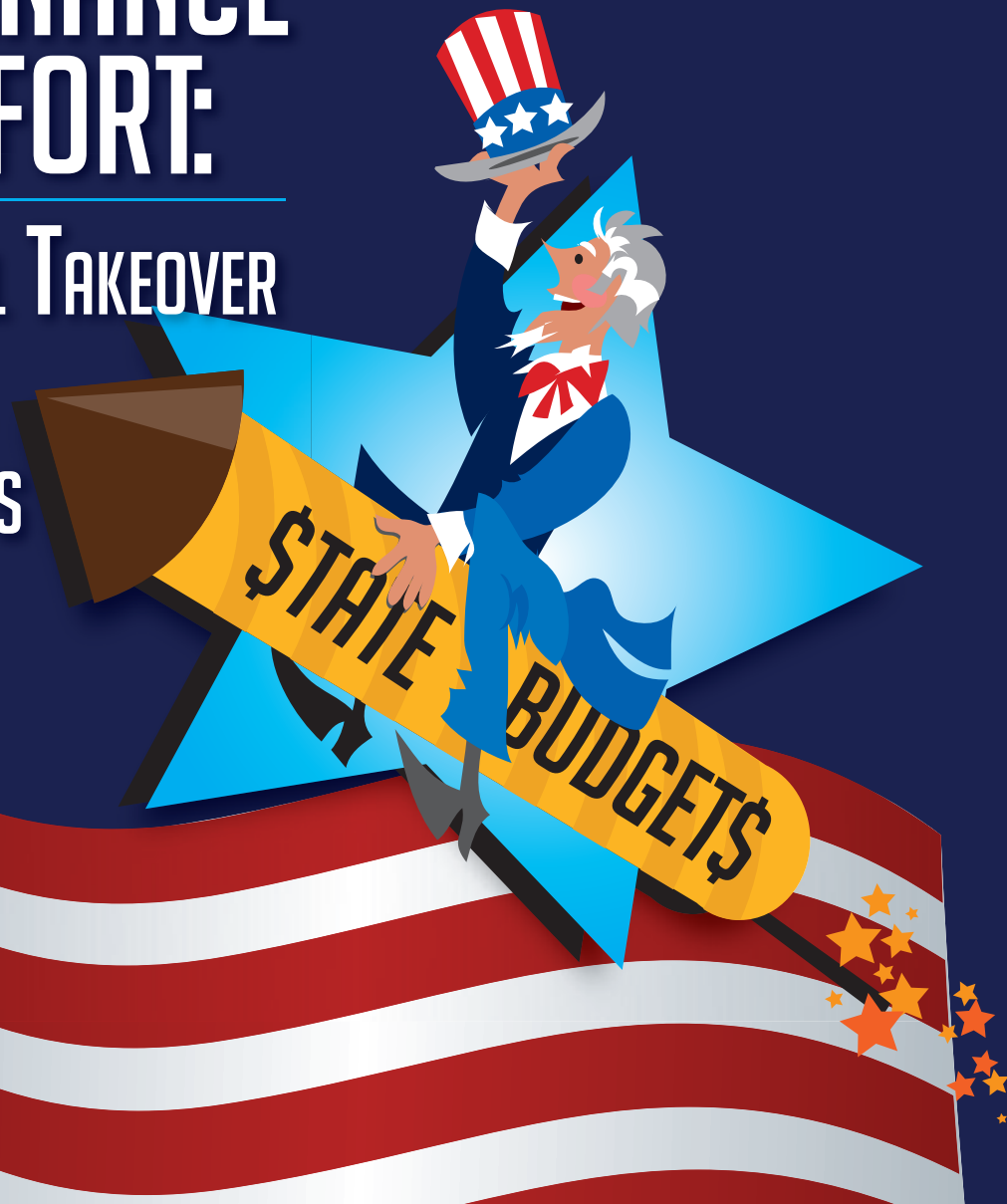


# MAINTENANCE OF EFFORT:

## THE FEDERAL TAKEOVER OF STATE BUDGETS



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July 2015



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## Executive Summary

Maintenance of Effort (MOE) requirements related to federal grants to the states have removed the power of a state's elected officials to control their own budgets. The Congressional Budget Office clearly states the intent of these MOEs: "Federal grant programs provide a mechanism for federal policymakers to promote their priorities at the state and local levels by influencing the amount of money spent by state and local governments and the types of activities on which those governments spend their money."

The two most well-known programs with MOEs are also the birthplace for the concept. Medicaid and Elementary and Secondary Education Act, now known as No Child Left Behind, were created in 1965 under President Lyndon Johnson and his vision of a "Great Society." In FY 2014 these two areas of the budget consumed over two-thirds of the state of Kansas' General Fund expenditures, partially driven by the MOEs they contain.

These MOEs bind governors and legislators to spending requirements with no regard to the state's budget situation or governing priorities. The MOEs can most reliably be described as an addictive drug. One must maintain a certain level of the "drug" to avoid a painful withdrawal. The confounding part of MOE compared to drug addiction is that MOE addiction can be passed on by others who previously used the "drug" by starting or expanding a program with MOE.

MOE mandates can be explicit, implicit or regulatory, but each form has costs and implications for state policy

makers. MOEs can often be created within a government agency with no legislative oversight or input. Instead, many agencies have staff whose primary job is to secure federal funding opportunities.

There is a long held constitutional premise that prohibits one legislature from binding a future legislature to an appropriation, but the construct of MOEs directly contradicts that belief. In and of itself, the binding nature of MOEs is a major issue in light of the premise of one legislature being unable to bind another.

Returning power to state elected officials, in terms of MOEs, requires a vigilant and proactive approach to mitigating the federal takeover of state budgets. Transparency in the grant application process combined with more aggressive oversight by a state's elected officials is necessary to restrict the federal takeover of even larger amounts of budget.

Ultimately, state legislators must consider that their choices in policy through budgeting are subject to limitations controlled by MOE. Legislators and citizens should take the words of the Congressional Budget Office to heart and understand the goal of MOE is for "federal policymakers to promote their priorities" through the control of the budget. States should be encouraged to work in concert to establish the proper constitutional balance between a state's prerogative to control policy priorities, the budgetary impact and federal interests.

### The Three Most Dangerous Words in Any Federal Program

We often hear talk of “worms” buried in software that take over your computer and the steps you should take to avoid them. We do not hear these same warnings and counter measures for what is a long-running and potentially more dangerous “worm” since it affects every citizen who pays taxes. The federal government buries a “worm” in many of their programs that, either by design or happenstance, have already taken over large parts of state budgets or continue to grow. Most Kansans can be forgiven for having never heard of the term “Maintenance of Effort” (MOE). This term is ubiquitous amongst anyone who has had to construct a state budget and is known as a feature that seriously hampers a state’s ability to make effective and efficient use of taxpayer money. The more time one spends examining the budgets of multiple states the more alarming it becomes each state’s budget has been effectively “spent” before the legislative appropriations process even begins. A window into Kansas’ budget highlights this phenomenon across the country; it also should be understood that the local government entities have some similar “handcuffs” served up by either association with a state program or direct acceptance of federal controls via grant monies.

### The Birth of MOE

MOE was born in 1965 under President Lyndon Johnson and his vision of a “Great Society” directed by the federal government. It is not surprising that the two single largest state budget items tied to MOE in the Kansas budget were created in the “Great Society” movement. In FY 2014 they consumed over two-thirds of the state of Kansas’ General Fund expenditures.<sup>1</sup> MOE was a central part of the Elementary and Secondary Education Act of 1965 (ESEA)—reauthorized in 2001 as the No Child Left Behind Act (NCLB).<sup>2</sup> The MOE provisions included in ESEA place a requirement on both the state and local school systems to maintain a funding level no less than 90 percent of either total aggregate spending on public education or the amount expended per pupil for the previous year in state and local funding.<sup>3</sup> In effect, it created a “floor” for expenditures in the programs subject to ESEA, ensuring they would never be reduced below this ever-increasing minimum. That same year, Medicaid was created in the Social Security Administration by Title XIX to the Social Security Act, 42 U.S.C. §§ 1396 et seq.<sup>4</sup> While Medicaid is a federal program, it allows the states an option to join and administer the

program at the state level. It did not take long for all states to join the program and become subject to Medicaid’s unique MOE. Medicaid did not directly stipulate funding levels, but it required eligibility levels to remain at a pre-ordained level, discussed in more detail later in this analysis.

Those early MOEs gave rise to an ever-increasing number of similar arrangements and spawned a host of new usages and types of MOEs. Fast forward to 2015 and now MOEs exist in almost every sector of state affairs in ways no one could have anticipated. This declaration by the Congressional Budget Office offers an insightful observation on the expansion of grants and attendant MOEs: “Federal grant programs provide a mechanism for federal policymakers to promote their priorities at the state and local levels by influencing the amount of money spent by state and local governments and the types of activities on which those governments spend their money.”<sup>5</sup> This amounts to federal policy manipulation that may not represent the policy views of elected officials, let alone citizens.

### Overview of MOE and State Budgets

Even those who deal regularly with the programs subject to MOE struggle to define MOEs in a context that reveals the true immensity of the impact on state budgets let alone the many different forms MOEs can take.

Supporters of MOEs and the associated spending often obscure the facts in extolling the virtues of shared federal/state funding programs. A version of which is often heard in committee hearings and almost approaches cliché, “The underlying principle is to ensure that federal grantees (and cooperative agreement awardees) are committed to maintaining the same level of services already being provided (and as described in their application) after receipt of a federal grant award. More specifically, the federal government wants awardees to rely on state and local funds as much as possible in order to maximize state and local resources. This ensures that federal funds “supplement” rather than “supplant” (replace) normal activities.”<sup>6</sup> This would not be a problem if it were actually a true statement, but the exceptions are more the rule when you look at total dollars controlled by MOE provisions and the effects on state government budgets.

The lead example, Medicaid, is the single largest cost sharing program that contains MOE as a major provision. As noted earlier, Medicaid is actually a federal program administered at the state level. The reality of Medicaid

conflicts with the basic premise, as outlined above, used by MOE apologists—there would not be service level from Medicaid without the federal stipulations because it was a wholly new federal endeavor. The problem is that, once accepted, a state committed to a “level of services” floor under the Medicaid MOE, is now subject to the restrictions on the amount that spending can be reduced, if at all going forward. Expenditures must not be reduced even if a state finds a better way to provide an equivalent or better service. Under such a potential situation, the waiver process allowed for within Medicaid MOE is, at best, fraught. Otherwise, a state would have to undermine the savings found in one portion of the program simply by increasing spending in another. When Kansas instituted the managed care KanCare reforms of Medicaid the process of going through the waiver application took several years from proposal to beginning implementation. The process is daunting even for a waiver like KanCare that did not decrease spending or reduce services. The only way to avoid the MOE of a particular Medicaid program is to completely withdraw from the program. Obviously the political impact, let alone the impact felt by program recipients, of ceasing a program that a large number of people have become dependent on is difficult, if not impossible. The sheer fiscal immensity of the Medicaid program precludes a state from even considering operating the program at the state level. States are then left with the reality of having state funding dictated by the federal overseers of Medicaid and previous legislative action.

The MOEs contained in Medicaid and ESEA are akin to an addictive drug. One must maintain a certain level of the “drug” to avoid a painful withdrawal. The confounding part of MOE addition remains that it is effectively contagious from one legislative action to future legislatures that have not yet been elected.

Once a Governor and Legislature accept a program with MOE, the trap is sprung. Every administration that expands the program hands down to the next administration a bigger MOE to deal with. One need not look further than Kansas to observe a state in which the slow creep of Medicaid expansions, not to mention other MOE programs, has largely handcuffed future administrations and legislatures. Regardless of future governing priorities, leaders will be constrained in their approach to state government and potential reform efforts, no matter how ineffective a program may be or the state’s financial situation. The federal government has the ability to levy fines on states for what they view as a violation of a program’s MOEs. For example, Kansas received a \$26 million levy from the Department of Health and Human Services (HHS) resulting from the FY 2010 reallocation of school funding after withdrawal of the federal

“stimulus funds” in special education. While those charges had no merit and the fine was ultimately rescinded, it was a long and difficult process that illuminated the power the federal government has to arbitrarily claim a judgment in regard to MOEs.

There is a long held constitutional premise that prohibits one legislature from binding a future legislature to an appropriation, but the construct of MOEs directly contradicts that governing principle. The idea that the creation of these deliberate limitations on future administrations is certainly debatable and a major issue with the concept of MOEs in general.

Just as insidiously, many MOEs can be created by agencies without any input from legislative bodies. The application for many of the fully-funded or nearly-fully-funded grants only requires the agency to certify that they qualify for the grant. In many agencies, specific staff is employed to seek, apply and procure new federal grants and dollars. In fact, the federal government maintains a website to highlight grant or funding opportunities.

The table on the following page shows Federal and State cost sharing exists in nearly every state agency in the state of Kansas. While not all the amounts that are shown are subject to MOE provisions, the four at the top of the list are subject in most of their programs while the vast majority of the remaining state agencies have some form of MOE in one or more programs.

It should be understood that this is not unique amongst states and roughly one-third of most states’ All Funds budgets will be federal funds. The Texas Legislative Budget Board published *Top 100 Federal Funding Sources in the Texas State Budget*, which tracked the growth of federal funds as a share of the total Texas budget from only 21.2 percent in 1986 to 33.9 percent in 2012. During this time, total Texas state funding grew by only 6.7 percent while the federal cost sharing expenditures grew by 9.0 percent, reflecting the pressure these federal programs bring to the state budgeting process.<sup>7</sup>

## The Many Disguises of MOE

MOE mandates can be explicit, implicit or regulatory, but each form has costs and implications for state policy makers.

Medicaid has always had very explicit MOE requirements and there was an additional MOE condition added with the Affordable Care Act. The MOE provisions under both the American Recovery and Reinvestment Act (ARRA), the 2009 “stimulus bill” and the Affordable Care Act (ACA) require states to keep the same eligibility criteria for their Medicaid and Children’s Health Insurance Program (CHIP) that they had in place on March 23, 2010, the day the ACA was signed into law. States



## FY-2014 Federal Receipts by Kansas by Agency<sup>7</sup>

|  |                 |   |                        |
|--|-----------------|---|------------------------|
| Health & Environment--Health . . . . .               | \$1,922,391,537 | Emporia State University . . . . .            | \$7,974,027            |
| Department of Education . . . . .                    | \$469,866,089   | Department of Agriculture . . . . .           | \$4,885,124            |
| Kansas Department of Transportation . . . . .        | \$438,647,790   | Kansas Bureau of Investigation . . . . .      | \$3,817,327            |
| Department for Children & Families . . . . .         | \$305,707,457   | Attorney General . . . . .                    | \$3,273,010            |
| University of Kansas . . . . .                       | \$220,494,677   | Department of Revenue . . . . .               | \$2,436,402            |
| Kansas State University . . . . .                    | \$190,408,134   | State Library . . . . .                       | \$2,408,030            |
| Adjutant General . . . . .                           | \$60,696,793    | Department of Corrections . . . . .           | \$2,386,587            |
| Department of Commerce . . . . .                     | \$53,363,640    | Kansas Corporation Commission . . . . .       | \$1,737,821            |
| Kansas State University--ESARP . . . . .             | \$45,138,049    | Historical Society . . . . .                  | \$755,633              |
| Department for Aging & Disability Services . . . . . | \$40,772,812    | Insurance Department . . . . .                | \$658,183              |
| Wichita State University . . . . .                   | \$36,503,204    | University of Kansas Medical Center . . . . . | \$459,000              |
| Department of Labor . . . . .                        | \$31,033,968    | KSU--Veterinary Medical Center . . . . .      | \$341,927              |
| Health & Environment--Environment . . . . .          | \$23,472,353    | Judiciary . . . . .                           | \$313,829              |
| Fort Hays State University . . . . .                 | \$16,169,099    | Kansas Water Office . . . . .                 | \$294,095              |
| Department of Wildlife, Parks & Tourism . . . . .    | \$16,056,128    | Department of Administration . . . . .        | \$243,272              |
| Commission on Veterans Affairs . . . . .             | \$13,325,573    | Kansas Human Rights Commission . . . . .      | \$202,950              |
| Pittsburg State University . . . . .                 | \$12,916,135    | Board of Pharmacy . . . . .                   | \$170,187              |
| Board of Regents . . . . .                           | \$11,705,854    | Secretary of State . . . . .                  | \$76,500               |
| Highway Patrol . . . . .                             | \$10,477,141    | Sentencing Commission . . . . .               | \$63,269               |
| Office of the Governor . . . . .                     | \$9,467,836     | <b>Total Receipts . . . . .</b>               | <b>\$3,928,614,269</b> |

can expand eligibility and improve application, enrollment and renewal processes under MOE, but they are prohibited from reducing them.<sup>8</sup> This sounds rather benign, but upon closer examination they expressly address the “creation of new administrative barriers.”<sup>9</sup> The hitch for state Medicaid officials, budget offices and elected officials is determining what constitutes an administrative barrier. Does greater accountability requiring background checks, health counseling and/or drug testing for recipients constitute an administrative barrier? Advocates are adamant that any reduction in enrollment, which they view as created by impediments to being accepted, is in fact an administrative barrier. The wording of the ACA in regard to Medicaid very much leaves that view as a possibility. It should not be overlooked that it is the very federal agency--Health and Human Services (HHS)--that administers the program and determines what constitutes a “barrier.” HHS’s ability to assess arbitrary fines gives the federal government significant control of Kansas’ Medicaid programs.

The multiple programs in Medicaid also present opportunities for financial manipulations in ways that increase the complications of undoing them. For example, the Kansas Earned Income Tax Credit (EITC) payments that in FY 2012 were slightly over \$89 million<sup>10</sup> contain part explicit and part implicit MOEs. The Congressional Research Service reported that the “IRS estimates that in FY 2013, 22% to 26% of EITC payments—between

\$13.3 billion and \$15.6 billion—were issued improperly.”<sup>11</sup> Given this high rate of waste and the fact that Kansas’ EITC reimbursement rate of 16 percent was six to ten percentage points higher than surrounding states, Kansas explored reducing or eliminating EITC payments.<sup>12</sup> But roughly two-thirds of EITC is used to fulfill the MOE for Temporary Assistance for Needy Families (TANF) under an explicit agreement; meaning any reduction in EITC would bring a reduction in federal TANF funds of a similar amount. The remaining one-third, or roughly \$30 million, which while not under the control of HHS, was subject to the political dynamics of the implicit MOEs. Once a social program is created it becomes very difficult for legislators to repeal it without being attacked as “denying services to the poor.” The power of this type of implicit MOE should not be underestimated by any legislator considering a “temporary” assistance program. EITC is just one example of how MOEs are not always created solely by mandatory regulatory requirements for continued levels of participants or spending. The federal government uses several “carrots” to induce state participation in programs that carry the same sort of implicit MOE as EITC. The most powerful and prevalent is the offer to match some level of state and/or local government funding with federal matching funds. Hidden from the public eye are the trip wires buried in many innocuous sounding grants, designed to eventually convert federally funded objectives into either fully or partially funded state or local programs.

For example, there are some grants where federal cost sharing is for a limited time frame, after which funding from the federal government disappears. Unfortunately, that does not prevent agencies from applying for these grants at the state and local level. After acceptance of the funding, those who benefit from the grant become a built-in lobby to push for conversion to state or local funding when federal funds recede or disappear altogether. Many, if not most, of these programs find a way to become state or locally funded after the federal funding disappears.

Probably the most well-known of these “Catch 22” type grants are in the area of law enforcement and public safety. The amounts of federal dollars are not large but this hidden type of implicit MOE makes it very hard for state or local officials to abandon those grant’s programs regardless of need. This creates state expenditures that live on long after federal dollars disappear and illustrate the larger problem despite the relatively small dollar amounts.

| <b>FY-2014 Federal Receipts<br/>by Kansas Public Safety Agencies</b> |                     |
|--|---------------------|
| Highway Patrol . . . . .   | \$10,477,141        |
| Kansas Bureau of Investigation . . . . .                             | \$3,817,327         |
| Department of Corrections . . . . .                                  | \$2,386,587         |
| Judiciary . . . . .  | \$313,829           |
| <b>Total . . . . .</b>   | <b>\$16,994,884</b> |

Here is an example of how implicit MOEs work and why they can be effective in turning a federally funded “temporary” program into a permanently funded state program. Typically, some area of “need” is identified and grant money is provided by the federal government to help state or local officials deal with that “need.” The FY 2015 Enhanced Collaborative Model to Combat Human Trafficking grant provides a model. Human trafficking is certainly a problem worthy of government intervention but even such an appropriate “need” has some problems within the federal/state relationship. This particular federal program is a three year grant with a 75 percent federal to 25 percent state funding cost share.<sup>13</sup> The stated purposes: “Purpose Area 1, for the development of human trafficking task forces, or Purpose Area 2, for the enhancement of established human trafficking task forces.”<sup>14</sup> In other words, this is about hiring additional law enforcement personnel “task force” staff. On its face it seems like exactly the sort of cooperative approach to a social/criminal problem that should be done, but consider the problems that even such a worthwhile endeavor has in combating human trafficking.

First, one should consider this an interstate problem, which is the purview of the federal law enforcement

agencies. They have the authority and capacity to handle the crimes that cross state lines. The state’s law enforcement officers cannot operate across state lines, so they can only combat human trafficking within the state. Human trafficking in Kansas is not generally occurring intrastate, but rather it is an interstate crime mostly moving through Kansas. Law enforcement can already share information on these crimes and act with federal authorities within the state. What is really needed is a way to share information that would lead to the arrests of human traffickers, like a software or hardware purchase for greater speed and integration with federal records. However, the nature of the grant limits this type of expenditure and many other similar programs already being done at the state level to share law enforcement data.

The creation of a special task force appears to be a particularly poor allocation of state or local public safety funds, especially when the issue (human trafficking) is primarily of federal jurisdiction and the federal funding disappears in three years. Those law enforcement employees that were hired to do the work for the grant immediately have 75 percent of their funding gone, including all of the direct and indirect carrying costs of an employee.

The question “Would we do this if we were using 100 percent state dollars?” seldom is asked before an application is made for these types of grants. Once the grant is in place, the implicit MOE aspect of the grant takes control. Consider the position of a legislator who is asked to make up the funding for officers who are working on human trafficking complaints. Serious, good faith discussions about program efficacy and the unseen consequences of shifting funding from other programs are difficult to have within limited legislative calendars and a public arena that is more concerned with headlines and electoral palm cards. Those who apply for these types of grants count on this implicit MOE pressure to secure additional state or local funds to sustain the longevity of the programs.

It is not an isolated occurrence for federal funding to cease and the employees hired by the program to continue at the expense of state taxpayers. Many programs that are now fully or proportionally greater funded by state resources were born as one of these cost sharing arrangements with built in expiration dates. The expansion of employees and programs of the past that were driven by these types of implicit MOEs are unfortunately difficult to quantify in regards to current budgetary impacts.

Regulation is another area of federal and state cost sharing where different types of MOEs are attached to enforcement of federal rules and regulations by state

agencies. The federal Environmental Protection Agency (EPA) provides funding to the Kansas Department of Health and Environment's environmental units to carry out many of what would be federal tasks. Waste management provides a case in 2013 where Kansas obtained authorization from the EPA to administer the Resource Conservation and Recovery Act (RCRA) Corrective Action Program under what is known as State Implementation Plan (SIP).<sup>15</sup>

Kansas entered into a SIP which identifies how the State will attain and/or maintain the primary and secondary National Ambient Air Quality Standards (NAAQS) set forth in section 109 of the Clean Air Act ("the Act") and 40 Code of Federal Regulations 50.4 through 50.12, which includes federally-enforceable requirements. Each State is required to have a SIP that contains control measures and strategies which demonstrate how each area will attain and maintain the NAAQS. These plans are developed through a public process, formally adopted by the State, and submitted by the Governor's designee to the EPA. The Clean Air Act requires the EPA to review each plan and any plan revisions to ensure compliance with EPA's interpretation of the law.<sup>16</sup>

The agreement includes: (1) State-adopted control measures which consist of either rules/regulations or source-specific requirements (e.g., orders and consent decrees); (2) State-submitted comprehensive air quality plans, such as attainment plans, maintenance plans, rate of progress plans, and transportation control plans demonstrating how these state regulatory and source-specific controls, in conjunction with federal programs, will bring and/or keep air quality in compliance with federal air quality standards; (3) State-submitted "non-regulatory" requirements, such as emission inventories, small business compliance assistance programs; statutes demonstrating legal authority, monitoring networks, etc.); and (4) additional requirements promulgated by EPA (in the absence of a commensurate State provision) to satisfy a mandatory section 110 or part D (Clean Air Act) requirement.<sup>17</sup> Stated more simply, states must maintain federally mandated minimum requirements but are free to add additional stipulations. However, buried in the SIP is a troubling reminder about the risk of federal overreach, "Enforcement of the state regulation before and after it is incorporated into the Federally-approved SIP is primarily a state responsibility. However, after the regulation is federally approved, EPA is authorized to take enforcement action against violators."<sup>18</sup>

It is certainly arguable that this regulatory enforcement mechanism is advantageous to the state and may even be cost effective. However, the idea that the "EPA is authorized to take enforcement action against violators" of what was a state-created regulation, beyond federal

regulations, is the hidden MOE that may ultimately harm citizens, even if there is no financial MOE for the state. Once a state administration chooses a level of enforcement and regulation in their SIP, retreating from that level must be negotiated with EPA and is anything but a straight-forward process. This is but one more example of how one group of elected officials, or agency staff, can tie the hands of future policy makers.

The creation of MOEs often go unobserved in programs with dedicated funding streams. When an agency receives a dedicated funding stream it typically receives little scrutiny by the legislature or executive branch, who are focused on appropriated funds. For example, the Kansas Department of Transportation (KDOT) receives a dedicated funding source from sales taxes and motor vehicle taxes, and also receives \$438 million from the federal government, as the chart at the end of this paper shows. It is an example of the types of MOE arrangements that typifies the arrangement with federal government agencies: "The State must maintain the average aggregate expenditure of the State and its political subdivisions, exclusive of Federal funds and State matching funds, for safety programs eligible for funding under this part at a level at least equal to the average level of expenditure for the 3 full fiscal years beginning after October 1 of the year 5 years prior to the beginning of each Government fiscal year."<sup>19</sup> The "carrot" retains the availability to leverage the dedicated funding stream. On its face, a very appealing approach. However, succeeding administrations are handcuffed by these provisions. It is clear that because of the funding requirement to stay in compliance, you must at least commit the "average." This handcuffs the ability to move state funds to higher priority areas. A large bond issuance tied to state funding can be equally devastating and would leave the state dependent on cost sharing with the federal government. Again, unable to reallocate state funds or withdraw from the grants.

Kansas' defined benefit pension plan (KPERS) and the accompanying Unfunded Accrued Actuarial Liability (UAAL) account for the long-term, hidden costs associated with MOEs. Once federal funds are accepted the UAAL that accrues to these federal salaried employees becomes a legacy for state taxpayers when the program reaches the end of federal cost sharing. The taxpayers of Kansas are already experiencing the burden of making dedicated payments to reduce a large UAAL. In FY 2014 that amounted to about \$402 million of State General Fund expenditures that reduced the available funding for other programs.<sup>20</sup> That payment includes the UAAL created by federal salaries in MOE programs but because of the accounting process in the state of Kansas the federal share is not billed to the granting authority. The



amount of these hidden costs of MOE federal programs paid by Kansas taxpayers was about to increase as this paper was being written. The Kansas legislature recently passed a bill to issue a \$1 billion bond to further reduce the UAAL of the Kansas Public Employees Retirement system, the cost of which will be fully borne by state taxpayers.

There are also other hidden costs of these federal funds that are absorbed by the state's taxpayers. The easiest example to locate and understand is the direct costs of collecting and disbursing funds to the various state agencies that use them as matching funds for a federal program. For example, the cost of collecting and disbursing the tax dollars to the Medicaid system to obtain the federal matching funds---this is roughly a 60/40 arrangement---is fully absorbed by the state. The state attempts to capture indirect overheads of administrative costs in a program called a State Wide Indirect Cost Allocation Plan (SWCAP), but this plan does not capture direct costs such as the Revenue Department's collection of fund costs or the pension systems' administrative costs in its allocation. There are numerous other direct and indirect costs of administering and operating these federal grant programs that can be lost in the convoluted accounting processes of the state and not captured by SWCAP. While individual amounts are relatively small, it still does not justify letting the state taxpayer make up for the inadequacy in state accounting processes by having to foot the bill.

## MOEs are used to Control State Budgets

Federal policymakers are not the only people wanting to control state budgets; a bevy of advocates for government entities, special interest groups and beneficiaries of the MOEs also object to any attempt to rein in the programs.

A recent publication from the The American Association of State Colleges and Universities (AASCU) is quite clear, *Update on the Federal Maintenance of Effort Provision: Reinforcing the State Role of Public Higher Education Funding*, "While the Obama administration's efforts to make college more affordable has received significant attention in Washington, a lesser-known provision in federal spending bills may be just as important to upholding state financial responsibility to public colleges and universities. Known as "maintenance of effort" (MOE), this provision requires states to maintain spending above a certain threshold in order to receive federal funding tied to specific programs. MOE provisions aim to ensure that federal funds are used to supplement state funding for a specific purpose, rather than supplant existing state monies."<sup>21</sup>

AASCU pointed out that it is not just public higher education using the technique. "The use of MOE provisions

to protect state appropriations to higher education also establishes federal expectations of states similar to those formed in 1965 with the passage of the Elementary and Secondary Education Act (ESEA); this has proven effective in preventing many states from supplanting state funding commitments to elementary and secondary education."<sup>22</sup>

This form of "lobbying" for public higher education is quite blatant, saying "An emerging policy solution to counter states' funding cuts to their public higher education systems is the inclusion of "maintenance of effort" (MOE) provisions in federal legislation."<sup>23</sup> They add this rather insightful observation of a bill that they lobbied for --- Higher Education Opportunity Act of 2008 (HEOA), H.R. 4137<sup>24</sup> --- that originally created MOE for public higher education "The intent of the MOE measure was to ensure that state legislators did not subvert college access by making corresponding reductions or insufficient increases in state appropriations to higher education."<sup>25</sup>

Obviously AASCU feels that their judgement of what constitutes appropriate state funding supersedes that of a state's duly elected officials. In Kansas, AASCU includes all but the University of Kansas and Kansas State University as dues paying members of their lobbying organization; KU and KSU have their own lobbyists and may not feel the need to coordinate with other universities.<sup>26</sup>

Higher education and K-12 education funding these two entities accounted for \$4,926,913,265 of state funded expenditures in FY 2015 alone.<sup>27</sup> That is not an insignificant amount of funding by anyone's count, but it is just the beginning of the full impact of MOE on the Kansas state budget.

The largest MOE in the state budget is Medicaid and the construction of the MOE based on eligibility creates a very large budget problem; it is also the tool used by defenders of any of Medicaid's many programs to spread fear at the very mention of adjusting the MOE requirement. When several states requested block grants in terms of dollars without an eligibility requirement, some program advocates translated that as a back door attempt to end MOE and began their defense.

A case study of how favored programs are defended is provided by those opposed to adjusting the MOE in a Medicaid block grant. The left-leaning Center for Budget and Policy Priorities (CBPP) released a media alert titled, *Repealing Health Reform's Maintenance of Effort Provision Could Cause Millions of Children, Parents, Seniors, and People With Disabilities to Lose Coverage: Repeal Would Also Cause Loss of Jobs*.<sup>28</sup> CBPP suggested repeal of the maintenance-of-effort provision also would slow economic growth and job creation. "Repeal of the MOE provision would have adverse economic effects for two

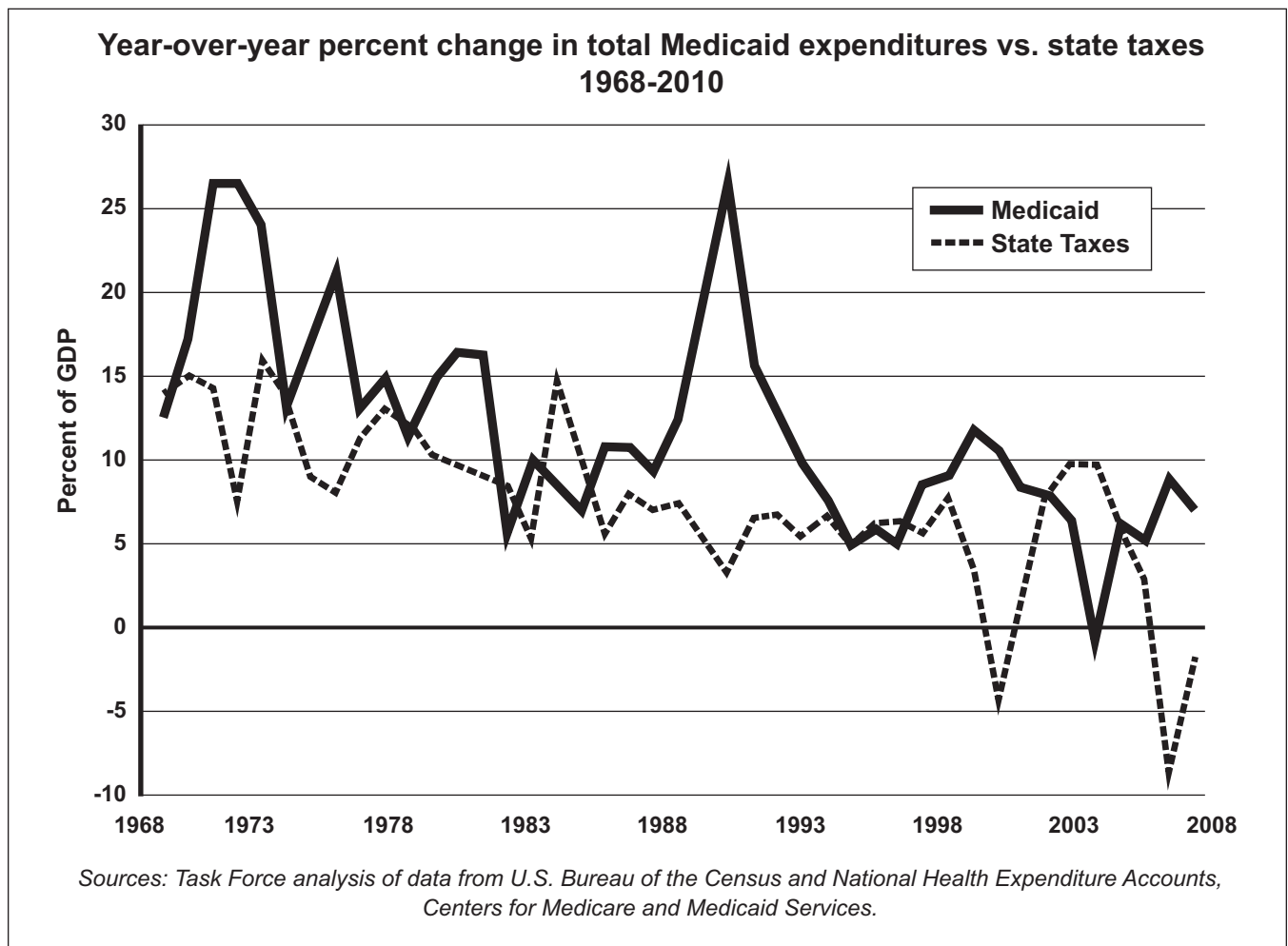
reasons. First, every dollar in reduced state Medicaid expenditures would result (on average across the states) in a reduction of \$1.33 in federal Medicaid expenditures, for a total reduction of \$2.33. If a state used the dollar it saved in state Medicaid funds elsewhere in its budget, there still would be a net withdrawal of \$1.33 from the economy — the opposite result of what the weak economy needs.” Such arguments ignore unseen economic consequences, such as the fact that leaving that \$1.00 in the hands of the state’s citizens would produce other economic activity and the feds not borrowing the other \$1.33 would avoid the need for more taxes to pay the debt and interest. Even this purported economic impact pales in comparison to the threat of coverage losses. “ ... many working poor parents would likely lose coverage, large numbers of children could lose coverage, seniors and those with disabilities could lose long term care services and finally that repealing MOE and going to a block grant would undermine health reform.”<sup>29</sup> CBPP was unable to cite a single instance where a Governor had announced they would employ any of these strategies if they received a block grant without MOE provisions.

## The Impact on the Kansas Budget

One has to begin with Medicaid and its attendant social services that are listed in the State General Fund profiles as Human Service/Caseload for two major reasons: 1) its sheer size in both dollars and resident participation and 2) its unique MOE. In FY 2014, the last full year that actual expenses are available, Medicaid consumed \$1.006 billion or about 17 percent of General Fund spending.<sup>30</sup>

The history of Medicaid’s expenditure levels in relation to available revenues has created issues for state budgets almost since inception of the program. The chart below is a composite of all states and reveals the disconnect between state tax revenues and Medicaid expenditures.

Medicaid is not just unique in being a federal program administered by the states; it also requires a MOE based on eligibility levels (e.g., families with children and income levels not exceeding a specific percentage of the federal poverty level) instead of prior funding levels for Medicaid. This approach subjects states to medical cost increases and prevents states from trying to manage costs by changing eligibility rules for those whose personal behaviors may be causing additional medical expenditures.



The issue with the MOE in Medicaid is compounded by fluctuations in the Federal Medical Assistance Percentages (FMAP), which are the percentage rates used to determine the matching funds for each state in cost sharing of the program. If a state has a FMAP rate of 40 percent the state will pay \$40 and the federal government \$60 for every \$100 of qualified Medicaid expenditures. It is allocated annually with the federal government using a three year rolling average of per capita income data, using a formula to compare a state’s relative “wealth” to other states, as the main driver that determines what percentage each state pays.<sup>31</sup> One of the major problems with the way the FMAP is calculated is that it bears no relationship to the financial situation of an individual state and Kansas provides a great example of this disconnect in the FMAP formula.

As a new administration took office in January 2011, Kansas had just finished FY 2010 with a negative ending balance of \$27.4 million and was facing a \$424 million increase in Medicaid expenditures for FY 2011 and FY 2012.<sup>32</sup> Most of that increase (\$309 million)<sup>33</sup> was due to Kansas’ share of the FMAP rate increased to the point whereby Kansas would be paying \$29.50 per \$100 of qualified expenditures in FY 2010 to \$40.90 per \$100 by FY 2012.<sup>34</sup> FMAP’s impact on the latest Kansas budget year of FY 2015 amounted to \$115 million of increased state expenditures yet this large expenditure increase driven by the federal government goes largely unreported.<sup>35</sup>

Elementary and secondary public education is another area of some significance, although the education MOEs are not quite as restrictive as Medicaid. The K-12 MOE sets a floor for the state on funding for cost sharing programs of 90 percent of the prior year. A more restrictive MOE exists in the area of special education where the qualifying individuals under the Individual Disabilities Education Act (IDEA) requires “the State Education Agency (SEA) and Local Education Agencies (LEA) demonstrate that the level of state and local funding remains relatively constant from year to year. Failure to meet MOE requirements may result in the LEA losing eligibility to receive IDEA entitlement funding and requiring an LEA to repay funds, using a non-federal source, to the SEA, which is required to send funds to the US Department of Education. At the local level, IDEA requires that LEAs expend the same amount of local/state funding for special education and related services as it expended in the previous fiscal year (34 CFR §300.203). There are provisions in IDEA to allow for decreases in an LEA’s MOE from one fiscal year to the next.”<sup>36</sup>

The following chart shows the federal programs in Kansas K-12 with MOE provisions applying to the state’s participation.<sup>37</sup>

| <b>Federal Aid to K-12 FY-2015</b>          |                  |
|---|------------------|
| <i>\$s in Thousands</i>                     |                  |
| Elem. & Secondary Education Prog. . . . .   | \$123,012        |
| Improving Teacher Quality . . . . .         | \$17,221         |
| 21st Century Community Learning . . . . .   | \$8,064          |
| Rural & Low Income Schools . . . . .        | \$575            |
| Language Acquisition State Grants . . . . . | \$3,750          |
| Ed. Research and Innovative Prog. . . . .   | \$2,400          |
| Vocational & Technical Education . . . . .  | \$4,195          |
| Alcohol & Drug Abuse . . . . .              | \$2,330          |
| School Food Assistance . . . . .            | \$187,595        |
| <b>Total Federal Funding . . . . .</b>      | <b>\$349,142</b> |

MOE cost sharing with the federal government will take on greater importance for legislators now that some states are suggesting they will opt out of the Common Core program. The U. S. Department of Education threatened Indiana — which was the first state to opt out — with losing their federal funding, revealing that federal agencies believe there are implicit MOEs that were not part of the original grant that they can use once you accept their funding.<sup>38</sup>

**How States Can Confront Problems with MOEs**

Strategies exist to combat the vast majority of the most common problems associated with MOEs. The problems can stop before they start or mitigated with a strategy for those MOEs already in place.

One strategy is to avoid taking as much federal funds as possible because of the many strings that come attached including, but not limited to, MOE. Decades of dependency is not as easily undone. States can also change the federal funds application process to prevent new MOE surprises. MOEs can be managed if a proactive approach is taken both in the application for federal money and the operational aspects once a state has accepted federal funds.

No federal grant applications should ever be submitted without legislative approval. The “power of the purse” belongs to the legislative branch and the creation of any type of MOE will almost certainly have an effect on the appropriation process. Agencies will argue that they may miss opportunities to apply when the Legislature is not in session, but a monthly meeting of a joint Senate and House appointed committee could review and rule on the acceptance of grants. Such a meeting would also give the public knowledge of the types of grants being sought and an opportunity to voice their support or objection to the grant. It also provides a public vetting of the question, “Would we do this if it were all state

dollars?” that may provide some needed skepticism to the premise of “free dollars from the Feds.”

The regulatory MOEs require a more stringent hurdle before any expansion of a State Implementation Plan (SIP) going beyond required federal regulation. They should require a full committee hearing, vote in both chambers and the Governor’s signature before being applied to the state’s citizens. Requiring this open and transparent process prevents one administration from tying the hands of their successors under the cover of a SIP that was solely agency controlled.

Once accepted, implementation of a typical grant is largely agreeing to federal guidelines and the filing of reports that obligations are being met. While there is some truth that a grant comes with certain provisions that are requirements for acceptance, that should not preclude state agencies from protecting the state by building proper documentation of both the discussions during the grant process and after actual acceptance. A volume of emails, telephone conversations, informal and formal meetings may take place before the finalization of grant funding and throughout the life of a program.

Full documentation limits the ability to freely interpret provisions by either party. The files for every program should contain all communications, including even informal inquires and responses by all parties. This becomes particularly important when administrations change on either the federal or state level where the incoming administration may have a slightly different interpretation of the grant agreement. States can negotiate successfully with federal agencies if they have a fact-based argument that is sufficiently documented.

There are other strategies for existing grants in regard to changing the dynamics of state and federal cost sharing. Kansas and any other state government can internally act relatively easily in a way that works hand in hand with political approaches to confronting MOEs of any type.

The very issues that are pressuring state budgets are having the same effect on the federal budget. The Congressional Budget Office in their March 2013 publication *Federal Grants to State and Local Governments* noted: “Adjusted for inflation, the amount of federal grants for health programs in 2011 was about seven times the amount in 1980. Over that period, such grants more than tripled as a share of GDP, rising from 0.6 percent in 1980 to 1.9 percent in 2011. In particular, the share of federal health grants in the national economy has increased significantly, primarily because of rising federal spending on Medicaid”. These sorts of pressures provide opportunities to negotiate for block grants for states to operate Medicaid while allowing the state to uncouple from the language regarding the eligibility limitations of the existing MOE. Kansas has already shown some

success in serving client bases with a waiver exemption and is positioned to continue the discussion with HHS for a block grant approach to Medicaid.

States can take advantage of the pressure the MOEs have created on the federal budget by ensuring that the federal granting authority pays their full share including those hidden costs of the grant that are legally allowable. This approach simultaneously reduces state expenditures while it applies additional pressure to the federal granting authority’s budget. The application only requires some changes in current state government accounting practices in order to identify and bill those costs. The necessary changes in accounting practices have long been in place in the private sector and are fully recognized by the federal government and the Governmental Accounting Standards Board. This approach also has significant benefits for state budgets beyond the MOE issue, but are beyond the scope of this current paper.

Ultimately, the issues over federal control of large parts of the state’s budgets will be settled by political and/or legal challenges based on constitutional issues. For example, HHS signaled some willingness to bend in the light of political pressure when a number of governors sent letters asking for a MOE exemption during the latest recession. HHS indicated they would negotiate the MOE but then added a provision that, “the Medicaid MOE provisions relating to adults expire when the Secretary determines that an Exchange established by the State under section 1311 of the Affordable Care Act is fully operational.”<sup>39</sup> While this was an unacceptable “bargain” it reveals the latitude that HHS believes they have in regard to the MOEs in Medicaid to alter its application under political pressure.

The relationship between the federal government and the various state and local governments that federal policymakers use “to promote their priorities at the state and local levels by influencing the amount of money spent by state and local governments and the types of activities on which those governments spend their money” needs to be addressed for the inequity in regard to the state’s rights.<sup>40</sup> Until a significant number of states join together to confront the onus of all forms of MOEs, the federal government will continue to control a large part of the state policy and budgeting process.

## End Notes

- <sup>1</sup> FY 2016 Kansas Governor's Budget Book Volume 1. Page 22
- <sup>2</sup> <http://www.aascu.org/policy/publications/policy-matters/April2010/>
- <sup>3</sup> Ibid
- <sup>4</sup> [http://en.wikipedia.org/wiki/Medicaid\\_History\\_of](http://en.wikipedia.org/wiki/Medicaid_History_of)
- <sup>5</sup> Congressional Budget Office Publication, *Federal Grants to State and Local Governments* March 2013 Page 9
- <sup>6</sup> "What Does 'Maintenance of Effort' Really Mean?" (*CharityChannel*, October 18, 2012).
- <sup>7</sup> Texas Legislative Budget Board, *Top 100 Federal Funding Sources in the Texas State Budget* February 2013
- <sup>8</sup> <http://www.hdwg.org/sites/default/files/MOE.pdf>
- <sup>9</sup> Ibid
- <sup>10</sup> *Kansas State Tax Expenditure Report*, Calendar Year 2012
- <sup>11</sup> <http://www.fas.org/sgp/crs/misc/R43873.pdf>
- <sup>12</sup> <http://www.taxcreditsforworkingfamilies.org/earned-income-tax-credit/states-with-eitcs/>
- <sup>13</sup> [http://ojp.gov/ovc/grants/pdf/txt/FY15\\_ECM\\_Competitive\\_Solicitation-508.pdf](http://ojp.gov/ovc/grants/pdf/txt/FY15_ECM_Competitive_Solicitation-508.pdf)
- <sup>14</sup> Ibid
- <sup>15</sup> [http://www.kdheks.gov/reports/2013\\_Annual\\_Report.pdf](http://www.kdheks.gov/reports/2013_Annual_Report.pdf)
- <sup>16</sup> <http://www.epa.gov/reg3airtd/airregulations/sips/sipdetail.htm>
- <sup>17</sup> Ibid
- <sup>18</sup> Ibid
- <sup>19</sup> <http://www.fmcsa.dot.gov/mcsap-basic-incentive-grant/motor-carrier-safety-assistance-program-basic-and-incentive-grants-maintenance-effort>
- <sup>20</sup> FY 2016 Kansas Governor's Budget Book Volume 1. Page 22
- <sup>21</sup> American Association of State Colleges and Universities *Update on the Federal Maintenance of Effort Provision: Reinforcing the State Role of Public Higher Education Funding* page 2
- <sup>22</sup> <http://www.aascu.org/policy/publications/policy-matters/April2010/>
- <sup>23</sup> <http://www.aascu.org/policy/publications/policy-matters/April2010/>
- <sup>24</sup> Ibid
- <sup>25</sup> Ibid
- <sup>26</sup> <http://www.aascu.org/members/by-state-and-territory/>
- <sup>27</sup> FY 2016 Kansas Governor's Budget Book Volume 1. Pages 116 and 127
- <sup>28</sup> <http://www.cbpp.org/research/repealing-health-reforms-maintenance-of-effort-provision-could-cause-millions-of-children>
- <sup>29</sup> <http://www.cbpp.org/cms/?fa=view&id=3397>
- <sup>30</sup> FY 2016 Kansas Governor's Budget Book Volume 1. Page 22
- <sup>31</sup> [http://nhpf.org/library/issue-briefs/IB828\\_FMAP\\_12-11-08.pdf](http://nhpf.org/library/issue-briefs/IB828_FMAP_12-11-08.pdf)
- <sup>32</sup> Ibid
- <sup>33</sup> Ibid
- <sup>34</sup> [http://budget.ks.gov/publications/FY2013/FY2013\\_GBR\\_Vol1-3-8-2012.pdf](http://budget.ks.gov/publications/FY2013/FY2013_GBR_Vol1-3-8-2012.pdf) and [http://budget.ks.gov/publications/FY2014/FY2014\\_GBR\\_Vol1-Corrected\\_1-28-2013.pdf](http://budget.ks.gov/publications/FY2014/FY2014_GBR_Vol1-Corrected_1-28-2013.pdf)
- <sup>35</sup> <http://aspe.hhs.gov/health/reports/2015/FMAP2016/fmap16.pdf>
- <sup>36</sup> [http://sped.dpi.wi.gov/sped\\_grt-moe](http://sped.dpi.wi.gov/sped_grt-moe)
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- <sup>38</sup> <http://www.theblaze.com/stories/2014/05/07/federal-govt-issues-warning-to-state-that-wants-to-opt-out-of-common-core/>
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