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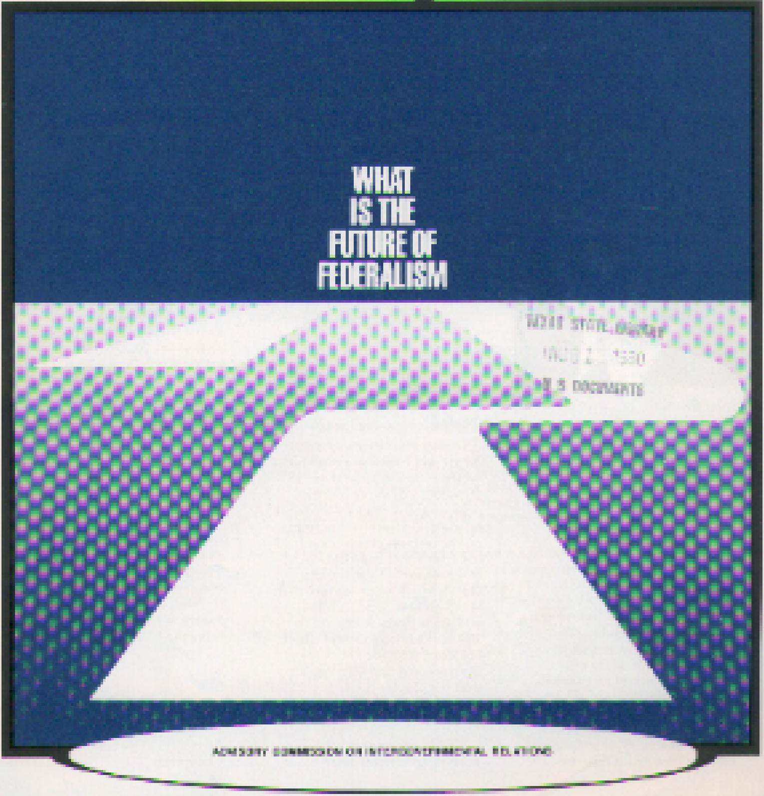

WHAT IS THE FUTURE OF FEDERALISM

ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS

View From The Commission

Dear Reader:

This issue of *Intergovernmental Perspective* deals with a subject important to all of us interested in intergovernmental relations: The future of what Justice Hugo Black has called "Our Federalism."

During the past 20 years especially, both the nature and vitality of the federal system as envisioned by the country's Founders have been very significantly affected. The federal system remains intact, but the workability of the system is perhaps more in doubt today than it has been at any time in nearly 200 years.

ACIR concluded in its recent study of the federal role in the federal system, "Contemporary intergovernmental relations are more pervasive, more unmanageable, more ineffective, more costly, and above all, more unaccountable, than they have ever been." The coming years may well pose challenges even more fundamental to our national well being.

In recognition of both past changes and future uncertainty, the U.S. Congress instructed ACIR to study and evaluate the "forces likely to affect the nature of the American federal system in the short-term and long-term future and possible adjustments to such system . . . in light of future developments."

In response to this mandate, ACIR will convene a conference on the future of federalism on July 25-26, drawing together present and former government officials, representatives from public interest groups, and leading scholars on political, fiscal and judicial federalism. Our objective will be to capture their views on how American federalism is likely to change in the 1980s, the general forces which are likely to bring about these changes, and the adjustments that our system needs to perform well in the face of these future forces.

To provide background information and some futuristic visions for the conference, ACIR commissioned three papers. George Break, professor of economics at the University of California at Berkeley, will analyze the future of fiscal federalism; Lewis Kaden, professor at Columbia Law School, will consider the future of judicial federalism; and Aaron Wildavsky, professor of political science at the University of California at Berkeley, will examine the future of political federalism. ACIR staff is preparing a paper which reviews the dramatic changes of the past 20 years and examines the analytical problems inherent in forecasting the developments likely to occur in the next decade.

This issue of *Perspective* highlights portions of the paper prepared by ACIR Senior Analyst David Beam and papers relating to the future of fiscal and political federalism by Professors Break and Wildavsky. A summary of the conference, including complete texts of these papers, will be published later this year.

Abraham D. Beame

Abraham D. Beame
Chairman

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Staff
Executive Director:
Wayne F. Anderson
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Contributors:
Kenneth Ainsworth
Al Davis
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Production:
Diana Roberts
Franklin A. Steinko

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Intergovernmental Focus

Congress Makes Budget Cuts, Considers GRS Reauthorization

House and Senate budget conferees, in agreeing to the First Concurrent Budget Resolution for fiscal year 1981, made deep cuts in certain intergovernmental aid programs in order to produce the first nominally balanced federal budget in 12 years. The impact on state and local governments will be made somewhat clearer following the "reconciliation process." Under this procedure, utilized for the first time in the six-year old Congressional Budget Act history, the budget conferees have instructed House and Senate committees to make cuts to meet their spending limits.

Interest groups representing state and local governments have responded to the tight fiscal situation by generally agreeing to accept reduced federal assistance. But they agonize over where cutbacks should be made.

On behalf of the National Governors' Association, Governors Bowen (IN) and Busbee (GA) said, "We are not asking for more federal aid than is now proposed by the Administration and Congress. We are just asking for more flexibility. The federal budget cuts pending before Congress would strip away virtually all discretionary grants available to states and leave largely untouched the almost 500 categorical grant programs that have contributed much more significantly to the fiscal problems confronting the federal government."

Spokesmen for the National Conference of State Legislatures said that they "are willing to accept cuts in federal aid to states to help balance the federal budget" but would like to help "guide the Congressional scalpel."

The National League of Cities Board of Directors stated that "cities are willing to take funding cuts in the interest of fighting inflation as long as major urban programs were reasonably funded and budget restraint shared by all." The budget agreed to by the conferees "does not meet the test."

Reauthorization of general revenue sharing is consistently ranked by state and local interest groups as a top priority. In spite of this longstanding support, the outlook for continuation of state participation in GRS and increased funding for localities appears grim, at least for fiscal 1981. Budget conferees rejected recommendations to restore part of the states' share and instructed authorizing committees in the House and Senate to allow $4.6 billion for GRS in FY 1981, compared to a current funding level of $6.9 billion annually.

The ACIR's endorsement of General Revenue Sharing was reaffirmed by Chairman Abraham Beame in testimony before the House Subcommittee on Intergovernmental Relations on March 26. Recognizing that "the Commission support for renewal may appear to put us downwind as federal policymakers bail out the fiscal ship of state," Chairman Beame stressed that GRS, including the state share, should be shielded from federal budget paring.

Action on General Revenue Sharing now shifts from the budget process to the authorizing committees. Since GRS is due to expire this year, Congress must vote to reauthorize the program. The House Subcommittee on Intergovernmental Relations, chaired by Congressman L. H. Fountain (NC), has concluded mark-up of legislation to extend the program to localities for three years with certain changes. No state government sharing was recommended. The bill would continue the present allocation formula basically in its present form. The Subcommittee voted to defer consideration on most proposals to redefine the "tax effort" portion of the formula, except to limit the taxes counted on a per capita basis to 25% of the statewide average.

Although the Subcommittee bill does not allow for continued state participation in GRS, a countercyclical assistance program was included in the pending legislation to funnel aid to both state and local governments. The antirecessionary program would take effect following a two-quarter decline in real Gross National Product and a two-quarter drop in real wages and salaries. The measure sent to the full Government Operations Committee authorizes $500 million in countercyclical aid for FY 1981 and $1 billion annually for fiscal years 1982 and 1983. Adoption of this program for the coming fiscal year will require passage of a more liberal second concurrent budget resolution.

The deadline for Congressional consideration of the second concurrent resolution is September 15.

Prior to Congressional adjournment in early July, the House Government Operations Committee began consideration of the revenue sharing bill. In the first of a series of votes to come, the Committee authorized the state share subject to annual appropriations for 1982 and 1983.

FLSA Tribulations Continue, Trials Likely

Recent Department of Labor regulations defining "traditional" state and local government functions have drawn fire from public interest groups whose constituencies could stand to pay considerably more in salaries and overtime to some employees as a result.

The definition of "traditional" state and local functions is important because the 1976 U.S. Supreme Court ruling in *NLC v. Usery* exempted such functions from minimum and overtime wage provisions of the *Fair Labor Standards Act.*

On December 21, 1979, the Department of Labor published final regulations defining what are and are not traditional state and local activities.

On behalf of the "Big Seven" state and local interest groups, Bernard Hillenbrand, Executive Director of the National Association of Counties, protested DOL's action in a letter to President Carter. He stated, "We appreciate the fact that you have other more pressing international and domestic concerns at the moment, but this issue seriously threatens the intergovernmental partnership which we have all strived so long to establish."

DOL's ruling defines, for example, mass transit as a "nontraditional" municipal function. Mass transit workers are therefore covered by the FLSA amendments. Already, local governments are defendants in legal actions brought by transit employees in Augusta and Macon, GA, and in San Antonio, TX. The American Public Transit Association argues that transit is a traditional function because it is provided as a public service, is subsidized by all governmental levels, and because operating costs exceed the amount deemed socially responsible to charge the general public.

Impacted public interest groups have requested that the President suspend the ruling until the matter can be studied further and until an intergovernmental and interagency task force can be appointed to consider the matter and make recommendations.

Legislation Considered to Limit State Taxation Powers

On March 31, the House Committee on Ways and Means held hearings on H.R. 5076, a bill which would limit the state's power to tax income and dividends of multinational corporations.

H.R. 5076 would prevent states from taking into account the income of any related foreign corporation and would limit the ability of states to apply their income tax to dividends received by a corporation from foreign corporations.

The testimony of some 50 witnesses reaffirmed the belief in many quarters that considerable disagreement still exists between businesses and taxing jurisdictions. Ferdinand Schoettle, professor of law at the University of Minnesota, testified that "the United States Treasury should become involved in thinking about the appropriate role for the states in the state taxation of foreign income." The importance of state taxation to international commerce was emphasized at the hearings, notably by the International Chamber of Commerce, the Dutch Employees Federation, the Conference of British Industry, and the California Council for International Trade.

Similar legislation, S. 1688, has been introduced in the Senate. The Senate Finance Committee is scheduled to hold hearings over the summer.

ACIR expressed its concern as early as 1967 about state taxation of multistate corporations. ACIR staff is monitoring closely legislative developments at the federal level which would affect states' powers in the taxation of both multistate and multinational corporations, and will report on this subject to the Commission later this year.

Grant Reform, Sunset Bills Advance in the Senate

On May 14, the Senate Subcommittee on Intergovernmental Relations unanimously approved S. 878, the "Federal Assistance Reform Act of 1980." The proposal now awaits action by the Senate Governmental Affairs Committee.

The bill has received strong bipartisan support under the leadership of Senator James R. Sasser (TN) and Senator William V. Roth (DE), ACIR members who have long urged grant system improvement. At a press conference prior to the Subcommittee mark-up, the Senators cited the need for the grant reform measure, noting a "new era of limits" in federal spending and pointing to the cost savings that the measure would permit.

The proposal represents the first piece of important grant reform legislation since the *Intergovernmental Cooperation Act of 1968.*

Title I of S. 878 encourages consolidation of categorical grants in the same functional area, a step long advocated by the ACIR. Title II would improve federal audit capability by providing for single federal financial and compliance audits and authorizing wider federal acceptance of qualified state and local audits. Title III strengthens the joint funding concept to permit state and local governments to coordinate categorical grants used for the same purpose. Title IV would simplify and standardize certain national policy requirements which are generally applied to federal grant programs. Title V requires improved information on federal assistance funds available to state and local governments, strengthens single state agency requirement waiver provisions, requires advance notice of federal level decisions to alter recipients funding levels, and affords grant recipients a year of optional compliance with altered federal regulations.

ACIR staff assisted in drafting S. 878, and Commission members are on record in support of the proposal. The House has taken no action on similar legislation.

A related grant reform proposal, S. 2, the "Sunset Act of 1980," also was the subject of recent Senate action. On June 17, the Senate Governmental Affairs Committee by a 12 to 3 vote accepted a strong version of the sunset concept. Under S. 2, any federal aid program would terminate unless specifically reauthorized by Congress every ten years.

A much weaker version of sunset awaits action before the House Rules Subcommittee on Legislative Process. H.R. 5858 permits authorizing subcommittees to preselect which programs will be subject to review and the bill contains no automatic termination provisions.

In 1977, ACIR recommended Congressional passage of sunset legislation, and Commission members have testified in support of a forceful version of the program review and elimination process.

Over 30 states have enacted sunset laws since the nation's first sunset proposal was passed in Colorado over four years ago.

Forecasting the Future of Federalism

by
David R. Beam

In 1976, the Congress asked the Advisory Commission on Intervernmental Relations to study and evaluate forces likely to affect the future of the American federal system and possible adjustments to such a system, if any, which might be desirable. In response, ACIR has convened a conference to discuss what the American federal system might be like in the 1980s and beyond. This article—and the two that follow—lay the background for that conference and ACIR's examination of the issue. The material presented here is excerpted from longer papers which will be presented in full at the conference and in a post-conference report to be published later this year.

As the 1980s begin, the nation looks forward to the events of the next ten years and beyond. Newspaper articles, periodicals of either a popular or scholarly cast, and a considerable number of private and public organizations and commissions are identifying trends, developing prognostications, and proposing solutions to potential problems of the future.

Although such projects are traditional, in this decennial year the task is being approached with a somewhat more urgent spirit than in either 1970 or, especially, 1960.

The overarching factor is the high and rising tide of disenchantment with national conditions and with the performance of governmental (and other) institutions. A lack of confidence—indeed, a sense of betrayal—is now widespread. As measured by either objective indicators or popular moods, the economic, political, and social fabric is badly strained. A sense that national progress is inevitable, or can at least be assured through public leadership, has been weakened, even lost.

Although these frustrations and disappointments are often intensely personal in their impact—lost jobs (or promotions); too-costly houses, food, transportation; unsatisfactory social or marital relationships; conflict among the generations—the ultimate causes seem to be more situational than individual. This century and its final decades are identified as a period of thoroughgoing societal transformation and potential human crisis by experts in a variety of fields. Thus, they echo the balladeer's refrain: "the times, they are a changin'."

What is true of American society generally is equally true of American federalism. In the view of the Advisory Commission on Intergovernmental Relations, as reflected in the findings of its recent study on "The Federal Role in the Federal System: The Dynamics of Growth," and a series of other reports, contemporary federalism is in serious disarray. Like the economy, and like the political system generally, intergovernmental relationships have lost their pragmatic virtue: in many respects, they no longer work. Thus, there is a sense of potential crisis in the decade ahead, requiring tough decisions and new directions; an awareness of limits, affirmed by the fiscal constraints produced by the nationwide "tax revolt" and measures to restrict spending at all levels; and a recognition that many of the key organizing ideas of the past—intergovernmental relations as a "cooperative" venture, a "sharing" of responsibilities—may no longer apply.

A Clouded Crystal Ball

Despite the urgency of the forecasting task, a review of the historical record shows that social, economic, and political forecasting is a risky business. Knowledgeable experts were quite unable to foresee even the broad outline of the changes in American federalism which occurred over the past two decades.

It should be recalled that, circa 1960, there was much concern among economists about the excessively small size of the public sector and, among political scientists, about the political deadlock which seemed to prohibit strong national actions. Yet the nation was then nearing a period of rapid expansion of government in general and of federal domestic responsibilities in particular.

Similarly, in the late 1960s, few anticipated the national policy trends which were to dominate the decade ahead: energy, environment, and the economy. Neither were the "quiet revolution" in state government organization over the past 15 years, nor the succession of urban crises in the same period, generally forseen in advance.

> **Over the past 20 years, each of the key institutions of governance has changed, leading to new forms of systemic behavior.**

These weaknesses, moreover, seem endemic to social science forecasting: the case of federalism is by no means unique. A wide variety of trends and events involving employment, inflation, agricultural production, fertility, mobility, public opinion, and political behavior have caught the nation and its leading analysts off guard.[1] The obstacles appear to be inherent in the subject matter, rather than just limitations of effort, theory or technique.

At the root of these problems is change. Not simple change—alterations in size, for example—but development, or reorganization: changes of relationship. The subject matter of the social sciences is fluid and, therefore, necessarily perplexing.

Many examples might be offered as illustrations of the time-bounded quality of social science generalizations. From the economic sphere, there is the changing relationship in the 1970s between the rates of inflation and unemployment; from the political arena, one might recall the emergence of "big government" as a concern of liberals as well as conservatives in the latter 1960s; in social relations, there is the rapid acceptance of "dual careers" as a norm for married couples of middle and high, as well as lower, social status. Given this dynamism, social scientists need not fear that their task will ever be completed, the final book written, the ultimate "laws" all discovered. Society changes as they watch; the "conventional wisdom" of the past, however well grounded, sooner or later becomes outmoded.

Similar observations surely can be applied to the study of American federalism. Over the past 20 years, each of the key institutions of governance has changed, leading to new forms of systemic behavior. While the identity of the actors remains the same, the mode of operation and relationships with each other are now quite different.

Textbook descriptions of the Congress, the presidency, interest groups, the political parties, the states, the judiciary, and others, circa 1960, are badly dated. For example, during the past 20 years, power in the Congress has been radically diffused, and members have seized the initiative in many aspects of domestic, budgetary, and even foreign policy. The federal courts, once regarded as neutral "umpires" of federalism—or even a highly conservative force—have played an aggressive and activist role in dealing with social issues. The political parties, always highly decentralized, have been substantially reorganized on a national basis, and reduced in influence. Over these years, too, state and local governmental jurisdictions have "come to Washington" on a full-time basis, establishing new lobbying offices and strengthening their national associations. The changes in each institution have necessarily impacted the others. To cite one obvious case, the presidency has lost a great deal of its influence and prestige as Congress has asserted itself, interest groups have proliferated, and the political parties have declined.

Compared to 20 years ago, then, it is a "whole new ball game," with new team lineups and many new rules as well. The character of these changes in federalism is not adequately conveyed by reference to the rising levels of federal spending and taxation, or even the increase in intergovernmental programs. During the sixties and seventies, the style of play altered—chiefly from one of widespread constraint to widespread activism, coupled with a thoroughly atomized system for decisionmaking. Hence, rather than condemning the stultifying effect of "veto groups," analysts and politicians (of liberal and conservative stripe) now are much more concerned about the excessive benefits obtained by "special interests." Rather than deploring the power of the oligarchs of Congress and its ruling "conservative coalition," they criticize the legislature's lack of both leadership and a spirit of willing "followership." The presidency, long regarded as the mainspring of the system, was only a few short years ago described as dangerously imperialistic; now, it is faulted for being excessively weak. And, instead of explaining why the government budget is necessarily "too small" in a democracy, many experts have turned their attention to explaining why it is necessarily "too large." Yesterday's "solid truths" have become today's historical trivia.

Crisis, Choice, and Complexity

Futurists and analysts of various stripes have identified three key factors as contributing to the changeability—and, hence, the unpredictability—of social processes: crisis, choice, and complexity. Each of these three "C factors" can alter the structural equations of reality, leading to new forms of behavior, by introducing new variables or changing the interaction of pre-existing ones. That is, social indeterminancy stems in large part from:

- ☐ the important influence of unexpected *crises*, surprises, and chance events;
- ☐ the major element of freedom of *choice* in the actions of human decisionmakers; and
- ☐ the poorly understood *complexity* of large-scale, interdependent social, economic, and political systems.

Crisis

A review of the past suggests that unexpected dislocations—including many "crisis" events—have loomed large as influences upon the course of the nation's development. From the standpoint of federalism, the key examples are, of course, provided by the Great Depression and the Second World War. The governmental impact of the Depression was far-reaching, adding many new regulatory and assistance programs, overturning previous Constitutional interpretations, and—perhaps most revolutionary of all—redefining the appropriate scope of national responsibilities.

In a similar way, the Second World War profoundly changed American society and the role of government within it. Federal revenue and debt expanded drastically out of wartime necessity, and never returned to previous levels. Federal intervention in the economy also was essential throughout the conflict and encouraged the belief that it could be managed effectively from Washington.

Other less profound dislocations—perhaps more aptly termed "surprises" than crises—also have had substantial impact on intergovernmental relations, though usually

[1]For a discussion of past failures in social science forecasting, see Seymour Martin Lipset, "Predicting the Future of Post-Industrial Society: Can We Do It?," *The Third Century: America as a Post-Industrial Society,* Seymour Martin Lipset, ed., Chicago, IL, University of Chicago Press, 1979, pp. 1-35.

confined to just one or a few narrow fields. One leading example is provided by the successful launching of the Soviet satellite "Sputnik" in 1957. Aside from its obvious stimulative effect on the American space program, Sputnik also dramatically altered the terms of the national debate over federal aid to education. The need to match the technical achievement and apparent military superiority of the Russians ended a long-standing religious and racial stalemate on school aid, leading to the rapid development by the Congress and Administration of what became the *National Defense Education Act* (NDEA). Its passage, less than one year after the Soviet launch, was nothing short of phenomenal, and marked a major turning point in the growth of a federal role in the field.

A more recent example was the energy crisis of the 1970s, which established an important new field of intergovernmental concern, spawning: a new federal department; a variety of new assistance programs and conservation requirements; interstate tensions over resource development and its impact; and a challenge to the ethic of environmental quality which once seemed to be a paramount national objective.

This crisis-oriented style of policy formulation may actually be quite typical of American institutions and processes. A recently published comparison of welfare reform issues in the U.S. and Canada indicated that "contrary to the view that the United States depends most on incremental change, the most significant change occurs during rare periods of jarring but constructive crisis."[2] The author, Christopher Leman, cited experience with old age insurance, unemployment insurance, and income maintenance in support of his "big bang" theory of policymaking. In all of these areas, policy development was characterized by long periods of stability punctuated by occasional episodes of rapid change. Similarly, one might recall the bursts of social legislation in 1964-65, consumer protection laws in 1966-68, environmental measures in 1969-70, and energy legislation in recent years. The existence of these discontinuities does, of course, make policy forecasting more difficult.

Choice

The recent history of the development of American federalism also suggests that the future is unpredictable because it is made, not simply endured. Willy-nilly or by design, human choices play a major role in determining the course of events. People are—if not exactly in the driver's seat—also not simply along for the ride. Indeed, to some extent, the future is its own "cause" because of the purposiveness of human action. Willis Harman notes:

> We all are accustomed to thinking of the past as a cause of subsequent events—a decision was made, a law was passed, an encounter took place, and *as a result* various other events transpired. We reason this way every day. Less obvious is the fact that our view of the future shapes the kind of decisions we make in the present. Someone has a vision of the future—of a great bridge, a new industrial process, or a utopian state—and *as a result* certain events are taking place in the present. Our view of the future affects the present as surely as do our impressions of the past or the more tangible residues of past actions.[3]

Although policy analysts have traditionally devoted most of their attention to the investigation of large, impersonal "forces" in determining governmental events, the record shows that a decisive role also is played by the personality, interest, values, and commitments of the decisionmakers themselves. Moreover, it is not just the very few "great" men and women of history, but a great many lesser individuals, too, who sometimes leave their stamp on governmental trends. Individuals tucked away at strategic locations in the legislature, the bureaucracy, interest groups, on the media, or elsewhere can influence outcomes by pointing out problems or proposing solutions to them.

The crucial importance of the individual in the shaping of the development of federalism over the past 20 or more years was dramatically portrayed by the Commission's recent study of the growing federal role. The report disclosed that policy entrepreneurs in the Congress have been preeminent in encouraging recent programmatic growth.

Of course, entrepreneurial politics is not the exclusive province of the legislature. It is practiced by Presidents, bureaucrats, and a variety of other well placed individuals as well.

The importance of individuals has many ramifications, each of which creates further uncertainty from the standpoint of the forecaster. The passage of a bill may depend crucially upon committee assignments, upon changes of chairmanships, upon all the vagaries of personal psychology and life which may influence how one allocates one's time and attention. These factors magnify the importance of communications networks, of timing, of the correctly phrased argument, of the cocktail party conversation. And they pose endless difficulties for the futurist.

Indeed, any form of forecasting in which the human factor looms large contrasts with the situation in the physical sciences, and is better compared with playwriting,

> with the characters and their initial relationships well defined, but the script as yet unwritten. . . . The characters live out the play and create it as they go along. The real world is "ad lib" in important respects.[4]

As in a good play or novel, the "plot" of the future must flow from the nature of its characters, but also reflect their capacities for choice and change:

> the events of the future will happen because people, institutions, and nations are what they are and behave as their characters and circumstances dictate. . . . Action must follow from internal dynamics.[5]

Again, as in any drama, there always is more than one potential denouement. Ascher argues that it therefore "is much safer for forecasters to generate a series of conditional forecasts, each based on a policy alternative, than to presume what the policymakers are going to do."[6]

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[2]Christopher Leman, *The Collapse of Welfare Reform: Political Institutions, Policy, and the Poor in Canada and the United States*, Cambridge, MA, The MIT Press, 1980, p. 199.

[3]Willis W. Harman, *An Incomplete Guide to the Future*, San Francisco, CA, San Francisco Book Company, 1976, p. 1.

[4]Robert U. Ayres, *Uncertain Futures: Challenges for Decision-Makers*, New York, NY, John Wiley and Sons, 1979, p. v.

[5]*Ibid.*, p. vi.

[6]William Ascher, *Forecasting: An Appraisal for Policy-Makers and Planners*, Baltimore, MD, Johns Hopkins University Press, 1978, p. 213.

Complexity

More than anything else, perhaps, the development of new federal intergovernmental programs over the past two decades has been an education in complexity, an explication of the obduracy of social problems and the obtuseness of the governmental intervention strategies aimed at their solution. Despite—or even, in some cases, because of—the good intentions and substantial efforts of the federal government, the nation's schools are worse, its health care more expensive, the crime rate higher, unemployment more widespread, neighborhoods just as segregated, decent housing less available, and "hard core" poverty seemingly just as intractable as in 1960. If there is a summary finding to be drawn from the host of federal evaluation studies prepared over the past dozen years, it is the harsh judgment: "little, if any, effect." Outright failures are commonplace.[7] Even the most charitable assessments agree that the sponsors of new social programs expected and promised far more than they delivered.[8]

As an appreciation of complexity has grown, these results have seemed more comprehensible. Apparently, the operation of complex social systems—that is, systems "in which there are at least a moderate number of variables or parts related to each other in organic or interdependent ways[9] —is inherently difficult to understand, even harder to control, and often quite impossible to forecast. Consequently, such systems are sources of frustration to the policymaker, the expert analyst, and especially the futurist.

It is not even clear that traditional concepts of causation can be meaningfully employed. The systems analyst's motto, "everything is related to everything else," is a counsel of caution to both policymakers and futurists. If everything is connected, then causes are multiple. The very distinction between "causes" and "effects" can lose its meaning if a series of variables interrelate through a variety of positive and negative feedback processes.

To cite just one of many similar cases, the rampant inflation of recent years seems to be "too complicated for any single-cause explanation and too intractable to respond to any single-remedy policy."[10] Instead, in the opinion of Robert M. Solow, the economy has become "inflation-prone" because of the interlocking decisions of a variety of private and public actors.[11]

Complex systems also tend to behave "counterintuitively," to use Jay Forrester's term.[12] It is his view that the human brain—despite its remarkable performance in other areas—is not adapted to comprehending the multiple causal loops and nonlinear feedback processes which characterize the operation of social systems. For this reason, human intuition and judgment often lead people to make wrong decisions.

In several different ways, the term "complexity" is an apt description of modern conditions. The segmented economy and society of the past have become intricately interconnected ones of a national—and even international —scale. And the complexity of the intergovernmental system has increased over the past 20 years by several orders of magnitude. Essentially every major field of activity, in every state and community area, has become a tangled network of overlapping, interrelated, confusing, and often conflicting, administrative relationships.

Effective management and planning are often impossible. Programmatic complexity also "overloads" the political process, as each grant and regulation must be reevaluated and reauthorized under the watchful eye of a host of interest group beneficiaries. Pluralism, once considered a virtue, has run amok, reducing accountability and sometimes precluding effective action in the "special interest" state.

Where complexity reigns, ultimate outcomes are uncertain. The task facing those considering the future of federalism is doubly difficult, for both socioeconomic problems as well as the possible responses to them by all three levels of government both must be anticipated. One order of complexity thus confronts another.

Conclusion

The shortcomings of past efforts at prophecy, together with a consideration of the implications of crisis, choice, and complexity for social, economic, and political processes, all suggest that the task confronting the forecasters of federalism is a very formidable one. More starkly, it clearly is impossible to determine what the condition of American federalism will be ten years hence—just as present circumstances were not foreseeable ten years ago.

Impossibility clashes sharply with necessity, however, as the process of governance itself depends upon images of the future. Indeed, every vote, every budget, every statute, every agency or court ruling, embodies two implicit futures: what will happen *without* the action contemplated, and what would happen *with* it. Such forecasts and promises (of energy shortages or surpluses, of economic problems or recovery, of environmental degradation or improvement, of more crime or less) are the very stuff of political rhetoric and policy choice. Every politician, and every citizen, is whilly-nilly a "futurist," like it or not. Some simply are more careful about their activities than others.

The lesson which both past experience and expert futurists offer is that a variety of outcomes is always possible. The future is neither fixed nor singular. Paul Dickson notes that "one of the things virtually all futurists believe is that there is a broad array of *alternative futures* open to us."[13] Moreover, the future will be shaped by human actions: "the most fundamental tenet of futurism is that we are, to a large degree, creating the future right now with our present decisions, discoveries, policies, actions, and inactions."[14] Thus, while social and economic trends and events provide a necessary backdrop, federalism in the 1980s—as in the past—will be what we make it.

David R. Beam is a senior analyst at the Advisory Commission on Intergovernmental Relations.

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[7] For a broad overview of evaluation studies, see James E. Prather and Frank K. Gibson, "The Failure of Social Programs," *Public Administration Review* 37, September/October 1977, pp. 556-64.

[8] A sympathetic and informed appraisal of Great Society programs may be found in Sar A. Levitan and Robert Taggart, *The Promise of Greatness*, Cambridge, MA, Harvard University Press, 1976, which does, however, fully recognize underestimation of the difficulties involved and the problem of overpromising. See p. 290.

[9] Todd La Porte, "Organized Social Complexity: Explication of a Concept," *Organized Social Complexity: Challenge to Politics and Policy*, Princeton, NJ, Princeton University Press, 1975, p. 5.

[10] Robert M. Solow, "All Simple Stories About Inflation Are Wrong," *The Washington Post*, Washington, DC, The Post Publishing Co., May 18, 1980, p. G5.

[11] *Ibid.*

[12] Jay W. Forrester, "Counterintuitive Behavior of Social Systems," *Technology Review* 73, January 1971, pp. 1-15.

[13] Paul Dickson, *The Future File*, New York, NY, Avon Books, 1977, p. 16.

[14] *Ibid.*

Fiscal Federalism in the 1980s

by George F. Break

Despite the dark clouds and stormy atmosphere with which the decade is beginning, there are bright spots on the horizon that offer the possibility that the 1980s may go out like March, as a lamb.

State and local governments can take hope from demographic trends, which not only can be predicted with some accuracy for the period but promise relief in several respects.[1] Schools and universities, freed of the inexorable pressures of rising enrollments, should be in a position to reduce their claims on the public purse or to improve the quality of their services. The baby boom generation will be in its most productive life cycle phase, providing more in tax revenue than it receives in services and transfers. Public sector wage rates, having risen at least to equality with comparable rates in the private sector, should exert less upward pressure on government budgets than they have in the past. Even petroleum prices appear to have reached levels at which alternative energy sources begin to look economically attractive. If so, the real cost of oil supplies should be much more stable in the 1980s than in the 1970s, and inflationary pressures should be correspondingly moderated.

These bright spots are, of course, only possibilities—opportunities that depend on a combination of fortune and enlightened action by the nation. One critical uncertainty has to do with inflation control, which depends among other things on the society's willingness and ability to raise its levels of saving and investment and to strengthen the other determinants of economic growth. Other crucial factors are the nation's ability to respond to the challenge of operating in a less secure world, both politically and economically, and the skill with which it handles the adjustment to higher energy and natural resource costs. Unless these hurdles can be surmounted in an efficient and cooperative way, there can be little basis for optimism.

FISCAL FEDERALISM IN A HIGH-INFLATION ECONOMY

While the general economic welfare is bound to suffer greatly from high inflation, the impact on different groups is very uneven. There are many losers and some gainers, but the effects on different levels of government can to some degree be predicted.

The Federal Government and Inflation

Though combined in the unified budget, the social security system and the remainder of the federal government's fiscal activities should be treated separately.

Social Security. An important change effected by the 1977 Amendments to the *Social Security Act* converted the system from one whose very survival was threatened by accelerating inflation to one that profits moderately from it.[2] What make the difference are the time lags built into the law. Whereas taxable wages, and hence system revenues, are likely to react quickly to increases in the Consumer Price Index (CPI), retirement benefits are adjusted upward only once a year. It is also estimated that the benefit entitlements of active workers react to a higher rate of wage increase with about a two-year lag. The system's Board of Trustees estimated in their 1979 annual report, for example, that for the 1979-2003 period, a long-run annual CPI increase of 2% would produce average OASDI system expenditures equal to 10.74% of taxable payroll, com-

[1] Richard A. Easterlin, "American Population since 1940," *Postwar Changes in the American Economy*, Martin Feldstein, ed., Chicago, IL, University of Chicago Press, for the National Bureau of Economic Research, forthcoming.

[2] Alicia H. Munnell, *The Future of Social Security*, Washington, DC, The Brookings Institution, 1977, pp. 30-60.

pared to a projected level of 10.40% for a 6% inflation rate.[3]

Apart from these favorable lag effects on the financial position of the social security funds, a number of less certain influences also exist. One is created by the ceiling on taxable earnings. As long as it is there, the sensitivity of wages above and below that level to inflation will affect the sensitivity of system revenues to rising prices. The most ominous threat to system solvency would come from a close relation between inflation and a combination of high levels of unemployment and low rates of growth of real income and wages. The latter two phenomena seriously affected social security financing in the 1970s. The 1979 Advisory Council on Social Security, for example, concluded that under the impact of high unemployment and slow wage growth "the combined OASDI trust funds declined from 73% of annual outlays at the beginning of 1974 to 29% at the beginning of 1979."[4] Whether high inflation does significantly slow the nation's rate of economic growth and raise the incidence of periods of high unemployment is an unsettled economic issue. Nevertheless, the threat is there, adding to the numerous discomforts of living with inflation.

Other Federal Budget Items. The rest of the federal budget contains a diversity of items, some indexed for inflation in the sense that the real revenue yield or the real expenditure flow tends not to be affected by the rate of inflation, some underindexed and some overindexed. Putting them all together, Edward M. Gramlich estimated that in 1973 federal expenditures had an average inflation elasticity (the ratio of the percentage increase in the current dollar value of the item to the percentage increase in prices) of 0.68 and total receipts an elasticity of 1.17.[5]

In the absence of discretionary actions by Congress, then, the indication is that the federal budget gains from inflation. Two of the main contributors to those gains that are of special interest here are grants to state and local governments, assigned an inflation elasticity of zero, and individual income tax revenues, estimated by both Joseph A. Pechman (1973) and the Council of Economic Advisors (1975) to have an inflation elasticity of 1.6.[6] This high sensitivity results both from the use of nominal, rather than real, taxpayer incomes as the tax base and from the lack of any automatic upward adjustment for inflation of the tax rate brackets, personal exemptions, and other structural features of the tax. Both kinds of inflation indexation could be adopted for the federal individual income tax, but the threat they pose to the growth of federal revenues has been a major barrier to their enactment.

In general, then, federal budgetary conditions tend to be eased by inflation. At the same time, of course, inflation may increase—or create—pressures for change in certain federal programs. Serious continued erosion of the value of private pensions, for example, may stimulate demands for higher social security retirement benefits.[7] Failure to index the federal individual income tax for inflation, by creating severe taxpayer inequities and economic distortions, may so undermine the popular image of that tax that the government will have to seek other forms of revenue or risk the acceleration of pressures to cut back expenditure levels significantly.[8] Inflation, in short, is likely to prove a very unpleasant parasite for any economy to live with long.

Inflation, in short, is likely to prove a very unpleasant parasite for any economy to live with long.

State and Local Governments and Inflation

While the federal government is mainly a transfer agent, shifting funds from one group to another, state and local governments are mainly providers of direct services to the public. In 1976, the latest year for which National Income and Product Accounts data for all three levels of government are available, purchases of goods and services were only 34% of total federal expenditures but 56% of state, and 96% of local expenditures.[9] If grants-in-aid are excluded from the spending totals, the service components of total direct expenditures were 40% federal, 90% state, and 96% local. State-local spending in an inflational economy, therefore, will be dominated by the behavior of wage rates and the prices of private goods and services. Of the two, the local sector is the more labor intensive. In 1976, for example, compensation of employees was 61% of local purchases of goods and services, compared to 47% for state governments.[10]

In general, public and private sector wage costs should react to inflation in much the same way. Unanticipated accelerations of inflation tend to reduce real wage rates while unexpected decelerations raise them. There are some indications, as in 1979, that state-local sector wage rates react less rapidly than others to anticipated inflation, but unless these lags are later made up, the quality of government services must fall. Over the longer period, then, current services budget projections will be mainly a function of the probable levels of comparable wage rates in the private sector.

The nonlabor component of government purchases should also show an inflation elasticity of unity, in the absence of strongly divergent price trends. Unfortunately, rising inflation rates tend to be accompanied by just that phenomenon. If such conditions persist in the future, state and local budget officials may need to become experts in the behavior of different commodity and service prices, both as causes and as effects of inflation.

One potentially important difference in the reaction of sector labor costs to inflation may occur in the provision of

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[3] The Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, *1979 Annual Report*, Washington, DC, U.S. Government Printing Office, 1979, p. 69.

[4] 1979 Advisory Council on Social Security, *Reports: Social Security Financing and Benefits*, Washington, DC, U.S. Department of Health, Education and Welfare, 1979, p. 31.

[5] Edward M. Gramlich, "The Economic and Budgetary Effects of Indexing the Tax System," *Inflation and the Income Tax*, Henry J. Aaron, ed., Washington, DC, The Brookings Institution, 1976, pp. 272-78.

[6] Cited, *ibid.*, p. 273.

[7] *Business Week*, New York, NY, R. B. Alexander, May 12, 1980, pp. 92-99.

[8] George F. Break, "The Impact of Inflation on the Federal Tax System," *Tax Notes*, December 3, 1979, pp. 735-39.

[9] David J. Levin, "Receipts and Expenditures of State Governments and of Local Governments, 1959-76," *Survey of Current Business*, Washington, DC, U.S. Department of Commerce, May 1978, pp. 15-21.

[10] *Ibid.*, pp. 16-17.

retirement benefits. Gramlich's estimates give federal civil service and military retirement expenditures an elasticity of 1.33—the results of a law that deliberately overindexes those benefits.[11] State and local governments compete more directly for workers with the private sector, where the situation is quite different. There inflation has already eroded the value of many pension benefits, and unless future pressures for relief focus on the social security system, state and local governments are likely to find their employee retirement costs rising sharply. That would add still more time bombs to those already ticking for the many governments still operating with grossly underfunded pension plans.

On the revenue side of their budgets, state governments seem much better protected from the ravages of inflation than their local subdivisions. The individual income tax, which in 1978 provided 26% of state tax collections but only 5% of local, is highly sensitive to both economic growth and inflation. Because of their greater progressivity, state income taxes are typically more sensitive than local; however, six states—Arizona, California, Colorado, Iowa, Minnesota, and Wisconsin—have indexed their personal income tax structures for inflation, thereby reducing the inflation elasticity of their tax systems. Their tax bases, nonetheless, still use nominal rather than real income, and this tends to increase tax burdens on both business and property incomes as inflation accelerates.[12]

The retail sales tax, which provided 30% of state tax collections in 1978 and 8% of local, may also be a highly inflation-sensitive source of revenue, though this quality is more uncertain than for the individual income tax. If inflationary expectations induce people to save less and to shift their spending from tax-exempt services to taxable consumer durables, sales tax revenues will rise rapidly with inflation. On the other hand, since the price elasticity of demand for such items as food, medical services, and gasoline (that are frequently exempt from this tax) is less than unity, any relative increase in the price of those items, such as has recently fueled inflationary fires, will leave consumers with less money to spend on taxable goods. These shifts, at constant saving rates, will reduce the inflation elasticity of the sales tax. For states that use a credit-rebate mechanism instead of exemptions to relieve low income families from excessive sales tax burdens, on the other hand, sales tax revenues will tend to respond quickly to inflation unless the credit-rebate allowances are indexed so as to maintain their real values.

Forecasting retail sales tax revenues in an inflationary economy has become a hazardous undertaking. In California between 1974 and 1978, for example, the growth in sales tax receipts was consistently underestimated by state revenue analysts.[13] Further study of the determinants of sales tax revenues is clearly needed.

The main source of local tax revenue, the general property tax, is even more of an enigma in the present context. Providing 80% of local tax collections in 1978 and 2% of state, the property tax has traditionally been regarded as a relatively growth-insensitive source of revenue. The reassessment lags on which this conclusion has mainly rested, however, can be minimized or eliminated under a well-monitored statewide law requiring property assessment at full market value, or some fraction thereof. The fact, moreover, that inflation tends to make the ownership of tangible assets more attractive for most people than investment in stocks, bonds, and other financial assets has the effect of making housing prices rise more rapidly than the general price level. This works to increase the inflation sensitivity of a well-managed property tax. A remaining uncertainty, however, is the extent to which good assessment practice tends to stress normal, long-run market value rather than current sales prices. The more it does, and the more inflation is regarded as a temporary phenomenon, the less elastic the property tax base will be.

On the revenue side of their budgets, state governments seem much better protected from the ravages of inflation than their local subdivisions.

Selective sales and excise taxes, which provided 18% of state tax collections in 1978 and 3% of local, tend to be strongly inflation insensitive. Specific excises imposed on a quantity, rather than a value, basis such as those on gasoline, tobacco, and alcoholic beverages, have a built-in zero inflation elasticity that could be negative if rising prices induce consumers to shift purchases away from these items.

The most important kind of nontax revenue for both state and local governments is intergovernmental aid. In the National Income and Product Accounts measures for 1976, for example, federal grants were 27% of state receipts, while federal and state grants together comprised 46% of local receipts.[14] Intergovernmental grants, as already noted, tend to have a low built-in sensitivity to inflation. For local governments this means that almost half of their general fund revenue is likely to fall in real purchasing power as inflation accelerates. Pressures may of course be put on grantors to raise their support levels, but it is politically easier to reduce real grant aid by expanding nominal grant funds in a noninflationary economy. As major grant intermediaries, states both lose and gain from the inflation insensitivity of intergovernmental aid. It is true that inelastic federal aid amounts to more than one-quarter of their general revenues, but they can shift much of this inflation burden to local governments through their own inelastic state aid programs. Indeed, in 1976 they did more than that, since state grants to local governments were 35% of total state National Income and Product Accounts receipts, compared to the 27% they received in aid from the federal government. On their intergovernmental aid accounts, therefore, both state and federal governments appear to gain budgetary ease from inflation at the expense of the local public sector.

[11] Gramlich, *op. cit.*, pp. 273-77.

[12] T. Nicolaus Tideman and Donald P. Tucker, "The Tax Treatment of Business Profits under Inflationary Conditions," *Inflation and the Income Tax*, Henry J. Aaron, ed., pp. 33-80. Also see Martin Feldstein and Lawrence Summers, "Inflation and the Taxation of Capital Income in the Corporate Sector," *National Tax Journal*, Columbus, OH, National Tax Association, December 1979, pp. 445-70.

[13] Robert T. Deacon, Perry Shapiro and Terence Smith, "What Has Happened to the California Sales Tax?", *National Tax Journal Supplement*, Columbus, OH, National Tax Association, June 1979, pp. 305-13.

[14] *Survey of Current Business, op. cit.*

FISCAL FEDERALISM IN A SLOW-GROWTH ECONOMY

Perhaps the most ominous economic note on which the 1980s have begun is the recent pronounced slowdown in the increase of U.S. productivity rates. Real output per worker-hour rose by more than 3% a year between 1948 and 1966, fell to about 2.25% in 1965-73, and was only 1% a year between 1973 and 1977. Toward the end of the 1970s, average labor productivity change was negative. Both labor and total factor productivity have been increasing less rapidly in the U.S. than in other major countries since 1960.[15]

Government has been both a contributor to and a sufferer from these plummeting growth trends. Whether they will continue in the 1980s, stabilize at some low level, or recover to some intermediate figure is, of course, unknown. Few experts expect a return to the performance of the economy before 1973, but the Townsend-Greenspan projections made for *Fortune* do set the rate of growth of real output per worker during the 1980s at 1.7% a year.[16] Certainly that kind of decade average could be achieved given the will and the wit to do so. Since both of these prerequisites are subject to some doubt, the potential impact of a slow-growth economy on intergovernmental fiscal relations is a topic well worth discussing.

One effect, and not an altogether unpleasant one, would be that low-productivity growth in the public sector would be less conspicuous as the private sector moved closer to that comatose condition. The relative price of government services would no longer rise steadily and inexorably as it does in a high-growth economy propelled by rapid productivity increase in the private sector.[17] Invidious comparisons would tend to disappear as the performance of the private sector sank back toward that of the public sector. These changes would not necessarily alter the overall demand for government services. In a high-growth economy both real per capita income and the real price of government services rise steadily and produce offsetting effects on demand for public sector output. In a low-growth economy both trends are muted, but their net impact may be much the same. One important intergovernmental effect does, however, seem likely. Since the real value of transfer expenditures is determined by private sector prices, these programs, unlike purchases of goods and services, tend not to be affected adversely by lagging productivity advances in the public sector. In a high-growth economy, therefore, the real price of federal government benefits, which flow significantly from transfer programs, tends to rise less rapidly than the real price of state and local benefits, which are generated largely by direct service operations. In a low-growth economy, conversely, these adverse pressures on state, and especially local, governments would be moderated.

"Perhaps the most ominous economic note on which the 1980s have begun is the recent pronounced slowdown in the increase of U.S. productivity rates."

Another widely discussed effect of a shift from high to low-economic growth is an intensification of interest in, and conflict over, the distribution of claims to national output. It is much easier politically to divide up increments to total output than to redivide a fixed amount of goods and services. As Henry Rowen emphasized in the title of an article presenting his case for economic growth and increased productivity, "A Rising Tide Lifts All Boats."[18] Or, to change to the classic figure of the pie, which has to be made to go around—a larger share for one person means a smaller one for someone else. A likely result of slow growth, then, is increased social tension as rising demands for government aid, subsidies, and transfers run headlong into stiffening opposition to higher taxes and lowered living standards. One result might be much sound and fury to little or no effect. Fewer government projects and programs might be approved because agreements on the appropriate allocation of benefits would be harder to come by. Taxpayer insecurity over future demands for more and more redistribution might provide support for tax and expenditure limitation measures, especially at the federal level where most of the action is. Alternatively, if pressures for more income support were to dominate, federal tax burdens could be expected to rise since in the foreseeable future transfer expenditures can no longer be expected to expand at the expense of defense spending.

While the specific details are hard to foresee, the federal government is likely to be the main arena for the battles over redistribution and at the same time for efforts to raise the nation's economic growth rate. Some state and local governments will be little affected by any slowing of the national growth rate, but others, which might have grown slowly in a high-productivity economy, will face the disagreeable prospect of actual decline. Migration from declining to expanding regions may increase, producing important fiscal effects on the communities involved. In her 1975-76 study of Massachusetts cities and towns, for example, Helen Ladd found that per capita expenditures were lowest in communities with moderate growth rates, highest in declining areas, and moderately high in rapidly expanding municipalities.[19]

If slow growth does intensify public interest in income redistribution, regional rivalries are likely to increase as well. Intergovernmental fiscal relations will then be both more important and more difficult. Another set of forces pointing in the same direction was set in motion by the OPEC oil price increases in 1973.

FISCAL FEDERALISM IN A WORLD OF HIGH-COST ENERGY

The last years of the 1970s were buffeted by the large windfall gains and losses created by the massive oil price increases of the period, and the 1980s are likely to see more of the same. Regions rich in natural resources, and particu-

[15] Edwin Mansfield, "Technology and Productivity in the United States," *Postwar Changes in the American Economy,* Martin Feldstein, ed., *op. cit.*

[16] William Bowen, "The Decade Ahead: Not So Bad If We Do Things Right," *Fortune,* New York, NY, Clifford Crum, October 8, 1979, pp. 83-104.

[17] William J. Baumol, "Macroeconomics of Unbalanced Growth: The Anatomy of Urban Crisis," *The American Economic Review,* Nashville, TN, The American Economic Association, June 1967, pp. 415-26.

[18] Henry Rowan, "A Rising Tide Lifts All Boats," *Taxing and Spending,* San Francisco, CA, Institute for Contemporary Studies, Winter 1980, pp. 63-82.

[19] Helen F. Ladd, "Municipal Expenditures and the Rate of Population Change," Cambridge, MA, Department of City and Regional Planning, Harvard University, Discussion Paper D79-6, May 1979.

larly in sources of energy, will prosper while other regions struggle to maintain accustomed standards of living. Allen Manvel, for example, estimates that in the six-year period from fiscal 1974 through 1979, severance taxes and oil and gas rents and royalties yielded $2,040 per capita in Alaska, $1,459 in New Mexico, $1,099 in Louisiana, $845 in Wyoming, $472 in Texas, and $410 in Oklahoma, the country's six major oil-exporting states, but produced only $17 per capita in all other states.[20] Alaska has already eliminated all state income tax burdens on long-term residents, and more fiscal dividends are eagerly expected. Such regional windfall gains are not the stuff of which domestic tranquillity is made. At the very least, they seriously undermine the case for basing the distribution of federal aid (as does the revenue sharing law) on an area's per capita personal income rather than on its ability to raise government revenues.

The other side of the high-cost energy coin shows the beginning of a complex set of internal relocations set in motion by the changed environment. In addition to the interregional migrations noted in the preceding section, there are likely to be many business and household relocations as people seek to minimize the costs of energy. In the short run the central cities may gain at the expense of suburbia; in the longer term information systems technology may help create a decentralized cottage industry type of economy in which many people work at home much of the time and commute to the office only occasionally. Whatever the future may bring, the nation's cities will need to remain flexible, probably more dependent on their own resources and perhaps enjoying it the more withal. The more diverse and uncertain the fiscal challenges of different communities and states, the stronger the case for unrestricted rather than categorical federal grants.

These internal uncertainties of reaction to high-cost energy are matched by possibly even more critical external ones of availability of supplies under disturbed world conditions. Dealing with these contingencies is the federal government's responsibility, already manifested in the developing debate over relative funding levels for defense and domestic programs. Given the staying power of the latter, any substantial expansion in defense spending is likely to require tax increases and to result in a larger federal sector.

In addition to all of these new responsibilities in the energy area, the federal government may also be approaching an important watershed in its international economic relations. The two sharply different directions that may be taken have much in common with the major policy alternatives facing the federal grant system. On one side of the divide lies an ever more tightly controlled domestic economy, protected from foreign competition by tariffs, quotas and regulations, valuing the security of the status quo above the potential economic gains from vigorous, unfettered international competition. This is in many ways the easier policy choice since it involves the pursuit of obvious short-run gains at the expense of long-run, uncertain ones. The danger, of course, is that the low-trade world economy, like the low-growth domestic one, may some day awake to the true cost of comfortable complacency but find the climb back to the watershed difficult, if not impossible.

On the other side of the divide lies the deliberate pursuit of high levels of international trade based on each nation's exploitation of its own comparative economic advantages.

Whatever the future may bring, the nation's cities will need to remain flexible, probably more dependent on their own resources and perhaps enjoying it the more withal.

In the world of the eighties the developing countries are rich in human labor and natural resources, the developed countries in technology, knowledge, and skills. Each party can gain by buying what the others do best. For the federal government it is a matter of encouraging the steady development of such an interactive world economy while moderating some of the major adjustment costs likely to be suffered by domestic producers and thereby alleviating the insecurities that many perceive in a world of unregulated competition and trade. In these difficult endeavors the federal government may find a valuable ally in the multinational corporation, or the new variation on that theme that Peter Drucker calls a "transnational confederation" (a term that fiscal federalists will find of particular interest).[21]

In the domestic economy much the same policy choice exists. Should we encourage vigorous interregional competition and local self-reliance? If so, the federal grant system would face a major reorientation toward tax and revenue sharing and block grants. Or should we continue recent trends toward a centralized fiscal system, tightly controlled from Washington? If so, categorical grants would remain the dominant federal aid instrument. This choice, more than any other, will determine the shape of fiscal federalism in this country during the 1980s. It is by no means the first time that such an important crossroads has been encountered.

George F. Break is Professor of Economics at the University of California, Berkeley.

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[20] Allen D. Manvel, "Some U.S. Beneficiaries of OPEC," *Tax Notes*, February 4, 1980, pp. 166-67.

[21] Peter Drucker, *Managing in Turbulent Times*, New York, NY, Harper & Row, 1980.

The 1980s: Monopoly or Competition?

by Aaron Wildavsky

The 1980s will witness a struggle between rival tendencies over the spirit of federalism as the American form of government. The choice will be between monopoly and competition. Will government be based on a bureaucratic division of labor within policy spheres criss-crossing levels of government, or will there be competition over service delivery among a greatly enlarged number of providers? Putting the question in the context of citizen activity, will there be participation via bureaucratic instigation or via citizen choice among alternative bureaucracies?

Bureaucratic Monopoly

The French philosopher Alain once said that there is more in common between two parliamentarians, regardless of ideology, than between them and any citizen. Similarly, we may say that bureaucrats at different levels of government may have more in common than they do with any outsider. They share expertise; they make work for one another. Indeed, they cannot exist without each other. They owe their jobs, even their future opportunities to the solidarity of their spheres. Of course, they do not entirely agree or there would be no reason to differentiate themselves. Their task is to adjust the system internally so that national directives are made tolerable to those who must carry them out in the field. As the participants move from and between the executive branch, Congressional committee staffs, state and local governments, universities and consultancies, however, they are less likely to be concerned about where they live now and more about the good opinion of those in their sphere who will determine how well they will live next year.

As citizens are sucked into spheres of policy, participation becomes cooptation. Hearings are held to soak up citizen energies as well as to learn to mitigate their objections. Intervenor status is granted so that the government subsidizes people to put pressure on it. There may be occasions when intervenors want less done, as in certain environmental matters, but for the most part, the more expert they become, the more they want done in their sphere. Since the bureaucracies devote all their effort to these policies, over time they should be able to deflect and to shape what they hear from "the voice of the people." Whatever their differences, citizen and bureaucrat will agree that their sphere should be enlarged and that it should deal with its own problems.

Let us pause for a moment to consider the pass to which we have come. The actors are bound together by a common interest in spheres of public policy. The nongovernmental actors are organized by responding to governmentally created opportunities. There is music (or is it moolah?) in the spheres. Their operatives move in and out of governmental positions. They want what any red-blooded American interest group wants: government subsidy without governmental control. They bargain out a common set of regulations with which both can live; the price of program change, as we know, is program growth. Individual citizens are also organized, their activities ordered by the demands of due process, sequenced by the requirements of intervenor status, overwhelmed by the facts that become the common language of those whose places they must someday take in order to amortize their enormous investment of time and energy.

Contrast these marriages of convenience among producers of governmental products, including routinized objection to them, with the citizen or state as the unit of action. Here the object is to save time and attention while making choices responsive to diverse desires. If everyone has to participate in everything (or almost), normal life becomes impossible. If everyone has to be expert on everything, citizens would be driven by the demands of government. So would localities. If the same sort of time, attention and expertise were required to participate in economic life, consumption would become all-consuming and no one would have a chance to make a living. Just as prices enable consumers to do well enough, or to comparison shop, so might governmental services be arranged to simplify rather

"If they had their way entirely, governmental agencies would all have the equivalent of the post office's monopoly of first-class mail."

than "complexify" choice.[1]

The basic proposition of big government, running across state and national lines, fortified by conventional administrative wisdom, is monopolist: governments should control the allocation of services to citizens within their jurisdictions without competition. If they had their way entirely, governmental agencies would all have the equivalent of the post office's monopoly of first-class mail.

In private industry the theory is competitive but the practice often is not. Following William Niskanen, Director of Economics, Ford Motor Company, we may stipulate that, *if it could get its way*, industry would prefer competition among its suppliers and monopolistic access to its consumers That is why it is necessary to bring external force to bear to assure competition. The same sort of pressure must be brought to bear on government if it is to give up its monopolies. Before action can be taken, it is essential to provide an alternative theory justifying competition for governmental goods and services. Public choice theory does just that.

The Consumer Approach

Since the citizen is at the center of its attention, public choice theory arranges everything to make things easy and understandable for him and not for bureaucrats. No one likes competition (after all you can lose) except the consumer whose life is made predictable by the uncertainties imposed on others.

For the citizen, then, overlap, duplication, and redundancy (synonyms, in this context for competition) are not wasteful but wonderful. They enhance reliability of supply; if one supplier won't, another will. They cut down information costs; products may be distinguished by prices; they may be exchanged; and, given diversity, their mixes may be compared at the margins. Redundancy results in suppliers working hard to guess what citizen consumers want rather than the reverse. Competition is the better mouse trap that has a variety of units competing to beat a path to the citizen's door.

Anyone who has to deal with governmental agencies, or who wants to apply for grants, knows that it is useful to have a multiplicity of points of access and largesse. It is then possible to play them off against one another or simply to go to the most receptive place. Thus, individuals can sort themselves out among agencies with different rules, objectives, and personal predelictions. Similarly, grievances encountered in one place may be redressed in another. There is no *a priori* made of action that fits everyone; instead of fitting citizens into a mold, that is, requiring that they be uniform, it is better to demand that agencies be diverse.

Who is to say what is the appropriate scale of activities? Outside of a limited area, including, perhaps water and sewers, many unsubstantiated claims are made for economies of scale. The division of labor facilitated by large size may suit certain specializations but is unlikely to result in more cops on the beat or teachers in the classroom or case workers in welfare.

The major movement in education in the United States after the Second World War has been the consolidation of rural school districts. Every study ever done shows that the larger the size, the worse the scholastic or social performance no matter what measure is used. One understands that consolidation may be useful to state and national associations of supervisors or may reduce the number subject to governmental oversight, but it is a bad buy for citizens subject to it.

If producers of goods and services have to compete with one another, however, they may decide to be as large or small as they like, running the risk of inconveniencing only themselves. They are the ones in touch with production technology; they, not the citizen consumer, have the knowledge to make informed choices. If they deem it desirable to sign additional contracts to extend their service areas, or trade areas at their geographic margins, or agree to emergency support or loan of equipment, they can gain whatever advantage there may be in size without losing responsibility to the users.[2]

A consumer approach will lead to better, if not bigger, state government. Consider, for example, the quandry of state governments in dealing with pensions and disability payments (it is easy enough for the two to merge) for its employees. Given the normal operation of the political process, it is all too tempting to hide the true costs of pension provisions by pushing them into the future when another generation will have to pay. The future, apparently, is now and the result is huge "unanticipated" costs. The direct way of dealing with this phenomena is to set up special committees to monitor retirement provisions. Several states have done just this. But, after the first flush of enthusiasm wears off, a return to business as usual may be expected. Contracting out, by contrast, requires no constant surveillance. Whatever other faults the agreement has, other people—the service providers—are responsible for "fringe" benefits. *All the financial costs are on top, out* in the open. The relationships are easier to monitor, thus leading to more effective and responsive government.

Growth In Government(s)

If this (dual) hypothesis has merit,[3] evidence of twin trends should have appeared by now: growing size of all levels of government, and an increase in the number of entities and proposals for producing services that used to be monopolized. And, of course, there should also be opposition to threatened loss of monopoly.

Size is sure. All levels—local, county, state, national—have grown rapidly in real terms in the last quarter century. Part of the puzzle of federalism is that while it appeared for a time that the national level was gaining at the expense of the state and local, the underlying trend is for all levels to grow, different ones spurting ahead then

[1] See "Citizens as Analysts," Chapter 11, *Speaking Truth to Power*, Boston, MA, Little, Brown, 1979, pp. 252-83.

[2] See Robert Bish and Vincent Ostrom, *Understanding Urban Government*, Washington, DC, American Enterprise Institute, 1973.

[3] An excellent introduction may be found in M. A. Sproule-Jones, *Public Choice and Federalism in Australia and Canada*, Research Monograph No. 11, Centre for Research on Federal Financial Relations, Australian National University Press, 1975.

dropping behind but never declining absolutely or relative to national product. Perhaps, as Sherlock Holmes said about the dog that didn't bark, the clue is in what is missing, namely, no decline. As a general rule, the more different sources of funds—the more streams that flow into the river—the larger it will be. By competing for control, by challenging the others, total spending is increased. By creating anomalies, inconsistencies, inequities and inequalities, the levels, though this is not immediately apparent, work together to increase total output of spending.

The second trend toward a larger number of competing units, if there is one, requires evidence. In policy proposals, the signs of things to come are there. There are a variety of proposals, seriously entertained in Congress, for competition among medical plans, with savings shared among employers and employees. Voucher plans in education are live issues in several states. California is experimenting with giving welfare recipients a choice of services. And so on.

At a less impressionistic level, there has been a substantial growth in the amount of services provided by special districts, accounting for a decline in the relative position of localities in providing services. In libraries, mass transit, health, housing, urban renewal, hospital, parks and recreation services the number of states with a multiplicity of providers has grown sharply.

An interesting change is taking place in the same 1,800 federally assisted planning units throughout the country. Their original planning functions, other than accumulating huge amounts of data, by all accounts have atrophied or never existed. These Councils of Governments (COGS, as they are sometimes called) or planning commissions or districts have taken on certain middlemen functions between the "feds" and the localities. More interesting, for us, however, is a noteworthy tendency for them to become entrepreneurs in their own right, offering for sale a variety of services.

Having identified two trends, one strong and persistent toward monopoly, and the other just beginning to come to competition, which do I think will prevail? And which, more importantly, do I think ought to prevail?

If conditions stay the same, other things being equal (or whatever dodge one cares to use) monopoly will grow. The spheres of policy will solidify themselves. Indeed, feeling their oats, they will attack the remnants of private providers. Monopolistic bureaus will literally not be able to understand why reason and rationality do not demand that like activities be grouped together and dictate that certain classes of activities be provided exclusively through government. Bigger will be better, as, by then, everyone who matters will plainly see.

But the likely is not necessarily the inevitable. A better question would be to ask what we would be willing to help make happen. Unless citizens are in the grip of forces they cannot control, they can help determine whether the federal system will be more monopolistic or competitive. And the more competitive it is, the more choice is available to citizens, states, and localities, the more diversity there can be, which is a *sina qua non* if there is to a federal system in which things are done differently in some states than in others.

"A consumer approach will lead to better, if not bigger, state government."

Decongestion Requires Limitation

In a memorandum from Executive Director Wayne Anderson to members of the Advisory Commission on Intergovernmental Relations, dated February 20, 1980, he sums up the seriousness of the current situation:

> 'Overload' of our intergovernmental system, which is predominantly the consequence of our bigger, broader, and deeper federal aid system, is the central and most prevasive intergovernmental problem facing this nation, our research richly documents. Decongestion of the system, we believe, is the foremost need for the 1980s if we are to improve the effectiveness, efficiency, equity, and accountability of all three levels of government.

How are we to achieve decongestion if the government keeps growing? Ultimately, growth at the federal level must be reflected in corresponding catch-up spending at the state and local level. Were that not so (and it is hard to see how it could be otherwise with federal structure built into the legislative process), then the spectre of the states being subservient to the central government might become a reality. But this, as social workers say, is not the presenting problem. The time when advocates of a vigorous federalism could take comfort from the sheer growth of state spending is past. True, there has been a much-to-be commended invigoration of state analytic and executive capacities. They are, in general, more capable than their predecessors. Unless there is action to limit governmental growth, however, the very capability of this new generation, which naturally has an interest in its own survival, will convert a virtue into a defect.

Anderson's next comment deserves to be taken seriously: "In the staff's view, this federal role subject makes a very different kind of demand on the Commission than usually is the case because it necessarily involves discussion of our whole political system."

The two problems—perpetuation and reinvigoration of the federal system on the one hand, and making government at all levels less monopolistic and more competitive on the other—are directly connected. As the song says, you can't have one (independent state and local initiatives) without the other (competition at all levels of government).

Unless the expectation of continuing governmental growth is stopped, there is one thing that is inevitable: the intergovernmentalization of everything.

So long as governmental agencies, and their clientele, can solve their problems by addition, they have no incentive to limit their activities. On the contrary, there is every incentive for policy entrepreneurs to come up with new proposals to distribute benefits—good deeds like virtue being unlimited—that do not appear to have costs in the most meaningful sense of government having to give up something else for them. Given zero opportunity costs, state and local governments also want to share in doing good. The political curse is taken off the federal goliath by turning implementation over to states and localities. The struggle that evolves over execution may lead to minor modifications but does not change the fatal fact that a new or expanded program exists and is generating additional support.

Without spending limits, federal government, which was instituted to protect citizens, will end up by overwhelming them. Without limits, the access to government offered by federal structure will dwarf the citizens it is supposed to serve. What will become of government of, by, and for the people when most of us are employed by government? If government of, by, and for its own clients and employees is not exactly what we want, some form of limitation is necessary. What might that form be in a federal system?

The virtue of the central government is uniformity; its laws would be loathsome if they were to treat citizens differently, depending on where they lived. The virtue of state governments is diversity; their laws would be redundant if they repeated themselves regardless of locale. Stamping out carbon copies is something the center should do but states should not. What can we say about the conditions for these two virtues?

The first thing is that each maintaining its own virtue is a condition for attaining the virtue of the other. If states maintain diversity, this gives the center a stronger rationale—its lack is being made up elsewhere—for sticking to uniformity. And so long as some things are done on a uniform basis, there is a stronger rationale for varying others.

Thus, the second point states it is all right for the central government to limit expenditures, which facilitates a uniform rate of spending, but not for the states as a class. It is desirable for some states to impose limits but not for all. Even for those who impose limits, it is preferable that they choose different levels (higher and lower) and different modes (limits as proportions of national product, or personal income, or as balanced budget requirements, etc.). By stressing diversity among states, lessons may be learned that would otherwise not be possible. By maintaining diversity, citizens may sort themselves so they live with the kind of government they want.

Reprise

If there are to be priorities, including a division of functions among levels of government, there must be a reason to do so and a mechanism for doing it. Limitation leading to competition would constitute a reason. But what would be the mechanism? Strong political parties, built on a federal basis (an important qualification) might provide the necessary guidance together with the ability to arrange compromises. But they are not on the horizon. While advance partisan registration, funneling federal funds through parties instead of candidates, and reducing the number of primaries might help, no one believes any of this is likely in the near future, if at all. At the same time there is no universally recognized theory or formula for a division of functions that could command assent. Under these circumstances—agreement on spending limits but not on how to divide the money by level of government—attempting a cognitive or planning approach, under which correct decisions flow from agreed premises, is not on. Instead, I have been recommending an interactive approach designed not only to implement but to discover what works best. The greater the number and variety of organizations for providing goods and services from government, which constitutes a competitive, citizen-centered approach, the better able the system will be to go one way in regard to this and another to that. The people do not have to postulate either the optimal size of producing units or the optimal pattern of spatial structure. Rather these would be seen as the outcome of citizens, states, and localities getting the best deal they can, correcting errors as they go along, provided there is an effective financial constraint.

Because one cannot predict policy outcomes (for if we could, we could also achieve the optimum by planning) or posit the most appropriate governmental structures, the uncertainty may prove unattractive. Some of us have been proceeding on the assumption that nothing good occurs unless some bureaucracy is in charge of making it happen. Well, we have been down this road and it is a dead-end.

An open-ended competitive approach may make former monopolists more nervous but it should also leave consumers of services more confident. If it is a question of who should bear the costs of change, citizens as sovereigns should pass them on to those who are supposed to serve them. The alternative to hearing the federal skeleton rattling in the governmental closet is to provide the federal structure with cartilage in the form of competition.

Would an approach focused on expanding choice of services be antifederal? Since this consumer-oriented approach does not rest directly on strengthening state governments, the question is bound to arise. To appreciate its relevance one only has to ask whether federalism is about structure alone and whether structure itself is about maintaining strong state governments? As posed, the question comes close to the position that federalism is allied to large government, the only consideration being that states grow apace with the national government. Thus, we are led again to consider what we conceive to be the essence of federalism, American style.

There can, of course, be no definite answer to a question that asks as much what we would like American government to be as what it may once have been. My answer, it should now be evident, is that the genius of American federalism is competition, not monopoly. American history, origins and development, I think, is misconstrued if it is conceived to be about monolithic structures—national and state—clashing by day, cooperating by night. Its key terms are separation and division. There never was a question about whether there would be states, only whether there would be a national government. The cost of this national cohesion was containment through separation of powers within government and division of authority between different levels of government. Again, the key term is competition within and among the levels of government. Thus, if one is so disposed, and I am, a competitive approach may be viewed as an effort to recover the operative principles of American federalism under altered circumstances.

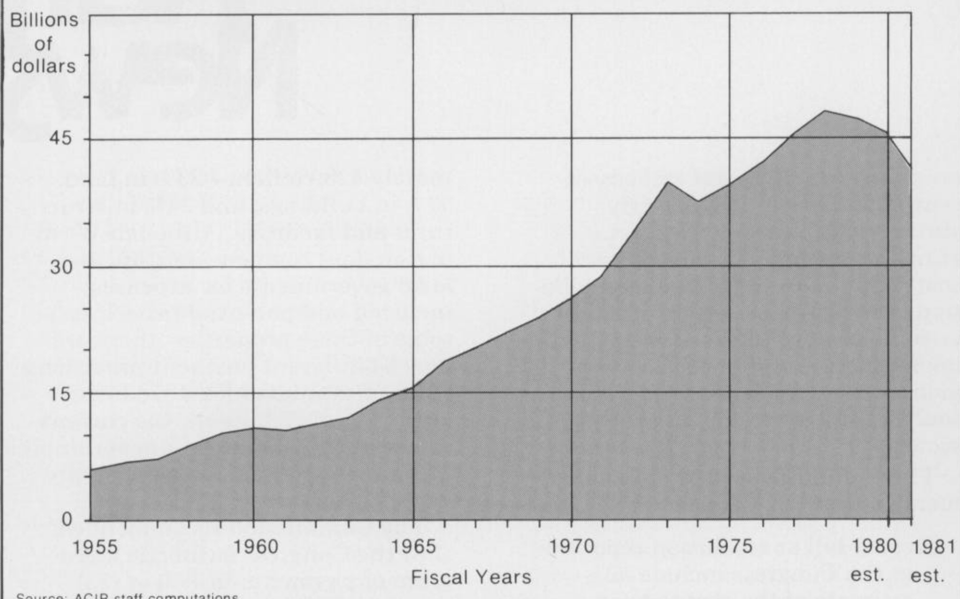
If we do create competition for citizen favor, it may confidently be predicted that as government gets better, federalism, whatever it is, will be said to have a fine future. If we don't, our government, i.e., federalism, will be said to have failed.

Aaron Wildavsky is professor of political science at the University of California, Berkeley.

This article is excerpted from a paper commissioned by ACIR entitled "Bare Bones: The Federal Skeleton in the Closet of American Government." This paper, along with other papers and materials from ACIR's Future Forces of Federalism Conference will be published late in 1980.

A Fiscal Note

Federal Aid in Constant (1972) Dollars, 1955-81



Source: ACIR staff computations.

Federal Grants-In-Aid In Relation To State-Local Receipts From Own Sources, Total Federal Outlays, and Gross National Product, 1955-81 Est.

	Federal Grants-in-Aid				
	In Billions of Current Dollars		As a Percentage of—		
Fiscal Year[1]	Amount	Percent Increase	State-Local Receipts From Own Source[2]	Total Federal Outlays	Gross National Product
1955	$ 3.2	4.9%	11.8%	4.7%	0.8%
1956	3.7	15.6	12.3	5.3	0.9
1957	4.0	8.1	12.1	5.3	0.9
1958	4.9	22.5	14.0	6.0	1.1
1959	6.5	32.7	17.2	7.0	1.4
1960	7.0	7.7	16.8	7.6	1.4
1961	7.1	1.4	15.8	7.3	1.4
1962	7.9	11.3	16.2	7.4	1.4
1963	8.6	8.9	16.5	7.8	1.5
1964	10.1	17.4	17.9	8.6	1.6
1965	10.9	7.9	17.7	9.2	1.7
1966	13.0	19.3	19.3	9.6	1.8
1967	15.2	16.9	20.6	9.6	2.0
1968	18.6	22.4	22.4	10.4	2.2
1969	20.3	9.1	21.6	11.0	2.2
1970	24.0	18.2	22.9	12.2	2.5
1971	28.1	17.1	24.1	13.3	2.8
1972	34.4	22.4	26.1	14.8	3.1
1973	41.8	21.5	28.5	16.9	3.4
1974	43.4	3.8	27.3	16.1	3.2
1975	49.8	14.7	29.1	15.3	3.4
1976	59.1	18.7	31.1	16.1	3.6
1977	68.4	15.7	31.0	17.0	3.7
1978	77.9	13.9	31.7	17.3	3.8
1979	82.9	6.4	30.9	16.8	3.6
1980 Est.	89.8	8.3	30.5	15.8	3.5
1981 Est.	91.1	1.4	28.3	14.9	3.2

[1] For 1955-76, years ending June 30; 1977-81 years ending September 30.

[2] As defined in the national income accounts.

Source: ACIR staff computations based on U.S. Office of Management and Budget, *Budget of the United States Government*, annual, Washington, DC, U.S. Government Printing Office; *Fiscal Year 1981 Budget Revisions*, Washington, DC, U.S. Government Printing Office; and unpublished data; Bureau of Economic Analysis, *The National Income and Product Accounts of the United States, 1929-74*, Washington, DC, U.S. Department of Commerce; *Survey of Current Business*, Washington, DC, U.S. Department of Commerce, various issues; and ACIR staff estimates.

Erosion of Federal Aid To States, Localities

For the first time in the 16 years of our record keeping, as of fiscal year 1981, the real purchasing power of federal aid to states and localities will have fallen for three successive years.

The revised Administration budget for fiscal year 1981 includes $91.1 billion for states and localities. Although this amount is higher than the $89.8 billion for 1980 and $82.9 billion for 1979, inflation is causing a bigger drop in purchasing power. When adjusted for inflation, the figures show an 8.3% decline from 1980 to 1981. Similar declines in inflation-adjusted federal aid dollars were 2.9% in 1980 and 2.7% in 1979. These cuts contrast sharply to the increases in the earlier 1970s and 1960s. Constant dollar aid rose at an average annual rate of 8.6% in the 1960s and at an average rate of 8% per year from 1969 to 1978.

Aid trends can also be looked at in reference to the size of state-local budgets financed from own sources to the federal budget as a whole, or to the size of the economy measured by Gross National Product. Aid as a percentage of each of these measures also began to fall in 1979, the same year from which the inflation-adjusted dollar level of aid began to fall.

The fiscal 1981 aid declines hit all major aid categories except one. Only for income security grants will the dollar level rise faster than the general rate of inflation. In two categories, dollar levels actually fall. On an inflation-adjusted basis, the brunt of aid declines is borne by the revenue sharing dollar. Just in terms of current dollars, General Revenue Sharing falls 16%. Transportation, declined as well, but by only 1%. Grants for health, education, training, social services, community development, and natural resources fail to keep up with inflation but do not fall in dollar level.

Al Davis
Frank Tippett

ACIR News

ACIR Adopts Recommendations on Payments-in-Lieu, Federal Role

In its meeting June 19-20, ACIR made recommendations relating to two tough intergovernmental questions: what can be done to relieve the current "overload" in our intergovernmental system and should Washington reimburse state and localities for federally owned real property?

In adopting a series of recommendations relating to the first, and broader, question, the Commission completed action on its two-year study of the "Federal Role in the Federal System," which found that "contemporary intergovernmental relations have become more pervasive, more intrusive, more unmanageable, more ineffective, more costly, and above all, more unaccountable."

As first steps toward "sorting out" federal, state, and local assignments of functions, the Commission acted to:

- ☐ reaffirm its recommendation that the federal government assume full financial responsibility for the provision of Aid to Families with Dependent Children, Medicaid, and general assistance;
- ☐ recommend that the federal government move toward the assumption of full financial responsibility for those existing governmental programs which are aimed at meeting the basic human needs for employment security, housing assistance, medical benefits, and basic nutrition; and
- ☐ call for a substantial reduction in the number of remaining federal assistance programs through termination, phase out, and consolidation.

The primary candidates for termination and phase out would be the 420 small federal categorical grant programs which account for only 10% of all grant funds; programs in functional fields in which federal aid amounts to approximately 10% or less of the combined state and local outlays including federal aid; programs which do not embody essential and statutorily, clearly stated, national objectives; programs with high administrative costs relative to the federal contribution; and programs which obtain—or could obtain—most of their funding from state and/or local governments or fees for services or which could be shifted to the private sector.

The Commission further recommended that:

- ☐ every bill or resolution reported in the Congress include an estimate of the cost to be incurred by state and local government in carrying out or complying with such a bill or resolution;
- ☐ the President be given statutory authority to suspend temporarily implementation of enacted crosscutting national policy requirements when it becomes clear that serious and unanticipated costs of disruption will otherwise occur; and
- ☐ legislation be enacted calling for each federal department or agency to prepare and make public a detailed analysis of projected economic and noneconomic effects likely to result from any major new role it may propose.

Also adopted were recommendations calling for strengthened political parties, autonomy of state and local governments in national policymaking, and a national convocation to address the current malfunctioning of American federalism and to agree upon an agenda for intergovernmental reform.

The Commission also completed action on a study of federal payments-in-lieu of taxes to states and localities for federally owned real property such as office buildings, post offices and military bases. The Commission examined the related "open space" issue—federal tax exempt land holdings in the West—in a 1978 study.

ACIR estimates that in 1978 the total value of U.S. real property covered by this study was approximately $280 billion—23% in land, 53% in buildings, and 24% in structures and facilities. Although Washington does compensate state and local governments for expenses incurred and potential taxes lost for some of these properties (there are now 64 different payment provisions with an estimated FY 1978 budget authority of $2 billion), the current programs constitute an uncoordinated, incomplete and inequitable patchwork system.

The Commission recommended that the Congress authorize a program of payments-in-lieu of real property taxes to state and local governments in an amount equal to that which would be paid if the federal government were actually subject to the real property tax.

The recommendation was based on the finding of the Commission that "the current federal immunity from the real property tax not only leads to a significant erosion of the total state and local own-source revenue base but that it also leads to gross violations of the equity principle in public finance that taxpayers in equal circumstances be treated equally."

The Commission further recommended that:

- ☐ adoption of a reimbursement policy should be viewed as replacing rather than supplementing the bulk of the existing patchwork of in-lieu of real property tax payments and should be considered separate from all other federal programs which provide general and categorical assistance;
- ☐ the federal inventory of real property located within the United States should be perfected and updated biennially; and
- ☐ each state should examine its own real property tax immunity and consider authorizing programs designed to fully compensate local governments for revenues lost due to the exemption of state-owned real property.

Prior to making these recommendations, the Commission heard testimony from six experts: Douglas H. Clark, Assistant Director, Federal-Provincial Relations Division, Department of Finance, Canada; Charles Stephenson, former Chief, Government Research Staff, Tennessee Valley Authority; Robert Rafuse, Deputy Assistant Secretary for State-Local Finances, Department of the Treasury; Kenneth Hunter, Senior Associate Director, Program Analysis Division, General Accounting Office; Richard J. Davis, Mayor, Portsmouth, VA, and Jerry Emrich, County Attorney, Arlington County, VA.

ACIR To Hold Conference On Future Of Federalism

The Advisory Commission on Intergovernmental Relations will hold a Conference on the Future of Federalism in Alexandria, VA, July 25-26.

The conference is in response to a Congressional mandate to study and evaluate the "forces likely to affect the nature of the American federal system in the short-term and long-term and possible adjustments to such systems . . . in light of future developments."

The day and a half discussion will be limited to about 30 participants, primarily present and former government officials; representatives from public interest groups; and leading scholars on political, fiscal, and judicial federalism. The purpose of the conference is to identify leading views of how American federalism is likely to change in the 1980s, the general forces likely to bring about these changes, and the adjustments that our system needs to make to perform well in the future.

ACIR has prepared a paper for the conference which reviews the dramatic changes of the past 20 years and examines the analytical problems inherent in forecasting the developments likely to occur in the next decade.

Three other papers have been commissioned. The future of fiscal federalism will be addressed by George Break, economics professor at the University of California at Berkeley. Lewis Kaden, professor at the Columbia Law School, will discuss judicial federalism, and Aaron Wildavsky, political science professor at the University of California at Berkeley, will examine the future of political federalism.

The conference comes at this particularly crucial time, when the United States is fraught with economic and political turbulence and serious dislocations in energy supplies and other resources. Moreover, the end of the 1980s will mark the bicentennial of the U.S. Constitution. Thus, it is now especially appropriate to examine the fundamental relationship between the national government, state and local governments, and the American people.

GRS, Cigarette Bootlegging Subjects of ACIR Testimony

ACIR Chairman Abraham Beame and Assistant Director John Shannon testified before Senate and House Committees recently on General Revenue Sharing and cigarette bootlegging.

In Chairman Beame's testimony before the House Subcommittee on Intergovernmental Relations March 26, he urged the panel to renew federal revenue sharing and to specifically continue state participation in the program.

"The General Revenue Sharing program is the most attuned to the federal system, most economical of administrative costs among federal aid programs, well targeted on poor jurisdictions and particularly central cities, and most useful as a way of avoiding entangling functional and procedural requirements," he said.

Only General Revenue Sharing, among 498 different federal aid outlets, provides state and local policymakers with full discretion to decide how to use federal funds. "If Congress cuts General Revenue Sharing funds, it knows not what it will be cutting," he said. "In contrast, if Congress decides that the federal aid system must be a source of specific budget cuts, it can make more precise decisions reflecting current priorities."

In addition, Beame said, to withdraw revenue sharing from states "would probably result in reducing aid to local governments—those jurisdictions least able to bear the burden." He warned that Congress should not take an action that would be interpreted as penalizing states just when they are assuming a far more important role in aiding localities and in contributing to the "big ticket" expenditure items like schools and public welfare. The advent of federal General Revenue Sharing aided in strengthening the state role and to withdraw support now would be "precisely the wrong policy," he said.

ACIR Assistant Director John Shannon, testifying on April 17, before the Senate Committee on Appropriations on state revenue losses from cigarette bootlegging, described the methodology the Commission employed in its 1975 study of cigarette bootlegging and updated what has happened in the area over the past five years.

"Cigarette tax evasion has subsided considerably since 1975," said Shannon, who quoted Bureau of Alcohol, Tobacco and Firearms estimates that by FY 1979 cigarette smuggling revenue losses for the U.S. declined by over $57 million. Inflation is one likely cause of the decline, he said, since it affects the profit potential from bootlegging. Most high tax states have exercised restraint by not raising cigarette taxes above the levels of the mid-1970s at the same time that the price of gasoline, an important cost in smuggling, has risen dramatically.

Passage of federal legislation outlawing cigarette bootlegging in 1976 also seems to have played a key role according to Shannon, causing many of the border cigarette stores in North Carolina to close and increasing the awareness of the public of the illegality and harmfulness of cigarette smuggling.

Shannon cautioned that the trend might be reversed, however, if high tax states act to raise taxes again.

"If cigarette smuggling is ever to be controlled, high tax states must resist cigarette tax increases," he said. "It would also help if low tax states would consider indexing their cigarette taxes to inflation until their tax rates approach the national average."

ACIR Assistant Director Receives ASPA Award

David B. Walker, ACIR Assistant Director for Governmental Structures and Functions, was recently named the first recipient of a major award recognizing significant contributions to the field of intergovernmental management in the academic/research area.

The award, the Donald C. Stone award presented by the Section on Intergovernmental Administration and Management of the American Society for Public Administration, was presented to Walker "for his consistent and persistent efforts to improve intergovernmental management both nationally and internationally as a researcher, lecturer, and writer."

It was the first year that the Section on Intergovernmental Administration has recognized persons who have made significant contributions to the field of intergovernmental management.

Ray Remy, Deputy Mayor of the City of Los Angeles, received a Stone award for his work in the practitioner/policy implementation area.

ACIR Sponsors Workshop on Grant Consolidation

On May 22, ACIR sponsored a workshop for some 40 federal administrative and Congressional staff interested in grant consolidation.

Panel members at the one-day conference included: John Callahan, Del Goldberg and John Faso, Senate and House Subcommittees on Intergovernmental Relations; Jim Kelly, Tom Hadd, and Don Dworsky, Office of Management and Budget; Charles Culkin and Bill Thurman, General Accounting Office; Theodore Roumel, U.S. Public Health Service; John Gwynn, Environmental Protection Agency; John McKay, Federal Emergency Management Agency; and Ted Hodkowski from the White House Office on Intergovernmental Relations.

Discussed at the session were pros and cons of various types of consolidation, likely targets of opportunity, enacted consolidations, and the future of legislation calling for consolidation in specific functional areas and S. 878, "The Federal Assistance Reform Act of 1980," which sets forth a procedure for facilitating grant consolidation. S. 878 would empower the President to submit plans to Congress for the consolidation of federal assistance programs in the same functional areas. Once a valid consolidation proposal was submitted, Congress would express either its support for or opposition to the plan within a specified period of time.

ACIR supports grant consolidation as one way to maintain the current level of federal services while cutting administrative costs.

Study of State-Local Revenue Sharing Available

Although federal revenue sharing has garnered considerable attention in recent months, a second revenue sharing effort—the states sharing revenues with localities—has frequently gone unnoticed. Yet the dollars—and principles—at issue are equally significant.

In fact in certain states, state revenue sharing is much more important than the federal counterpart. For example, in 1980, Minnesota localities will receive $91 million in federal revenue sharing, but over $240 million in state-local shared revenues. Similarly, Wisconsin localities will receive $107 million in federal revenue sharing in 1980, compared to $474 million in state revenue sharing. Michigan communities will receive $196 million in federal revenue sharing and $425 in similar state dollars.

A soon-to-be released ACIR study examined the state of state-local revenue sharing, including case studies of three states—Wisconsin, Minnesota, and Michigan—which place a great reliance on sharing revenues with localities as an important means for redressing inequalities among financial abilities.

In 1978, 49 states shared over $6.8 billion in unrestricted state aid with localities, an amount representing over 10% of total state aid and making up the third largest type of state aid (behind education and public welfare). Between 1958 and 1978, state-local revenue sharing increased nine fold, from $687 million to the current $6.8 billion.

The primary rationales for state revenue sharing are: it is a way of compensating localities for property exempted from local taxation or removed from tax rolls; it is a way to harness the superior revenue raising ability of state tax systems to local needs for a more diversified, administrable, and economy responsive revenue source; it aids property tax relief; and it can recognize the differing needs among local governments for revenues and their varying abilities to raise it.

The design of state-local revenue sharing programs varies considerably from state to state. The various methods—including the use of differing formulas—are discussed in the ACIR study.

Single pre-publication copies of "The State of State-Local Revenue Sharing" may be obtained without charge. Requests should be addressed to ACIR, Taxation and Finance Section, 1111 20th Street, NW, Washington, DC 20575.

And Briefly: Books

The following publications are recent reports of the Advisory Commission on Intergovernmental Relations, Washington, DC 20575.

Citizen Participation in the American Federal System. (A-73)

As part of the renewal of General Revenue Sharing in 1976, Congress requested ACIR to study "the legal and operational aspects of citizen participation in federal, state, and local government fiscal decision-making." This report, the result of that study, discusses the use of citizen participation requirements in federal grants, the impact of those requirements on state and local governments and methods used by state and local governments to encourage citizen participation. The renewal of General Revenue Sharing in 1976 greatly increased the number of state and local governments expected to meet federal requirements for citizen participation. These requirements help people exercise their constitutional right of access to government and help state and local governments determine the needs of diverse groups.

The Commission found that citizen participation is an essential aspect of American government and recommended that all levels of government provide resources, leadership, and commitment for an effective program for citizen participation in the decisionmaking process. The federal government has the responsibility to ensure that citizens are given opportunities to be heard prior to administrative decisions.

This report discusses the historical background of citizen participation from its theoretical basis in the writings of Thomas Jefferson. It also analyzes the findings of a survey of local officials taken by the Commission and ICMA as well as several case studies. Information is provided in the tables with text and appendices following individual chapters.

Pre-Publication Copy of ACIR's **State and Local Pension Systems —Federal Regulatory Issues.**

In December 1979, the Commission considered the staff study and made recommendations relating to the intergovernmental aspects of state and local pension systems.

This pre-publication copy of the pension study is available on a limited basis from ACIR's Taxation and Finance Section, 1111 20th Street, NW, Washington, DC 20575.

The following publications are available directly from the publishers cited. They are not available from ACIR.

Local Finance in Great Britain, West Germany, and the United States: A Comparative Analysis, by John Shannon, Academy for Contemporary Problems, 1501 Neil Avenue, Columbus, OH 43201.

Urban Economic Development in Great Britain and West Germany: Lessons for the United States, Gail Garfield Schwartz, Academy for Contemporary Problems, 1501 Neil Avenue, Columbus, OH 43201.

Making Cities Livable: Lessons for the United States from Europe, by Johnathan Barnett, Joseph Riley, John P. Robin, and Ralph R. Widner, Academy for Contemporary Problems, 1501 Neil Avenue, Columbus, OH 43201.

Municipal Insurance Pools: An Appropriate Alternative for Local Governments?, New York Assembly Ways and Means Committee, State Capitol, Albany, NY 12224.

State Comprehensive Emergency Management: Final Report of the Emergency Preparedness Project, National Governors' Association, Center for Policy Research, 444 North Capitol Street, Washington, DC 20001.

Public Employee Compensation: A Twelve City Comparison, Urban Institute, 2100 M Street, NW, Washington, DC 20037. $10.

State Tax Policy 1979, National Governors' Association, Center for Policy Research, 444 North Capitol Street, Washington, DC 20001. $3.

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