDS, and Arthur Anderson have indicated an interest in bidding.

Texas has argued that it cannot proceed with plans to contract out TANF (as allowed by the welfare law) unless the Administration allows private contracting for Food Stamps and Medicaid, because maintaining separate eligibility systems for these programs creates administrative difficulties. To take the most obvious problem, a dual system would require many individuals to go to one location to apply for TANF and another location to apply for Food Stamps and Medicaid. Texas wants a one-stop eligibility center.

Texas state officials are becoming increasingly impatient with HHS and USDA for not having ruled on their proposal. In a recent letter to HHS, state officials threatened to proceed with the project without Federal approval. State officials also point out that they have pledged to reinvest the savings from their plan in additional health and human services programs, and that these savings could provide health coverage for 150,000 Texas children. Rep. Charlie Stenholm, one of the Administration's strongest welfare reform allies, complained about the delay to Frank Raines in a February 24th letter, saying the state of Texas is "willing to make accommodations to address administration concerns." Secretary Shalala has promised Texas an answer by early April. Most recently, we heard from Rep. Stenholm's office and from Gary Mauro that Texas would accept modifications of its proposal as long as we allow the State to go forward with releasing a "request for offers" ("RFO") to potential bidders.

Labor leaders would like us to refuse the Texas request entirely. They see even limited privatization as a dangerous precedent and have made clear that they view this decision as critically important to public employee unions.

Recommendation

All the relevant agencies and White House offices agree that the Administration should draw the line on the basis of our existing Medicaid policy, which allows privatization of some but not all administrative functions. Under this approach, the application, interview, and other information-gathering can be done by private employees; the eligibility determination itself, as well as appeals and quality control, must remain in the hands of public employees. In addition, the Administration should ensure that contracts protect against the possibility that private firms will use procedures that lead to inappropriate denials -- or, as OMB notes, inappropriate grants -- of program benefits.

This general approach has both strong precedent and good sense behind it. The Medicaid program already allows private hospital workers to do intake and eligibility work, up to the point

of actually determining eligibility. Allowing privatization of these functions, conditioned on appropriate contract incentives and safeguards, strikes the right balance between allowing states to explore innovative ways to deliver public services and ensuring that beneficiaries' rights are protected. There is little doubt that this approach will displace some state workers and displease public employee unions. But we have crossed this bridge already in Medicaid and other contexts; for example, the Department of Labor has granted a waiver to Massachusetts to contract out all employment services and is prepared to do the same for other states as well.

In line with this view, we recommend that we inform Texas of the principles we will apply in reviewing any privatization scheme and give formal permission to the State to issue its RFO. Once the State accepts a bid, we will review whether the contract appropriately accords with our principles. This approach gives Texas less than it asked for, but allows the State to proceed with some reforms. It preserves a role for public employees, but will still anger the unions.

II. Application of Labor Laws

As states begin to redesign their work programs to meet the work participation rates in the new welfare law, a critical question for both the labor movement and the states is whether worker protection laws -- particularly the minimum wage law (Fair Labor Standards Act) -- protect welfare recipients who take part in workfare or subsidized employment programs. The answer the Administration is ready to announce on this issue -- that as a matter of law, worker protections apply to welfare recipients as they do to other employees -- will mostly please the unions and displease the States.

Recommended Administration Position

A review conducted by the White House and relevant agencies has concluded that current law requires applying the minimum wage law and other worker protections to welfare recipients engaged in work activities. The new welfare law contains no exemptions from worker protection statutes for these individuals, leaving these protective statutes to operate as they would for any other worker. States therefore cannot, as they partly could before, set up and run work programs independent of labor laws. (The Family Support Act exempted workfare programs from the FLSA, but required work hours to be based on the minimum wage.)

The FLSA, when applied to people in workfare and wage supplementation programs, usually will require payment of the minimum wage. As long as participants in such programs count as "employees" under the Act, they will qualify for the minimum wage. A State could try to structure its program so that participants will count instead as "trainees" under the Act, because "trainees" are not entitled to the minimum wage. It will be extremely difficult, however, for states to construct programs in which participants will count as "trainees" under the FLSA and also count as performing work activities (and therefore counting toward work participation rates) under the new welfare law. As a result, application of the FLSA will usually mean that the State must pay the minimum wage to individuals in workfare programs.

The food stamp law gives states the ability to count food stamps as part of the minimum wage for some individuals engaged in workfare programs. Specifically, the state can count food stamps toward the minimum wage for welfare recipients without a child under the age of six, but not for welfare recipients with such a child. (We are checking now whether there is a legal way to allow states to count food stamps toward the minimum wage in all cases, but suspect we will not find any.) The state will be able to count the value of other benefits (child care, housing, or transportation) toward the minimum wage only when the FLSA allows the counting of such benefits for workers generally -- which is only in unusual circumstances.

In addition to the minimum wage law, the Occupational Safety and Health Act, unemployment insurance laws, and anti-discrimination laws usually will protect welfare workers; in addition, the NLRA usually will give them organizing rights. More uncertain is how the tax code will apply to individuals in workfare and wage supplementation programs. The Treasury Department is still considering whether monies paid to welfare recipients will be subject to FICA and other taxes or would qualify for the EITC. Our 1994 and 1996 welfare bills prohibited recipients from receiving the EITC or being subject to FICA.

Anticipated State and Congressional Response

We should expect the announcement of Administration policy to provoke strong criticism from the states and Congress. On March 3rd, Governor Whitman wrote in a letter to you that applying minimum wage laws to workfare participants would "end welfare reform as we know it" by placing states in the position of either failing to meet the law's work requirements or incurring large new costs. Even The New York Times editorial board, in discussing union plans to organize workfare participants, has opined that "what they are doing does not amount to a job" -- a view consistent with what many States and members of Congress will be saying.

The reason states will protest is obvious: applying minimum wage laws will increase the cost of running workfare programs. (Of course, requiring the minimum wage will not make it more expensive for states to help welfare recipients find unsubsidized private sector jobs or to subsidize private sector jobs.) In 36 states, the current cash welfare benefit for a family of three will fall short of a minimum wage salary even for a 20-hour work week. As the work requirement in the law increases to 25 and then to 30 hours, and as the minimum wage also increases, 48 states (all but Hawaii and Alaska) will discover that their welfare grants are insufficient. (See attached document.)

Counting the value of food stamps will ease this difficulty, to the extent that states can do so. (As noted above, states may not be able to count food stamps for individuals with children under six.) But even if both TANF and food stamp benefits are counted toward the minimum wage, Mississippi will immediately come up short. As the minimum wage increases and the work requirements increase to 30 hours, a total of twenty states will find themselves in this position.

This policy is a mixed blessing for recipients. The increased expense of public

employment will encourage state efforts to find private sector jobs for welfare recipients -- a policy we believe is desirable. But that same expense also may encourage states to cut recipients from the welfare rolls sooner, rather than place them in public sector jobs.

There is little doubt that once we announce our reading of the law, efforts will begin in Congress to exempt workfare programs from worker protection laws entirely or to enact more limited "fixes." We will have to track these efforts carefully and decide, as we gain more information, how to respond to them.

IMPACT ON STATES
OF PAYING MINIMUM WAGE FOR WORKFARE[1]
Example: Family of Three

Minimum Wage Costs

The monthly cost of a $5.15 minimum wage for 20 hours a week is $443 and for 30 hours a week is $664. The welfare law's work rates for single parent families are currently 20 hours a week; they rise to 30 hours in the year 2000.[2]

If States Use TANF Funds as "Wages"

In 36 states, current TANF benefits are not enough to pay for 20 hours a week at the minimum wage. In 48 states (all but Alaska and Hawaii), current TANF benefits are too low to pay for 30 hours per week of work at the minimum wage.

If States Use TANF and Food Stamps Funds as "Wages"

In one state, Mississippi, the combined TANF and food stamp grants are not enough to pay for 20 hours a week of work at the minimum wage. In 20 states, the combined benefits are not enough to pay for 30 hours a week of work. These states are:

Nevada	Oklahoma	North Carolina	Louisiana
Arizona	Florida	Kentucky	Texas
Ohio	Missouri	West Virginia	Tennessee
Delaware	Indiana	Arkansas	Alabama
Idaho	Georgia	South Carolina	Mississippi

New legislation may be required to count food stamps as wages for certain families.[3]

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[1] This table points out the potential shortfall for workfare programs, in which public funds would be the only source of wages for the recipient. In a wage subsidy program, the shortfall would be filled by a contribution from the employer. Thus, the application of the minimum wage will likely encourage states to have work subsidy, rather than workfare, programs.

[2] The new law requires for single parent families a minimum of 20 hours of work a week in 1997 and 1998, 25 hours in 1999 and 30 hours in 2000. The minimum for two parent families is 30 hours a week for all years. These calculations assume an average of 4.3 weeks per month.

[3] New legislation would likely be required to count food stamps as wages for most families, because the Food Stamp Act contains a prohibition against requiring individuals with children under age 6 to participate in work activities. This prohibition may be only partially waivable. Approximately 62% of families subject to the TANF work requirements have children under age six.