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Intergovernmental

PERSPECTIVE



**A THRESHOLD
YEAR FOR
FEDERALISM**

View From The Commission



Dear Reader:

Clearly 1981 was a big year for restructuring our federal system and for those of us interested and actively involved in that effort:

- It was a year when the President made "New Federalism" a high priority item on his domestic agenda—citing the need to restore responsibilities and revenues to states and localities.
- It was a year when the states' chief executives and legislators strongly urged a sorting out of the mix-master we know as our federal system so that responsibilities such as income

maintenance would be assumed by the federal government and responsibility for programs such as elementary and secondary education, highways, and law enforcement by state and local governments.

- It was a year when local officials began to rediscover their state capitols and to work with state leaders to solve the problems and to meet the challenges posed by additional responsibilities and fewer federal aid dollars.

These changes and more are described in this issue of **Intergovernmental Perspective**, which features the Commission's annual assessment of federalism in the preceding year. The material covered this year is particularly important since so many changes are apparently underway, changes many of us hope constitute a transition from a federally dominated federalism to a more balanced intergovernmental system.

The first article, by David Walker, Albert Richter, and Cynthia Colella, deals with changes in federal grant system, efforts at deregulation, and other intergovernmental developments emanating from Washington during 1981. The article highlights what has been cited

as the beginning rather than the ending of change.

Fiscal conditions of 1981 clearly were important factors in the year's developments. The second piece, by Susannah Calkins and John Shannon, describes what happened in the intergovernmental fiscal world in 1981, and how these happenings fit in with longer term trends and developments.

The impact of these fiscal and programmatic actions of 1981 on states and localities, the subject of the third article by Jean Lawson and Carl Stenberg, has been highly significant. Of particular interest in this article is the effect on state legislative-executive and state-local relationships.

1981 was significant to ACIR since it saw completion of its seminal work analyzing and making recommendations relating to federal, state, and local roles and responsibilities.

All in all, the year has been a monumental one for intergovernmental relations, and for the Commission. I am pleased to be a part of what is happening in both.

Lamar Alexander
Governor of Tennessee

Intergovernmental PERSPECTIVE

2 View from the Commission

Tennessee Governor Lamar Alexander, Vice Chair of the Commission, highlights some of the key intergovernmental happenings during 1981 and introduces the Commission staff's annual assessment of federalism.

4 1981: A Threshold Year for Federalism

While clearly 1982 will be an important year for intergovernmental relationships, these events should not completely overshadow the developments of 1981. ACIR has called it a threshold year for federalism, for it may well be considered the beginning rather than the end of dramatic change.

5 The First Ten Months: Grant-in-Aid, Regulatory and Other Changes

Significant changes in the federal grant system, along with initiatives in the regulatory area, relevant court decisions, and other intergovernmental events emanating from Washington are discussed in this article by ACIR Assistant Director David Walker and staffers Al Richter and Cynthia Colella.

23 The New Formula for Fiscal Federalism: Austerity Equals Decentralization

Fiscal federalism, always a significant intergovernmental concern, became a top domestic agenda item in 1981, as the federal government joined states and localities in slowing down the growth of spending. This and other events and trends developing in the year are described here by ACIR Assistant Director John Shannon and Susannah Calkins.

30 "Rebalanced Federalism" The States' Role and Response

In 1981 the spotlight turned to the states as they prepared to assume additional responsibilities at the same time they were dealing with cuts in federal aid and many were facing immediate or future budgetary difficulties. State legislative-executive and state-local relationships in particular seemed to be in a period of flux in 1981. Assistant Director Carl Stenberg and Jean Lawson analyze these and other trends in this article.

42 And Briefly: Books

During 1981, ACIR published 18 reports, two "In Briefs," and three Information Bulletins. They are briefly summarized here.

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1981: A Threshold Year for Federalism

On January 26, 1982, President Ronald Reagan in his first State of the Union address launched an effort to "make government again accountable to the people, to make our system of federalism work again."

The President's "single, bold stroke" to reduce the role of federal government in domestic affairs contained two major elements. The first is a tradeoff: Washington would take over the state portion of Medicaid and in return food stamps and the country's major welfare program, Aid to Families with Dependent Children (AFDC), would become the states' responsibility. The second portion would gradually hand over to states and localities some 124 categorical grant programs in areas including urban mass transit, waste water treatment, low income energy assistance, vocational rehabilitation, black lung disease, migrant health clinics, and legal aid.

A number of key assumptions seem to underlie the President's New Federalism agenda. These include: (1) "grass roots" governments are best equipped to diagnose and deal with problems; (2) states are willing and able to assume greater responsibility for the administration and financing of social programs; (3) state and local officials will cooperate and collaborate more closely than in the past and will be able to "get their acts together" in the near future; (4) the federal government has grown too large, influential, and costly and its operations need to be overhauled and streamlined; and (5) the appropriate roles of different levels of government can be identified and functions can be reassigned in a reasonably systematic manner.

Questions relating to crucial issues such as minimum welfare standards, equity among states and among recipients, state management and fiscal capacities, and state-local relationships are yet unanswered. They are the subject of extensive consultation and debate among state and local officials, interest groups and others.

Although the latest proposal has been criticized as a "diversionary tactic" and a "smokescreen" to draw attention away from serious economic difficulties, it has been generally acknowledged as a dramatic and innovative approach eschewing the traditional efforts to "tinker" with longstanding systemic problems and proposing major changes in our intergovernmental relationships and responsibilities.

In his speech to the nation, President Reagan cited ACIR's recent work which found that the federal

government has become "more pervasive, more intrusive, more unmanageable, more ineffective, more costly and above all more unaccountable." As a result of that study, ACIR called for a major sorting out of the federal system, with Washington assuming responsibility for welfare and other income redistribution programs at the same time reducing substantially the number of federal assistance programs through termination, consolidation, or devolution to state and local governments and the private sector.

The proposals outlined in January are clearly the most dramatic elements of the President's New Federalism vision. And although they dominated the headlines and talk show debates throughout the early weeks of the new year, they should not completely overshadow what has already happened on the intergovernmental front during the first year of the Reagan Administration. For example, in 1981, federal aid to states and local government declined in "absolute" dollars for the first time in two decades.* In 1981, nine new block grants were enacted, consolidating 77 categorical grants and 60 grants were quietly eliminated in one of the most sweeping changes in the structure of the grant system since the enactment of General Revenue Sharing in 1972. And in 1981, the strength of working partnerships between states and local government and governors and state legislators was put to the test as states began to take on additional responsibilities, once the domain of federal policymakers, generally without additional monies to help pay for them.

These and related developments are analyzed in this issue of *Intergovernmental Perspective*, ACIR's annual assessment of intergovernmental activity during the preceding year. As is customary, this assessment reflects the view of the ACIR staff, not the Commission. ACIR policy and recommendations are of course noted throughout the articles; however, the product is that of staff and should not be construed as a formal Commission position.

Although 1981 was probably one of the most significant years for intergovernmental relations in recent times, it may well be considered the beginning rather than the end of dramatic change. One way to put 1981 in perspective is to consider it as a threshold year for what may be more profound change yet to come—a first step toward what President Reagan hopes will be a major realignment and revitalization of our intergovernmental system.

Carol S. Weissert
Editor

*This decline is in federal aid to states and local governments, and does not include grants for payments to individuals.

Changes in the Grant System

One of the most dramatic and perhaps far reaching consequences of Reagan Federalism is the reduction in the size of the federal grant-in-aid system for the first time in the history of federal intergovernmental aids. The nature of that system may well be changing also, with greater responsibility for priority setting among categorical programs and for general administration shifted to state and local governments. The shift is particularly toward state government from Washington bureau heads via the consolidation of narrow categorical grants into broad, functional block grants.

The Fiscal Dimension

Table 1 highlights what has happened fiscally, based on OMB's October 1981 figures. In the last years of the Carter Administration, despite Congress' dropping the states from the General Revenue Sharing program (representing about \$2 billion), total grants-in-aid continued their year-to-year increase (although in constant dollars they had reached their zenith in FY 1978). Thus, grant outlays rose from \$91.5 billion in FY 1980 to a peak of \$95.9 billion in FY 1981. In FY 1982—when the initial impact of Reagan Administration policies will be felt—total grant outlays are estimated to drop to \$86.8 billion, a decline of 9.5%. Projected outlays for the following two years indicate some stabilization—\$87.7 billion for FY 1983 and \$88.7 billion for FY 1984. However, these projections are based on the continuation of programs already in existence, and Administration officials have indicated their intention to propose further policy changes along the lines of those that produced the reductions between 1981 and 1982. If those intentions are realized, total grants will be further reduced in FYs 1983 and 1984. Even should those reductions not occur, the current projections of little or no increase in total grant dollars will translate into a real reduction, considering the impact of inflation.

The 1982 reductions came about primarily through consolidations of 77 categoricals and two earlier block grants into nine blocks with a funding level substantially below that of the separate categoricals. Part of the rationale of switching to blocks was that by giving recipients greater flexibility and by loosening the red tape of categorical grant administration, substantial savings would be realized. The Administration cited 25% as an achievable reduction. According to OMB, this is very close to what actually happened: FY 1981 estimated obligations for the 77 superseded categorical programs totaled \$8.2 billion, while the Administration's September 1981 appropriations request for the nine blocks for FY 1982 totaled about \$6.1 billion, a decline of 25.3%.

The Administration did not rely solely on the grant consolidation process to reduce the size of the grant system, however. It moved to terminate or withhold funding for grant programs other than those included in the blocking, mainly through the Omnibus Budget Reconciliation Act of 1981. In October 1981, OMB reported that some 62 categorical programs funded in FY 1981 would not be funded in FY 1982 and therefore would be deleted from OMB's Catalog of Federal Domestic Assistance. The 62 included the various grant programs administered by the Title V multistate regional commissions, two discretionary programs of the Secretary of HUD, the inter-governmental personnel grant program, and four programs of the Environmental Protection Agency.

Table 1 also indicates the fiscal dimension of the Reagan Administration's emphasis on block grants. In FY

The First Ten Months: Grant-in-Aid, Regulatory, and Other Changes

by David B. Walker, Albert J. Richter,
and Cynthia Cates Colella

In his inaugural address, President Reagan declared his intention "to curb the size and influence of the federal establishment and to demand recognition of the distinction between the powers granted to the federal government and those reserved to the states or to the people."¹ Thus far, in pursuing these goals in the intergovernmental sphere, the Administration has focused on cutting down the size and influence of federal grants-in-aid to states and localities and on federal regulatory activities affecting those governments. This article examines how the Reagan Administration and the 97th Congress have fared in their first ten months in accomplishing these twin objectives and in making management and other institutional changes affecting states and localities. It also highlights the past year's trends in court decisions on issues relative to federalism.

¹Weekly Compilation of Presidential Documents, January 26, 1981.

Table 1

**Outlays for General Purpose, Broad-based, and Other Grants,
FYS 1980, and 1981-1984 (Est.)**

(dollar amounts in millions)

	Actual 1980	Est. 1981	Est. 1982	Est. 1983	Est. 1984
General Purpose					
General Revenue Sharing	\$ 6,829	\$ 5,156	\$ 4,010	\$ 4,033	\$ 4,027
Other	1,764	1,762	1,912	2,311	2,436
Subtotal	(8,593)	(6,918)	(5,922)	(6,344)	(6,463)
Broad-based					
Block Grants	9,385	9,647	10,186	10,855	11,162
Other	1,038	941	381	328	295
Subtotal	(10,423)	(10,588)	(10,567)	(11,183)	(11,457)
Other (categoricals)	72,448	78,383	70,285	70,183	70,818
TOTAL	\$91,464	\$95,889	\$86,774	\$87,710	\$88,738
Percentages					
General Purpose					
General Revenue Sharing	7.5%	5.4%	4.6%	4.6%	4.5%
Other	1.9	1.8	2.2	2.6	2.8
Subtotal	(9.4)	(7.2)	(6.8)	(7.2)	(7.3)
Broad-based					
Block Grants	10.3	10.1	11.7	12.4	12.6
Other	1.1	1.0	0.4	0.4	0.3
Subtotal	(11.4)	(11.1)	(12.1)	(12.8)	(12.9)
Other (categoricals)	79.2	81.7	81.1	80.0	79.8
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Office of Management and Budget, "Grants-in-Aid to States and Localities: October (1981) Update," October 15, 1981.

1980, block grants made up 10.3% of total grant outlays and in FY 1981, they were 10.1% but in FY 1982, they will rise to 11.7%. While the legislation creating the new blocks was effective at the beginning of FY 1982, two of the blocks do not go into effect until FY 1983, and for four others the states have the option to defer assumption of the programs until FY 1983. The expected gradual transition is reflected in terms of outlays rather than obligations or budget authority. Hence, the following year—FY 1983—probably is a fairer representation of the eventual effect of the new block grant enactments. Block grants are estimated to constitute 12.4% of total grant outlays in FY 1983 and 12.6% in FY 1984. Additional consolidation through future legislation of course would raise these percentages.

Functional Effects

Table 2 shows how the changes in the fiscal dimensions of the grant system wrought by Reagan Federalism have affected different functional areas. Here, the illuminating comparison is between the Carter projected FY 1982 budget and OMB's estimate of the enacted Reagan program for that year. The greatest reduction has come in Education, Training, Employment, and Social Services—a \$7.1 billion drop between the Carter and Reagan budgets. Major decreases here were in employment and training assistance and rehabilitation services and handicapped research. The second general area of marked decline was Income Security

(\$2.4 billion), with principal reductions in the child nutrition program, public assistance, and low income energy assistance. The \$500 million of unallocated "contingencies for entitlement reform" in the 1982 Reagan budget is part of the Administration's 12% cut.

Block Grants: The Shift in Responsibility

In addition to its fiscal impact, the movement to block grants will also have an effect on the basic federal structure—the sharing of power among the national, state, and local governments. Block grants put more discretion into the hands of state and local governments.

The Reagan Proposals

In the spring of 1981 the Administration proposed legislation consolidating some 85 categorical programs into seven block grants. It proposed merging 43 separate elementary and secondary education programs into two block grant programs—one to the states and one to local education agencies (LEAs); combining 39 categorical grants for health and social services into four block grants to states; and absorbing the categorical Urban Development Action Grant (UDAG) program into the existing Community Development Block Grant.

The Administration proposed funding the seven new block grants at a level about 25% below that of the superseded categorical, on the grounds that handing over the

money without many of the restrictions associated with categorical grants would realize savings through improved administrative efficiency. More specifically, the Administration argued, for example, that the health and social services programs proposed for blocking were uncoordinated, were based on varying criteria, and had separate planning processes and other administrative requirements. The new blocks, on the other hand, would enable the states to plan and coordinate their own service programs, establish their own priorities, and exercise program controls over resources provided to localities and nonprofit recipients. Similarly, the social services block would drop the plan approval process and matching and maintenance of effort requirements, would not require a pass-through, would require auditing and reporting only every other year, and would permit transfer of 10% of the blocked funds to other HHS blocks. The Community Development Block Grant, while eliminating only one categorical, would offer savings by replacing detailed applications with a statement of objectives, plus periodic certification by recipients of compliance with primary programs goals and civil rights protections.

Essentially, the absence of strings in these proposals gave them more of the look of special revenue sharing than of

the earlier block grants.²

The Nine That Made It

The major features of the block grants enacted in the **Omnibus Budget Reconciliation Act of 1981** are shown on pages 8-11. Nine block grants were created or revised. Two involve existing block grants: the Health Incentives Grant for Comprehensive Public Health, incorporated in the Preventive Health and Health Services block, and the Title XX Social Services block, expanded into the new Social Services block. In two cases (Primary Care and Low-Income Home Energy Assistance), a single categorical was transformed into a block; at the other extreme, the Education program consolidated 37 categoricals.

Four of the blocks are for health, three for social services and cash payments for the poor, and one each for education and community development. Seven are administered by the Department of Health and Human Services and one each by the Departments of Housing and Urban Development and Education.

²Special revenue sharing typically has no matching or maintenance effort provision, distributes funds automatically without an application, and requires no plan approval.

Table 2

Federal Grants-in-Aid Outlays, in Billions, By Function

FYs 1980 (actual), and 1981 and 1982 (est.)

Function	Actual 1980	Est. 1981		Est. 1982	
		Carter Jan. 1981 estimate	Reagan Oct. 1981 estimate	Carter Jan. 1981 budget	Reagan Oct. 1981 estimate
National Defense	\$ 0.1	\$ 0.1	\$ 0.1	\$ 0.1	\$ 0.1
Energy	0.5	0.6	0.6	0.8	0.6
Natural Resources and Environment	5.4	5.3	5.3	5.3	4.8
Agriculture	0.6	0.8	0.8	0.6	0.6
Commerce and Housing Credit	*	*	*	*	*
Transportation	13.1	12.9	12.7	12.8	12.4
Community and Regional Development	6.5	6.2	6.3	6.4	6.0
Education, Training, Employment, and Social Services	21.9	21.7	21.3	23.5	16.4
Health	15.8	18.6	19.3	20.2	19.8
Income Security	18.5	21.8	22.0	22.9	20.5
Veterans' Benefits and Services	0.1	0.1	0.1	0.1	0.1
Administration of Justice	0.5	0.4	0.4	0.3	0.2
General Government	0.2	0.2	0.2	0.2	0.1
General Purpose Fiscal Assistance	8.5	6.7	6.8	6.7	5.8
Contingencies for Entitlement Reform	—				- 0.5
TOTAL	91.5	95.3	95.9	99.8	86.8

* Less than \$50 million.

Source: Office of Management and Budget, "Grants-in-Aid to States and Localities: October (1981) Update," October 15, 1981.

Major Features of Block Grants Created or Altered by

	Community Development (small cities and rural areas)	Elementary and Secondary Education	Preventive Health and Health Services	Alcohol, Drug Abuse, and Mental Health
1. Number of programs superseded (identified in OMB's <i>Catalog of Federal Domestic Assistance</i>)	1 discretionary grant (Budget Reconciliation Act also expanded existing Community Development Block Grant by folding in 3 categoricals)	37 categoricals	1 existing block (Health Incentive Grant for Comprehensive Public Health Services) and 6 categoricals	10 categoricals
2. Funding level (in millions): superseded (old) programs (est FY 81 obligations) and new program (Reagan FY 82 appropriations request)	Old—\$796 New—\$952	Old—\$735 New—\$519	Old—\$160 New—\$84	Old—\$524 New—\$432
3. Nonfederal matching	10% by state if it elects to channel (see "pass-through" below)	None	None	None
4. Administrative costs—limits on federal funding	50% of costs, not to exceed 2% of federal allotment	Up to 20% of funds can be used for state operated programs and administration	10% of federal allotment	10% of federal allotment
5. Earmarking	No	No	Yes, for FYs 1982-84 specific amounts	Yes; specific amounts
6. Specific prohibitions on fundable activities or eligibles	No	No	States may not use funds for inpatient services, cash payments, purchase or improvement of property, or federal matching	States may not use funds for inpatient services, cash payments, purchase or improvement of property or federal matching
7. Transferability of funds	No	No	Up to 7% may be transferred for specified health purposes	Up to 7% may be transferred for specified health purposes
8. Maintenance of effort or non-supplant provision	No	Expenditures must be at least 90% of level for second prior FY. Federal funds must supplement	Federal funds will be used to supplement and not supplant nonfederal	Federal funds will be used to supplement and not supplant nonfederal
9. Pass-through provisions	State qualifies as distributor of block grant only if governor certifies that state will meet four specified conditions. Otherwise, HUD makes distribution	State must pass through at least 80% to local education agencies on basis of enrollment adjusted for number of higher cost children	No	"Earmarking" includes mandated funding in FYs 82, 83, 84 of community health centers federally funded in FY 80
10. General procedural requirements—Title XVII of Act: (1) Publication of proposed use report, (2) public hearing, (3) biennial financial and compliance audits	Not applicable	Not applicable	Yes	Yes
11. Other required state administrative procedures: a. Application for grant	No	Yes, but for as long as 3 years and Secretary approves criteria used to distribute funds locally	Yes, annually	Yes, annually

Omnibus Budget Reconciliation Act of 1981 (PL 97-35)

Maternal and Child Health Services	Primary Care	Social Services	Community Services	Low-Income Home Energy Assistance
9 categoricals	2 categoricals	1 existing block (Social Services for Low Income and Public Assistance Recipients) and 1 categorical	7 categoricals	1 categorical
Old—\$411 New—\$291	Old—\$321 New—\$215 (FY 83)	Old—\$3,008 New—\$1,974	Old—\$484 New—\$225	Old—\$1,714 New—\$1,400
\$3 state for each \$4 federal	FY 83—20%. FY 84—33 1/3%	None	None	None
None	State use of block grant for administrative costs prohibited	None	5% of federal allotment	Up to 10%
Yes, but no specific amounts	Yes, health centers funded in FY 82 must get same amount in FY 83.	Yes, specific minimums	Yes, at least 90% must go to localities, nonprofits, seasonal farm worker groups	No
Similar to Preventive Health and Health Services block grant	Only 5% of funds may go to certain community health centers	Similar to Preventive Health and Health Services block grant	May not be used to purchase or improve land or buildings, except for certain energy-related home repairs	Similar to Community Services, with 15% limit on repair
No	No	May transfer up to 10% for specified health and income security purposes	May transfer up to 5% for specified social service & income security purposes	May transfer up to 10% for specified social and health services
No	No	No	No	No
No	See "Earmarking." Also, any state not submitting application for FY 83, 84 or not qualifying for its allotment has its allotment distributed directly by HHS	No	See "Earmarking"	No
(Applicability under review 11/81)	Yes	Not applicable	Yes	Not applicable
Yes	Yes, annually, and federal approval required	No	Yes, annually	Yes, annually

Major Features of Block Grants Created or Altered by

	Community Development (small cities and rural areas)	Elementary and Secondary Education	Preventive Health and Health Services	Alcohol, Drug Abuse, and Mental Health
b. Assurances required in application or other statement, regarding:	Adequate information to citizens on funds available, proposed activities —Public hearings —Citizen participation in development of application	—Advisory committee to state education agency —Beginning in FY 84, annual evaluation of program effectiveness	—Criteria to evaluate performance —Cooperation with federal investigations —Identification of program need —Maintenance of records confidentiality	—Criteria to evaluate performance —Cooperation with federal investigations —Identification of program need —Maintenance of records confidentiality
c. "Secretary may not prescribe the manner in which the states will comply" with assurances	No such provision	No such provision	Yes	Yes
d. Publication of intended use report for public comment	Yes	Yes, for 20% of state share	Yes	Yes
e. Public hearings	No such provision	No such provision	By state legislature	By state legislature
f. Annual report and annual independent audit	Annual audit. Performance report required at times set by Secretary	State provides information Secretary requires for fiscal audit and evaluation of effectiveness	Yes	Yes
g. "Secretary may not establish reporting requirements that are burdensome"	No such provision	No such provision	Yes	Yes
12. Transition provision	Effective 10/1/81	Effective 10/1/82	In FY 1982, federal agency administers existing categoricals until state is ready to assume block grant. Thereafter, states must administer or lose funds.	In FY 1982, federal agency administers existing categoricals until state is ready to assume block grant. Thereafter, states must administer or lose funds.

Source: PL 97-35: OMB, Intergovernmental Affairs Division, "Catalog of Federal Domestic Assistance Programs Covered by the Block Grants in the 1982 Omnibus Reconciliation Act."

All nine go to the states; but the State Community Development grant requires the states to meet four conditions or else the relationship reverts to federal local; the Education grant requires 80% of the funds to be passed through to local education agencies; and the Primary Care, Community Services, and Alcohol, Drug Abuse, and Mental Health (ADAMH) grants earmark certain funds for pass through.

Table 3 shows how the enacted block grants compare with the Administration's proposals. The number of cate-

goricals consolidated fell short of the number proposed, but not by much (77 to 85). There are obvious differences in the scope of the blocks, judging by their titles, but the titles do not reveal everything about the component categoricals. In some cases, categoricals covered under a proposed block appeared in an enacted block with a quite different composition. By the time the Congressional committees finished their work, many categoricals that were proposed for blocking had been dropped, but others that were not in the original proposal were in the final mergers.

Omnibus Budget Reconciliation Act of 1981 (PL 97-35) (Continued)

Maternal and Child Health Services	Primary Care	Social Services	Community Services	Low-Income Home Energy Assistance
<ul style="list-style-type: none"> - Fair method for allotting funds, guiding health care assessment and services, assuring quality -- Assurance that service channels follow public schedule, are not imposed on poor, and are on sliding scale — State agency coordination with Medicaid's early screening and related programs 	<ul style="list-style-type: none"> - Establishment of criteria to evaluate fiscal, managerial, clinical performance — State agency's capability of managing, determining needs, evaluating performance of CHCs 	None	<ul style="list-style-type: none"> — Makeup of governing board of CAA or nonprofit private agency — Prohibition of political activities and transportation to polls — Coordination with emergency energy intervention programs 	<ul style="list-style-type: none"> — Conduct of outreach activities — Coordination with similar and related federal, state activities — Cooperation with federal investigations — Provision of fair administrative hearing for --aggrieved claimants
No such provision	No such provision	No such provision	Yes	Yes
Yes	Yes	Yes	Yes, Governor required to provide plan of how state proposes to carry out assurances on application	Yes, Governor required to provide plan of how state proposes to carry out assurances on application
No such provision	By state legislature	No such provision	By state legislature	By state legislature
Annual report, two year audit	Yes	Yes, at least every two years	Annual report to public but not to federal agency; annual independent audit	Annual report to public but not to federal agency; biennial independent audit
No such provision	Yes	No such provision	No such provision	No such provision
In FY 1982, federal agency administers existing categoricals until state is ready to assume block grant. Thereafter, state must administer or lose funds	Effective 10/1/82	Effective 10/1/81	In FY 1982, HHS administers existing categoricals until state is ready to assume block grant. Thereafter, states must administer or lose funds	Effective 10/1/81

November 12, 1981 OMB: 1981 Catalog of Federal Domestic Assistance: Federal Register, October 1, 1981, p. 48582 ff., and November 20, 1981, p. 57256 ff.

This mixing of the component categoricals is notably prevalent in the health/social services blocks, before and after.

The block grant proposal which apparently met with least success is Local Education. Major elements of this proposed block were dealt with in the Reconciliation Act — specifically, those for which entitlements are provided in Title I of the Elementary and Secondary Education Act of 1965. The Reconciliation Act declared a Congressional policy of lifting the burden from school personnel of

overly prescriptive regulations and administrative burdens, but the Act itself continues the separate funding and eligibility arrangements of the education programs for the handicapped and of the Title I Elementary-Secondary Education programs. It also retains such significant restrictions as maintenance of effort, non-supplant, and comparability of services. For all practical purposes, then, components of the Administration's Local Education block grant were not consolidated, nor were some of the basic restrictions lifted.

Table 3

**Number of Categorical Grants Consolidated by Block Grants:
Proposed by Administration, Enacted by Congress**

Proposed		Enacted	
Block	Number of categoricals	Block	Number of categoricals
1. Local Education	10	—	—
2. State Education	33	1. State Education	37
3. Health Services and Mental Health	17	2. Preventive Health and Health Services	6
4. Preventive Health	10	3. Alcohol, Drug Abuse, and Mental Health	10
5. Social Services	12	4. Maternal and Child Health	9
6. Emergency Hardship Assistance	2	5. Social Services	1
7. Community Development	1	6. Community Services	7
		7. Primary Care	1
		8. Low-Income Home Energy Assistance	1
		9. State Community Development	
		(Community Development-existing block)	3
TOTALS	85¹		77¹

¹These figures may not be completely comparable, although both are derived from OMB listings. Programs in OMB's "enacted" listing were identified by reference to OMB's **1981 Catalog of Federal Domestic Assistance**, those in the "proposed" listing were not. The "proposed" number is more likely an understatement than an overstatement in comparison with the "enacted" number.

Source: ACIR staff computations based on U.S. Office of Management and Budget, Fiscal Analysis Branch, Budget Review Division, "Grants-in-Aid in the Revised 1982 Budget," April, 1981; and U.S. Office of Management and Budget, Intergovernmental Affairs Division, "Catalog of Federal Domestic Assistance Programs Covered by the Block Grants in the 1982 Omnibus Reconciliation Act," November 12, 1981.

An important issue is the degree to which the new blocks incorporated the lifting of restrictions and the untying of strings that the Administration sought. Here generalizations are also difficult: the nine blocks vary, although the seven human services blocks—especially the four health ones—tend to be alike.

- Only three require matching—State Community Development, Maternal and Child Health, and Primary Care.
- Six carry some type of fund earmarking—all but State Community Development, Education, and Low-Income Home Energy Assistance.
- All seven of the human services blocks prohibit use of funds for certain activities or eligibles.
- Four (Preventive Health, ADAMH, Community Services, and Low-Income Home Energy Assistance) explicitly prohibit the federal government from prescribing how the states will comply with the required performance assurance.
- Three contain a maintenance of effort or nonsupplant provision—Education, Preventive Health, and ADAMH.
- Four—Preventive Health, ADAMH, Primary Care, and Community Services—are subject to general procedural requirements as to proposed use reports, public hearings, and biennial financial and compliance audits, as set forth in Title XVII of the **Reconciliation Act**, but it may be noted that these requirements actually liberate the recipients in that they are less stringent than similar requirements imposed on earlier categorical programs.
- Seven require state applications—all but State Community Development and Social Services. All but Social Services mandate various assurances to be submitted with the program application or the statement of proposed activities. These are generally

modest, however, merely assuring minimum compliance with generally accepted administrative practice. Three (Preventive Health, ADAMH, and Primary Care) require an annual report and an annual independent audit and the other six have somewhat less rigorous requirements.

The same three explicitly direct the Secretary not to establish reporting requirements that are burdensome.

Overall, so far as the states are concerned, it seems fair to conclude that the conditions attached to the blocks are more onerous than they would be under the special revenue sharing model but generally they are markedly less than they were under the displaced categoricals. As the above analysis suggests, this generalization holds with varying degrees of truth for each of the nine blocks.

State-Local Roles

With respect to the impact on state-local relations, the strong state orientation of the new blocks expands the state role and reduces somewhat the local role in the overall federal grant system. In the State Community Development block, a federal-state relationship replaces the direct federal-local relationship of the superseded Small Cities discretionary grant under the Community Development Block Grant. A similar change occurs in the Education block where 28 of the 37 supplanted categoricals went to local government agencies and/or local nonprofit organizations, exclusively or in addition to state agencies. In the Preventive Health block, four of the six superseded categoricals had a direct federal-local element: with ADAMH, four of ten; Maternal and Child Health, four of nine; Primary Care, two of two; and Community Services, four of seven. Only in Social Services and Low-Income Home Energy Assistance was the state government the exclusive eligible recipient before as well as after blocking.

Among the various types of local units, the ones mainly

deprived of a direct federal-local funding connection by the shift to block grants are the counties (Health, Social Services), school districts (Education), nonprofit organizations (Health, Social Services), and small cities and rural communities (State Community Development). Medium and large cities are least affected.

Yet, the interests of localities and nonprofit organizations are not unprotected. (Nonprofits are especially numerous in the human services area.) Apart from pass-through requirements (State Community Development and Education), three earmarkings help protect local funding, at least for a certain period. In addition, Title XVII of the Act requires that in administering the four blocks that now go only to states and replace categoricals that formerly went to local recipients, states must open up their policy decisions on block grant issues by preparing intended use reports, holding public hearings, conducting annual independent audits, and issuing annual reports (audits and reports also are required under the other blocks). Finally, seven of the nine place limits on state use of program funds for administrative expenses.

Implementation

President Reagan's intention of using block grants to implement his policy of returning power to the states thus far has been fully reflected in the implementation of the block grant legislation enacted by Congress. During a series of briefing sessions with state and local officials throughout the country in late summer and early fall, the Office of Management and Budget emphasized three themes that were to guide the federal role in putting the new programs into effect:

- simplicity and flexibility, assured through minimal, "bare bones" regulations and paperwork requirements;
- absolute neutrality by the federal executive branch as to priorities among program purposes with no interference or intrusion and no interpretation or embellishment of the statutes; and
- placing accountability at the state level, so that state officials will be held responsible by their citizens rather than by federal administrators.

In pursuit of these themes, OMB declared that OMB Circulars A-87 (indirect costs), A-102 (uniform administrative requirements), and A-95 (evaluation, review, and coordination of federally supported development projects) will not apply to the block grants. Auditing, long indispensable in federal oversight of state local program implementation, will be conducted by an independent entity

chosen by the states, but the states will have to assure that generally accepted accounting principles are followed. The General Accounting Office, however, will continue to exercise its general auditing responsibility. The "bare bones" regulation approach means that regulations will not elaborate on the law significantly and most of the answers not in the law will come from the states rather than from federal agencies' central or regional offices. In general, a federal attitude of working with and deferring to capable state processes will replace the traditional federal-grantee adversary relationship. Moreover, this new approach is to apply more widely than the new block grants: OMB announced in September its intention to simplify the regulations for categorical grants originally proposed but later dropped from the block grant enactments.

States that may have been skeptical of OMB's pronouncements should have been reassured to read HHS's interim final rules on its seven block grant programs. The rules state:

The Secretary has determined that the Department should implement the block grant programs in a manner that is fully consistent with the Congressional intent to enlarge the states' ability to control use of the funds involved. Accordingly, to the extent possible, we will not burden the states' administration of the programs with definitions of permissible and prohibited activities, procedural rules, paperwork and recordkeeping requirements, or other regulatory provisions. The states will, for the most part, be subject only to the statutory requirements, and the Department will carry out its functions with due regard for the limited nature of the role that Congress has assigned to us.²

At various places, the HHS regulations underscore the federal "hands off" attitude. For example:

- (On the application process) The Secretary is not prescribing any particular format for the submission or elaborating its contents beyond what is specified in the Act.
- (On public participation) The manner in which a state obtains public comment is at the state's discretion so long as statutory requirements are met. . . . The manner in which these hearings are conducted is in the state's discretion so long as statutory requirements are met.
- (On state and federal oversight) . . . the block grants

²Federal Register, October 1, 1981, p. 48582.

Elements of Block Grants: A Potential Aid to Congress

While the block grants that emerged in the Omnibus Budget Reconciliation Act of 1981 stemmed from the Administration's proposals, they bore the marks of having been worked out by a number of separate committees in each chamber of Congress. As a consequence, their basic features lacked a degree of consistency and standardization. An effort was made to overcome these shortcomings through Title XVII of the Act, which sets forth requirements generally applicable to the block grants, including distribution of funds, proposed use reports, public hearings, a transition provision, access to records by the Comptroller General, and state auditing requirements. By its

own definition, however, Title XVII does not apply to all the nine block grants and some months after enactment there was still a question about which ones were affected.

Out of his concern for the lack of consistency in the composition of block grants, Sen. David Durenberger (MN) undertook to explore the possibility of developing an agreed-upon set of block grant elements which could be used, at the least, to guide Congressional committees and the Administration in their construction of future blocks. He also held out the possibility, if the effort was successful, to develop language which could be made to apply to existing block grants by an amendment to the Reconciliation Act of 1981. To this end, the Senator held hearings by his Subcommittee on Intergovernmental Relations in October at which representatives of public interest groups and nonprofit groups generally supported his proposal's objectives.

will be exempt from the usual departmental grant administration requirements (found in OMB Circulars A-102 and A-87) . . . we are establishing a fiscal and administrative standard providing maximum discretion to the states and placing full reliance on state law and procedures.

- (On enforcement) The fundamental check on the state's use of block grant funds is the state's accountability to its citizens, which is implemented by public disclosure within the state of information concerning use of the funds. Accordingly, when an issue arises as to whether a state has complied with its assurances and the statutory provisions, the Department will ordinarily defer to the state's interpretation of its assurances and the statutory provisions.⁴

Similarly, the HUD regulations implementing the new State Community Development Block Grant and the revised basic Community Development Block Grant emphasize the federal government's deference to state discretion:

These regulations maximize the legislative thrust to provide states sufficient flexibility in administering the program. . . . In exercising his obligation and responsibility to review a state's performance, the Secretary will give maximum feasible deference to the state's interpretation of the statutory requirements consistent with the Secretary's obligation to enforce compliance with the manifest intent of Congress as declared in the statutory enactment.⁵

The regulation makes it plain that the new approach applies to the original entitlement CDBG as well as to the new state block:

A central and major change was the deletion of the application process for all grantees, entitlement and non-entitlement. This change derived from the intent of both the administration and Congress to deregulate a program in which federal regulatory intrusion had unnecessarily encumbered the process of receiving federal funds without a concomitant contribution to program quality.⁶

Since the new Education block grant does not take effect until October 1, 1982, preparation of the regulations is still in process.

Changes in the Regulatory Climate

A major trend in intergovernmental relations in the past decade has been the expansion of the federal government's role as regulator of state and local activities. Much of the growth stems from the multiplication of conditional grants-in-aid, but recently it has come increasingly from the federal government's use of instruments with greater elements of compulsion: direct orders, requirements applied to grants across-the-board to further certain social and economic policies, fiscal sanctions applied to one program to influence policy in another (crossover sanctions), and preemption of state and local activities when they fail to measure up to federal standards. While states and localities can escape federal mandates attached to a specific grant-in-aid by refusing the particular grant, they can not avoid easily these other forms of regulation.

State and local officials have expressed increasing con-

cern about the growth of this type of federal regulation, complaining about mandated, unreimbursed costs and unreasonable intervention into their affairs. Consequently, they have a vital interest in the Reagan Administration's plans for reducing the burden of regulation.

The Reagan Approach

The Administration's program for shrinking the public sector and, more pertinently, for limiting "the intrusion of the federal government into our daily lives"⁷ has as its principal emphasis, "freeing the economy of the hidden tax of complying with federal rules and paperwork requirements which do not contribute to the public welfare."⁸ While directed primarily toward regulation of private sector activities, the program also seeks to lift the weight of regulation on state and local governments.

Soon after taking office, President Reagan announced the creation of the Presidential Task Force on Regulatory Relief, chaired by Vice President Bush, and charged it with reviewing pending regulations for possible revision and proposing appropriate legislative remedies. Shortly thereafter, the President temporarily froze the "midnight" regulations issued during the last days of the Carter Administration, and in February he promulgated Executive Order 12291 on federal regulations.

The order requires agencies—other than independent regulatory agencies—to compare costs to the benefits of all new and existing major rules and to pick the least expensive way of implementing the rules. Major rules are those which have an economic impact of \$100 million or more, or cause a major increase in costs or prices or significant adverse effects on competition, employment, investment, or innovation. Under the direction of the Bush Task Force, the Director of the Office of Management and Budget is responsible for day-to-day administration of the regulation control process, including prescribing criteria for determining whether a rule is major, ordering a rule to be treated as a major one, and reviewing agency compliance with the executive order.

In Congressional testimony in April 1981, Chairman Murray L. Weidenbaum of the Council of Economic Advisers, a leading authority on the economic impact of federal regulations and a member of the Presidential Task Force, submitted a list of 34 specific actions designed to "either decrease directly the overhead costs of state and local governments or increase the discretion of state and local governments over regulatory matters with a state and local impact." They were divided into three groups: regulatory changes (five items), regulations postponed for further review (15 items), and existing regulations or regulatory programs targeted for review (14 items).⁹

The Task Force solicited ideas for regulatory reform from nearly 100 organizations representing business, consumers, and state and local officials. The public officials suggested changes in nearly 500 regulations, including both conditions of aid and the more direct regulatory measures. By early fall 1981, the task force announced 52 steps—including the 34 previously identified—to relax more than 1,200 regulations affecting states and cities. Among the most important actions here were:

- Revised rules to permit local authorities more discre-

⁷Office of the Press Secretary, The White House, **Fact Sheet**: "President Reagan's Initiatives to Reduce Regulatory Burdens," February 18, 1981.

⁸*Ibid.*

⁹Statement by Murray L. Weidenbaum, Chairman, the President's Council of Economic Advisers before the Senate Subcommittee on Housing and Urban Affairs of the Committee on Banking, Housing and Urban Affairs, April 23, 1981.

⁴*Ibid.*, pp. 48583-48585.

⁵**Federal Register**, November 20, 1981, p. 57256.

⁶*Ibid.*, p. 57257.

The Congress' Approach to Regulatory Reform

The "Regulatory Reform Act," S. 1080, would give legislative sanction to much of the President's regulatory reform program and go further in amending the **Administrative Procedure Act**. The bill generally would follow Executive Order 12291 in regard to the analysis of costs and benefits of proposed major rules and the definition of "major." Significantly, however, it would make an agency's determination of whether a rule will have a \$100 million impact subject to judicial review. The bill would not exclude the independent regulatory agencies from executive branch regulatory analyses or from Presidential review of these analyses.

On the general issue of judicial review, it instructs the courts not to accord any presumption for or against any agency action, which departs from the prevailing rule of law permitting the courts to defer to agency legal interpretations.

The President would be authorized to establish procedures for agency compliance with the regulatory analysis

- tion in providing the handicapped with access to mass transit.
- Withdrawal of DOT rules relating to urban transportation planning analysis, uniform traffic control devices among the states, and procedures for governing bus rehabilitation and emergency stockpiling.
- Withdrawal of the Education Department's rules requiring local school districts to instruct children not proficient in English in their native languages.
- Review of the Education Department's rules requiring schools and colleges receiving federal grants to spend as much on women's athletic programs as men's.
- Proposed changes in administration of the **Davis-Bacon Act** establishing prevailing wages for federally aided construction projects.¹⁰

One indication of the slowdown in regulatory activity was the drop in the number of pages of the **Federal Register**. From February 1 to November 26, 1980, 71,767 pages of the **Register** were published; for the same period in 1981, the number was 47,923, a decline of 33%.

In November, the Administration reported that state and local governments had been the biggest winners so far in its regulatory rollback. OMB was quoted as claiming savings to governments and regulated industries of \$500 million in annual costs and \$3.8 to \$5.9 billion in one-time start-up costs. The most costly items eliminated were the handicapped access and bilingual education regulations.¹¹

State and local officials welcomed the Administration's efforts, but pressed for more action. They were unhappy that, rather than providing immediate relief, most of the cited deregulatory actions involved review of some regulations or deferment of others still pending. Some felt that attention could be more productively focused on improving the regulation-development process, including granting states and localities more participation in that process.¹²

Some critics felt the Administration was placing too much emphasis on centralized review of rulemaking, rather than stressing fundamental change in major regulatory statutes,

procedure, a power he might delegate to the Vice President or to the Director of the Budget. Presumably under this provision, the President or his delegate would have as much authority to review and comment on agencies' regulatory activities as is permitted under the executive order. The President's exercise of this authority would not be subject to judicial review.

The proposed legislation also would (1) mandate a ten year "sunset" review of all major rules, and (2) require (as the executive order does) an annual agenda and calendar of rules expected to be acted on in the next year.

The Judiciary-Governmental Affairs conferees failed to reach consensus on several issues and agreed to bring them up on the floor. Included are the Governmental Affairs Committee's opposition to instructing the courts to depart from the prevailing rule on agency legal interpretations, and its support for a provision requiring the President to observe time limitations in establishing compliance procedures for rule-making by the independent regulatory agencies.¹³

Congressional Record, November 30, 1981, S14135-6.

... there is no solid evidence that these regulatory programs are even modestly effective. In most instances, the statutes mandate tasks so extensive that the agencies cannot meet deadlines, enforce the rules they set, defend themselves in court, and conduct retrospective evaluations of their effectiveness. More important, the statutes often forbid the use of a cost-benefit test in standard-setting, encourage economically inefficient regulations, and contain a strong bias against economic growth.¹⁴

Others faulted the inconsistency of the Administration's effort, citing evidence that the program favored business and industry as against consumers and that deregulation seemed to be pursued only when it was agreeable to those being regulated.¹⁵

The impact of regulations is not determined solely, of course, by the regulatory development process and the language of the rules. At least as important is the way in which the rules are enforced. Indications were that on this front the Administration was making significant changes. The **Washington Post** reported in November 1981, that the Administration was systematically cutting back its enforcement of hundreds of federal regulations,

systematically cutting back its enforcement of hundreds of federal regulations.

Through budget cuts, agency reorganizations and specific policy directives, Reagan officials have stopped tough regulatory enforcement. From the Department of Agriculture and the Environmental Protection Agency to the Department of Transportation and the Department of Labor, agencies are relaxing their once vigorous oversight of businesses and local government compliance with federal regulation.¹⁶

The article mainly cited cases affecting the private sector, but regulations affecting governments that were mentioned were civil rights and environmental protection rules.

¹⁰Neil R. Pease and Robert W. Hamilton, "Paper Federalism: States, Cities Want to Speed Up What Accompany Aid," **National Journal**, September 12, 1981, pp. 1624-29.

¹¹The **Washington Post**, December 1, 1981, p. 1.

¹²Pease and Hamilton, *op. cit.*

¹³Robert W. Grandall, "Has Reagan Dropped the Ball?" **Regulation**, September/October 1981, p. 16.

¹⁴*Ibid.*, p. 15, and Michael Wines, "Rhetoric and Reality," **National Journal**, October 10, 1981, p. 1824.

¹⁵The **Washington Post**, November 15, 1981, pp. F1-F3.

Congressional Action

Meanwhile, on Capitol Hill, Congress was not ignoring the regulatory field, reflecting at least in part its recognition that, while a great deal of reform can be achieved through executive orders, appointments to key positions, and modification of enforcement policies, legislation is indispensable for certain improvements, such as making orders permanent and applying reforms governmentwide.

The principal bills affecting regulatory reform in the 97th Congress are Sen. Paul Laxalt's (NV) S. 1080 (the House companion is Rep. George Danielson's (CA) HR 746) dealing with cost-benefit analysis, executive oversight, and sunset review of regulations; Sen. Dale Bumpers' (AR) S. 67 on the courts' authority to overturn regulations and permit outside participation in informal rule-making procedures; Rep. Elliott Levitas' (GA) HR 1776, (its Senate companion is Sen. Harrison Schmitt's (NM) S. 890) providing for Congressional veto of rules; and Sen. William Roth's (DE) S. 1601, allowing agencies and affected parties to develop new regulations in private negotiations.

The most comprehensive is S. 1080, the "Regulatory Reform Act." It was voted out by the Judiciary Committee and referred to the Governmental Affairs Committee, which produced an amended version. In late November a consensus substitute amendment was agreed to by the two committees and is expected to be sent to the floor in early 1982 (see box).

The other three regulatory measures have seen little action. The provisions of Sen. Bumpers' bill (S. 67) on oral testimony and cross-examination of witnesses were reflected in the consensus version of S. 1080, but the requirement that the courts not accord any presumption in favor or against agency action, while in the consensus amendment, was not supported by the Governmental Affairs Committee. Sen. Roth's bill (S. 1601) on private negotiations in rule-making was expected to be scheduled for hearings in early 1982 and it was anticipated that Rep. Levitas' proposal for a Congressional veto would be offered as an amendment in the coming floor debate on S. 1080.

The legislative veto proposal probably represents the most direct effort by Congress to exercise control over rule-making on a day-to-day basis. It has been introduced in the past several Congresses. President Carter opposed it as an unconstitutional encroachment into executive authority. HR 1776 would allow either House 60 days to pass a resolution striking down a rule. The veto would become effective if the other chamber did not vote within 30 days to nullify it. The President's signature would not be required. In contrast, a veto bill introduced in the Senate by Sen. Carl Levin (MI) (S. 344) provides for a veto by both houses and requires the President's signature.

Thus far, spokesmen for the Reagan Administration have indicated that they would accept Congressional vetoes—without any Presidential role—for independent regulatory agencies that are not directly responsible to the President, but would insist on a Presidential voice in any Congressional move to veto regulations issued by executive branch agencies.

Other Executive, Legislative Developments

The Administration and Congress took a number of other actions in 1981, that affected federal-state-local relations. Chief among the developments were the creation of the Presidential Advisory Committee on Federalism, possible changes in the A-95 project notification and review system, the application of cross-cutting requirements to new block grants, legislation to improve the administration of federal

aid, and changes in Federal Regional Councils, substate regional councils, and multistate regional organizations.

The Presidential Advisory Committee on Federalism

One of President Reagan's most visible steps toward a restructured federal system was the establishment of the Presidential Advisory Committee on Federalism. The Committee, chaired by Sen. Laxalt, consists of 51 members drawn from the White House staff, Cabinet members, Senators and Representatives, governors, state legislators, county commissioners, mayors, and private citizens. Its two major functions, according to Richard Williamson, assistant to the President for intergovernmental affairs and a member of the Committee, are:

to give a "federalism spin" in the short term for a broad range of Reagan policy initiatives, and, in the long term, to develop "megacepts" or ideas for a basic restructuring of the federal system.¹⁶

The full committee has had one meeting and scheduled a series of meetings of subcommittees to address specific functional and other federalism issues. By late November 1981, a principal point of concentration appeared to be the possible turnbacks of revenue sources to states and localities. Some state and local government members of the committee have been pushing, within the Committee and outside, for the Administration and the Committee to address the broader issue of sorting out and trading off functions between the national and state governments.

Simultaneous with the creation of the Advisory Committee, President Reagan set up the Coordinating Task Force on Federalism. Also chaired by Sen. Laxalt, the Task Force's other members are five top White House aides, the Director of OMB, and five Cabinet members. It is charged with coordinating intergovernmental matters within the Administration.

Regional Organizations

Efforts of the Administration and Congress in 1981 to curtail the public sector and the federal role had particular impact on two unique types of intergovernmental institutions—substate regional councils and multistate regional organizations. In the past two decades especially, the federal government had done much to promote these organizations with financial aid and program support, to the point where, at the end of the 1970s, the nation was virtually covered with both substate and multistate regional planning organizations with active planning programs. Early in his Administration, however, President Reagan proposed to eliminate most of the federal supports for substate and multistate regional planning, to fold certain other federal programs into new block grants, and to cut the amount of funding for still others.

Congress made a number of changes in block grant formats and provided somewhat more transitional funding than the President proposed, but most of his proposals with respect to substate regionalism were enacted. Except for some urban transportation planning and areawide aging funds as well as some transition funding from HUD and EDA, the federal government has withdrawn its financial support from the substate regional movement. Moreover, the Title V multistate regions have been abolished, Title II multistate river basin commissions have been terminated as federal entities, and the Appalachian Regional Commission's fate beyond FY 1982 is in question.

¹⁶Neal R. Peirce, "New Panels to Move Quickly to Help Reagan 'Unbend' the Federal System," *National Journal*, May 2, 1981, p. 785.

A further threat to the substate regional bodies is the possible basic change in the A-95 project notification and review process, since the bodies responsible for performing the A-95 clearances at the areawide level have been these regional councils.

The A-95 Process

OMB Circular A-95 calls for notification of interested and affected parties concerning federal and federally assisted projects before they are funded, and gives notified parties an opportunity to review and comment on the proposals prior to federal action. The objective is to promote interagency coordination at the federal level and help achieve consistency of federal and federally assisted projects with the plans and policies of states and localities.

While first issued in 1969, portions of the circular have been in operation since 1966. Its original enactment was supported strongly by ACIR. It has been evaluated a number of times, by OMB and others. OMB's 1978 assessment concluded that A-95 is "useful and constructive as an intergovernmental cooperation mechanism but its potential is far from being realized." Presently the need for its continuance is challenged and it is argued that the initial purpose of strengthened interlocal cooperation has been substantially achieved.

In August 1981, A-95 appeared on the high priority list

of the Bush Regulatory Task Force for regulatory relief. In addition, the **Omnibus Budget Reconciliation Act of 1981** removed the Community Development Block Grant program from the A-95 process and OMB exempted the nine new block grant programs as well, thus deleting about 60 former categorical grants from the list of about 250 that have been subject to the circular in recent years. Eliminated programs included HUD's Section 701 planning assistance program and a number of others which have funded the state and areawide planning organizations serving as A-95 clearinghouses. Some 60 more programs subject to the circular were terminated outright in other budget actions. The net effect has been to reduce the number of programs subject to A-95 review to 130, financially damage the clearinghouse organizations, and call into question the very existence of the A-95 process.

OMB staff has prepared a decision paper on A-95 for the Director with three options: (1) retain the circular as is, (2) modify it to make it operative on a state by-state basis and entirely at the discretion of the state, and (3) eliminate it. Sen. David Durenberger (MN) is planning to hold hearings on the Circular as soon as OMB publishes its proposal in the Federal Register.

The two principal acts undergirding A-95 (Section 204 of the **Demonstration Cities and Metropolitan Development Act of 1966** and Title IV of the Inter-

ACIR Recommendations: A Winner and An Apparent Loser

The Reagan Administration's "new federalism" requires that the federal government display greater sensitivity toward state and local desires while at the same time reduce federal expenditures and influence. Implementing these objectives, however, can produce mixed results. Consider the status of two ACIR recommendations: fiscal notes and contraband cigarette legislation.

Fiscal Notes. After floundering in Congress for several years, in 1981, fiscal notes legislation finally became law. HR 1465, as signed by President Reagan on December 23, requires cost-impact estimates on bills before Congress affecting state and local governments. Already enacted in at least 30 states, Sen. William V. Roth, Jr. described fiscal notes as an "attempt to force the federal government to recognize the serious problems it often causes for its partners in the federal system."

The proposal long has been a legislative priority for ACIR and such groups as the National Governors' Association, the National Association of Counties, and the National League of Cities. ACIR's recommendation of fiscal notes legislation is an outgrowth of its 11-volume study, **The Federal Role in the Federal System**, in which the Commission examined particular problems impeding the effectiveness of the federal system. Among its conclusions, the report states "that the current network of intergovernmental relations has become dangerously overloaded, to the point that American federalism's most trumpeted traditional traits—flexibility and workability—are critically endangered." Fiscal notes, by injecting greater discipline and managerial sense into the operations of the national government, are considered to be one solution to these problems.

Cigarette Bootlegging. While fiscal notes fared well under Reagan Federalism, the contraband cigarette law

was not so lucky. With the expected termination of the Bureau of Alcohol, Tobacco and Firearms (ATF), the contraband cigarette program's future is questionable. If the program is transferred to another department or agency, it will be reduced in scope, principally providing consultation to states in need of assistance.

The program's genesis goes back to 1977, when ACIR published a study on cigarette bootlegging which recommended federal legislation prohibiting the transportation of contraband cigarettes in interstate commerce. ACIR estimated 1975 net cigarette revenue losses to states of \$337 million. Principally as a result of the ACIR report, in October 1978, Public Law 95-575 was enacted making it illegal to transport, ship, receive, possess, distribute, or purchase more than 60,000 cigarettes not bearing tax indicia of the state in which they are found.

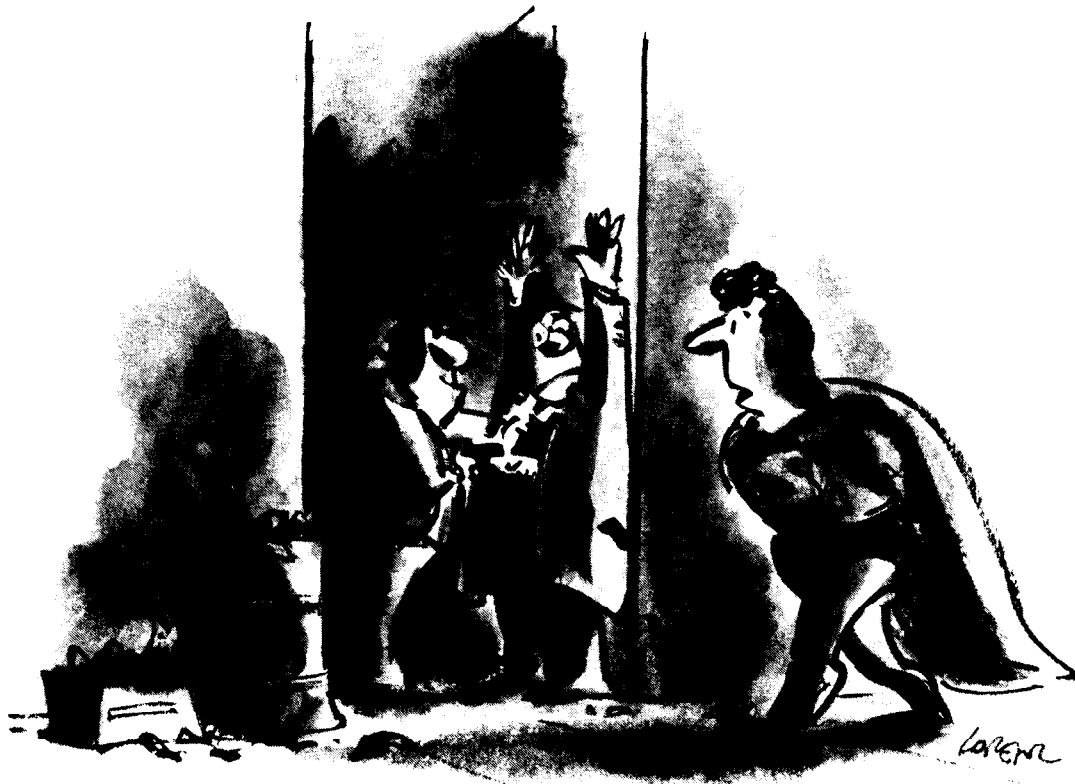
The cigarette contraband law is an example of a program jeopardized not by its record but by the Reagan Administration's need to reduce federal expenditures. An August 1981, ATF evaluation of the contraband Cigarette Program states:

The ATF Contraband Cigarette Program has met its goals in a cost-effective manner. State cigarette revenues have increased, major violators have been investigated and prosecuted, state assessments have been used to identify potential weaknesses within state controls, and state capacities to more effectively deal with their problems are improving.

The evaluation also concludes that "states actually collected at least an additional \$35.5 million from October 1979 to March 1981, which can be attributed to ATF's Contraband Cigarette Program."

Thus we have examples of an intergovernmental victory and a defeat. On the one hand, a law was enacted which might improve federal, state, and local relations. On the other, an intergovernmental program which apparently was successful at meeting its goals may disappear.

—Neal M. Cohen



"Sorry, but all my power's been turned back to the states."

Drawing by Lorenz; © 1981 The New Yorker Magazine, Inc.

governmental Cooperation Act of 1968) clearly require the President to provide regulations for the coordination of federal and federally assisted projects with one another and with plans prepared by state and local governments. If A-95 is repealed, there will be a need to assure such coordination by other, albeit simpler, arrangements, although it can be argued that through major cutbacks in the size and number of federal grants and through the development of a "habit" of interlocal and state-local information exchange during the A-95 years, the problem is more manageable than it was before.

It has been estimated that about 10% of the substate regional councils serving as A-95 clearinghouses will go out of business in 1982, as a result of federal budget cuts and that another 50% will suffer major financial hardships. It is unclear how this will affect the A-95 process. The states may make the notifications and perform the reviews in areas without regional clearinghouses and remaining areawide clearinghouses may continue to perform their duties despite reduced budgets. But it also is likely that less effort will be directed to the task. Almost certainly, the plans and policies upon which project reviews are based will receive less attention, but there will be pressure to find more efficient ways of effecting coordination. Increased state and local resources are likely to be needed in most regions to maintain even a slimmed down version of A-95 activity.

Federal Regional Councils

Federal regional councils (FRCs) were established by President Nixon in 1969, for interagency and intergovern-

ment coordination of federal activities in the ten administrative regions. Modified several times since then, the FRCs were restructured by President Reagan in July 1981. Changes involve reducing from 17 to nine the departments and agencies represented on the councils by dropping, among others, the Department of Commerce, the Office of Personnel Management, the General Services Administration, and the Small Business Administration. A notable change is functional: Each council is instructed to help in explaining to elected officials, including state legislators, special initiatives in the President's federalism program dealing with reform of the federal aid system through block grants, devolution of federal programs and functions, and reduction in the number and impact of federal regulations and administrative requirements.

Like the councils under the Carter Administration, the FRCs are to be under the

oversight and guidance of OMB but OMB is committing less manpower to do the job.

Federal Assistance Improvement Act of 1981 (S. 807)

In 1980, the Senate passed S. 878, "The Federal Assistance Reform Act of 1980," aimed at reducing the complexity and fragmentation in the federal grant system. The bill included several provisions recommended over the years by ACIR including processes for grant consolidation and simplification of national policy requirements attached to aid programs, simplification of audit procedures, renewal and strengthening of the 1974 Joint Funding Simplification Act, and several miscellaneous provisions to improve information on aid availability and to permit greater regulatory flexibility for state and local governments. The measure died with the 96th Congress when the house failed to act.

In 1981, Sen. James Sasser (TN) introduced S. 45, a bill similar to the predecessor S. 878, and Sen. Roth introduced S. 807, "The Federal Assistance Improvement Act of 1981." The major difference between the two bills is that S. 807 places special time and other procedural constraints on Congressional consideration of Presidential proposals for grant consolidation.

S. 807 received the endorsement of President Reagan and was voted out by the Governmental Affairs Committee in June with little or no opposition. Before going to the floor, however, the bill was referred to the Rules Committee because the accelerated Congressional procedure would require a waiver of Senate rules. Opposition to the waiver requirement, as well as to the grant consolidation principle, in general, by teacher, social welfare and related

organizations, resulted in the Rules Committee's voting to strike the "fast track" language from the bill. As of the end of November this left in doubt the fate of the grant consolidation title and possibly the entire bill.

In the House, two bills similar to S.807—HR 4465 (Rep. Harold Daub (NE)), and HR 4643 (Rep. Clarence Brown (OH)), and one similar to S. 45—HR 3680 (Rep. Wendell Bailey (MO)), were introduced. By late November, no action had been taken on either of these measures.

A "New" Hoover Commission

A measure to establish a Commission for More Effective Government, modeled after the Hoover commissions of the 1940s and 1950s, passed the Senate in 1981.

The bill, S. 10, would give the commission a charge to study the management, operation, and organization of the executive branch and independent federal regulatory agencies.

The commission would be made up of 18 members, six appointed by the President, six by the Speaker of the House, and six by the President Pro Tem of the Senate.

The View from the Judiciary

Major shifts in public policy take time to create waves in the federal courts, so the impact on judicial decisions of the first year of the Reagan Administration and the 97th Congress was still largely a matter of conjecture. This did not mean, however, that actions of the courts during the year were without interest or significance for those concerned with federalism issues.

Overall, the Supreme Court tended to avoid Constitutional questions in its 1980-81 term. Hence, the year saw little advancement in Constitutional doctrine. In several important areas of the law, the Court's decision produced a great deal of confusion among legal scholars and practitioners.¹⁷ This confusion extended to areas directly affecting the distribution of power in the federal system, including:

- Tenth Amendment challenges to Congressional uses of power;
- Grant law;
- Decisions under 41 U.S.C. Section 1983;
- Review of lower court institutional remedy cases; and
- State energy taxes.

Tenth Amendment Challenges

Since the mid-1930s, the states have been successful in only one major Tenth Amendment challenge to Congress' Article I, Section 8 powers. That case, of course, was **National League of Cities v. Usery**.¹⁸ In NLC, a challenge to Congressional use of the commerce power, the Court held that federal legislation oversteps its bounds where: (1) it regulates the "states as states;" (2) addresses matters that are indisputably "attributes of state sovereignty;" and (3) directly impairs the ability of states "to structure integral operations in areas of traditional functions." While liberal and conservative observers alike have criticized the reasoning which the Court employed to make its landmark decision, many were hopeful that future application of the three "tests" would significantly

¹⁷See for example, Prof. Jesse H. Choper of the University of California at Berkeley on equal protection, Prof. Yale Kamisar of the University of Michigan on search and seizure, and Prof. Lawrence Tribe of Harvard University on the First Amendment and judicial deference, as well as "The Supreme Court Review and Constitutional Law Symposium," **The United States Law Week**, 50 LW 2187 at 88, 89, and 90, September 29, 1981.

¹⁸426 U.S. 833 (1976).

strengthen states' rights in the federal system. Subsequent challenges to federal legislation based on the NLC criteria, however, have proven unsuccessful. And, 1980-81 was no exception.

Thus, in **Hodel v. Virginia Surface Mining and Reclamation Association**,¹⁹ the Court dismissed a Tenth Amendment challenge to the **Surface Mining Control and Reclamation Act of 1977**, a partial federal preemption. The Court held that:

If a state does not wish to submit a proposed permanent program that complies with the Act and implementing regulations, the full . . . burden [of regulating private mining activities] will be borne by the federal government. Thus, there can be no suggestion that the Act commandeers the legislative process of the states by directly compelling them to enact and enforce a federal regulatory program.²⁰

The decision was significant, for once again it demonstrated the seeming futility of trying to apply the NLC criteria to partial preemptions.

Perhaps even more significant was the Court's refusal to review a lower court decision in the case of **Los Angeles County v. Marshall**.²¹ That case involved the 1976 amendments to the unemployment insurance program—amendments extending coverage to all state and local employees. After over 40 years of participation in the program, the effect of the amendments was to offer a Hobson's choice to the states:

- (1) to conform and tax themselves and their political subdivisions for the costs of unemployment benefits, or
- (2) to fail to conform and accept the utter demise of the states' existing unemployment compensation program.²²

At first blush, these amendments appear not only to be coercive but, using the three NLC criteria, to constitute an infringement of the Tenth Amendment rights of the states. However, the Supreme Court's denial of **certiorari** following a circuit court's upholding of the amendments seemed to bear out a footnoted suggestion in the NLC decision itself that "different results might obtain if Congress seeks to affect integral operations of state governments by exercising authority granted it under the other sections of the Constitution such as the Spending Power. . . ."²³ Decisions such as **L.A. County and Hodel** have prompted legal scholar A. E. Dick Howard to lament that "NLC is an empty vessel waiting to be filled up."²⁴

Grant Law

Though technically a tax case, the **Los Angeles County** decision raised questions concerning the voluntary nature of grants and Congress' ability to circumvent commerce-related restrictions on regulating the states through its power to tax and spend for the general welfare and through enforcement of the Fourteenth Amendment. However, if the Supreme Court offered little solace to state governments in **L. A. County**, it chastised Congress for its ten-

¹⁹49 LW 4654 (June 15, 1981).

²⁰*Ibid* at 4660.

²¹631 F. 2d 767 (D.C. Cir.), **cert. denied**, 101 S. Ct. 113 (1980), **reh. denied** (December 1, 1980).

²²Charles S. Rhyne, **et al**, **Federal Grant Conditions**, Seminar Workpaper prepared for the 1979 NIMLO Mid-year Seminar, Washington, DC, March 25-27, 1979, p. 93.

²³426 U.S. 833 at 852, n. 17. By extension this includes the taxing power as is the case with unemployment insurance.

²⁴A. E. Dick Howard, **Speech before the Federalism Conference** sponsored by the Institute for Contemporary Studies, Washington, DC, September 9, 1981.

dency to impose vague and potentially costly conditions on grant recipients through its spending power.

Hence, in *Pennhurst State School and Hospital v. Halderman*,²⁵ a challenge to the so-called "Bill of Rights" contained in the *Developmentally Disabled Assistance and Bill of Rights Act of 1975*, the Court ruled that the "Bill of Rights" was too vague to constitute a condition of aid: "[I]f Congress intends to impose a condition on a grant of federal moneys, it must do so unambiguously."²⁶

Two additional statements made by the Court in *Pennhurst* may (though not necessarily) have a profound effect on future judicial grant rulings. In the first, Justice Rehnquist warned that "Though Congress' power to legislate under the Spending Power is broad, it does not include surprising stat[us] with post-acceptance or 'retroactive' conditions."²⁷ While it is unclear what would constitute a "retroactive" condition, it is at least conceivable that "[t]aken seriously, this approach would call into question basic features of the grant system such as enactment of new cross-cutting conditions which apply to existing programs."²⁸

Adding even more to the admonitory tone of the Court in *Pennhurst* was a footnoted suggestion that "[t]here are limits on the power of Congress to impose conditions on the states pursuant to its Spending Power."²⁹ Thereafter, among other cases, the majority cited *NLC*. Whether or not this may be taken as an intimation that the Court in the future, will be disposed to "fill up the empty *NLC* vessel" is impossible to tell—a footnote does not a strong precedent make. "Still," according to George Brown, "Supreme Court footnotes are often harbingers of things to come; and this particular statement may force lower courts to take more seriously challenges to grant conditions based on state sovereignty grounds."³⁰

Section 1983

If the Supreme Court, in its 1980-81 term, treated the commerce power in a "business-as-usual" manner and vacillated at best on the spending power, it did appear resolute in refusing to further extend the reach of 42 U.S.C. Section 1983, an 1875 amendment to the *Civil Rights Act of 1871* which was designed to enforce the Fourteenth Amendment.³¹ Briefly, Section 1983 allows injured parties to sue persons acting under color of state law for deprivations of Constitutional rights. Originally known as the *Ku Klux Klan Act* and designed to protect the rights of southern blacks, since the 1960s the law has engendered a litigation explosion against state officials and municipalities which, many contend, threatens their budgets through costly and sometimes capricious damage suits. Particularly disturbing to states and localities were two 1979-80 Supreme Court decisions, one of which treated municipalities as "persons," but "persons" disallowed from using a "good faith" defense in court³² and another which extended the reach of Section 1983 beyond Constitutional deprivations to deprivations under federal statutes.³³

²⁵49 LW 4363 (April 29, 1981).

²⁶*Ibid* at 4367.

²⁷*Ibid* at 4369.

²⁸George D. Brown, "The Courts and Grant Reform: A Time for Action," *Intergovernmental Perspective*, Vol. 7, No. 4, Fall 1981, p. 8.

²⁹49 LW 4363 at 4367, n. 13.

³⁰Brown, *op. cit.*

³¹See Cynthia Cates Colella, "The Mandate, the Mayor, and the Menace of Liability," *Intergovernmental Perspective*, Fall, 1981, p. 15.

³²*Owen v. City of Independence*, 455 U.S. 622 (1980).

³³*Maine v. Thiboutot*, 448 U.S. 1 (1980).

Though these rulings still stand, the 1980-81 term showed a judicial unwillingness to further liberalize the law.

Thus, both the *Pennhurst* case and *Middlesex County Sewerage Authority v. National Sea Clammers Association*³⁴ suggested that when federal statutes provide their own exclusive remedies for violations (for instance, termination of funds to a grantee), "they may suffice to demonstrate Congressional intent to preclude the remedy of suits under Section 1983."³⁵ Since many grant programs do have exclusive remedies, the rulings could significantly limit *Thiboutot*-type suits.

Of equal significance, on the Section 1983 front was the Court's 6-3 decision in *Newport v. Fact Concerts, Inc.*,³⁶ in which it ruled that "a municipality is immune from punitive damages under Section 1983."³⁷ Although, according to preliminary estimates, 169 local jurisdictions across the nation remain liable, under pending cases, for approximately \$4.2 billion in Section 1983 compensatory damages claims, the Court's decision offered considerable relief for 38 localities previously facing over \$1 billion in punitive damages.³⁸

Although this article deals primarily with the Court's 1980-81 term, an extremely notable Section 1983 decision has already been reached in the current (1981-82) term. The opinion signals a continuation and furtherance of last year's trend toward more conservative interpretations under the 100-year old civil rights act.

In *Fair Assessment In Real Estate Association v. McNary*,³⁹ the Court weighed Section 1983 against the principle of comity and found that comity "bars taxpayers' damages actions brought in federal courts under 42 U.S.C. Section 1983 to redress the allegedly unconstitutional administration of a state tax system."⁴⁰ The decision is immediately important for, in effect, what the Court did was to renounce its jurisdiction over a major class of potential suits under Section 1983—namely those claims involving questions of state and local taxation. While the judgment against the petitioners was unanimous, the opinion was only narrowly reached. Thus, the four-justice concurrence, written by Justice Brennan, was in strong disagreement with the route taken by the Rehnquist-led majority, calling its decisive weighing of comity and renunciation of jurisdiction, "unprecedented."⁴¹

Institutional Remedies

A fourth major area of intergovernmental concern is the use of federal judicial equity powers at the lower court level to control the daily administrative operations and budgets of state and local institutions. In the past, such institutional remedies focused largely on schools, but increasingly the trend has shifted toward correctional institutions and facilities for the mentally ill and retarded. Overall, in this area, the Burger Court has offered little direction to the lower courts. Thus, while

there are Burger Court opinions—notably those of Justices Rehnquist and Powell—that reflect a federal-

³⁴Slip Opinion, Docket No. 80-396 (June 26, 1981).

³⁵*Ibid* at p. 17.

³⁶Slip Opinion, Docket No. 80-396 (June 26, 1981).

³⁷*Ibid* at p. 11.

³⁸*Brief Amicus Curiae* of the National Institute of Municipal Law Officers in Support of Petitioners, *City of Newport, et al*, in the Supreme Court of the United States, October Term, 1980, *The City of Newport, R.I. v. Fact Concerts, Inc.*, No. 80-396, pp. 21-23.

³⁹Slip Opinion, Docket No. 80-427 (December 1, 1981).

⁴⁰*Ibid* at 1.

⁴¹*Ibid*, Justice Brennan concurring at p. 3.

ism-based concern about permitting federal courts to displace state and local control of their own institutions . . . when one looks at the Burger Court's record overall, it is hard to conclude that there has been much significant curbing of the use by lower federal courts of their equity powers vis-a-vis the states and localities.⁴²

Aside from *Pennhurst*, in which the Court ruled on statutory rather than Constitutional grounds, the most significant institutional case to come before the Supreme Court in its 1980-81 term was *Rhodes v. Chapman*,⁴³ a suit alleging that double-celling at the Southern Ohio Correctional Facility (SOCF) constituted cruel and unusual punishment under the Eighth and Fourteenth Amendments. Unfortunately, the facts in *Rhodes* will probably keep the case from being considered a real advancement in Constitutional doctrine, for double-celling notwithstanding, SOCF, in the opinions of both the Supreme Court and the district court, is a model institution. Hence, the Supreme Court ruled that double-celling in that facility was not unconstitutional and therefore was able to avoid the whole question of remedies in institutions which clearly violate the Constitution.⁴⁴

Despite the ruling of Constitutionality, Justice Powell's opinion did appear to warn the lower courts about excessive intrusiveness in state and local institutions:

When conditions of confinement amount to cruel and unusual punishment, "federal courts will discharge their duty to protect Constitutional rights." In discharging this oversight responsibility, however, courts cannot assume that state legislatures and prison officials are insensitive to the requirements of the Constitution or to the perplexing sociological problems of how best to achieve the goals of the penal function in the criminal justice system. . . .⁴⁵

State Energy Taxes

Finally, although they are commerce power-related, two cases involving the taxation by energy rich states of their energy resources deserve special mention. One involved Louisiana's so-called "first-use" tax on natural gas; the other, Montana's severance tax on coal. The first was held to violate both the Supremacy Clause and the Commerce Clause, while the second was held not to breach the Constitution on either ground.

*Maryland v. Louisiana*⁴⁶ involved a Louisiana state tax imposed on pipeline companies. The tax itself was rather complicated and fell on the first use of any natural gas brought into Louisiana which was not previously subject to taxation by another state or the United States. It primarily affected gas produced in the federal Outer Continental Shelf (OCS), subsequently piped into Louisiana for processing, and thereafter sold almost entirely to out-of-state customers.

In the Court's 7-1 opinion,⁴⁷ the Louisiana tax ran afoul on two major counts. First, under the U.S. **Natural Gas Act**, the Federal Energy Regulatory Commission (FERC) is charged with determining pipeline and producer costs and allocating the various costs among producers, processors, and consumers. However, Section 1303C of the Louisiana tax act mandated that the tax be borne by the consumers of natural gas. Plaintiffs⁴⁸—the State of Maryland, several other states, the United States, the FERC, and a number of pipeline companies—argued that the Louisiana law conflicted with federal law and was therefore in violation of the Supremacy Clause, a contention with which the Court agreed ruling that, "the Louisiana statute is inconsistent with the federal scheme and must give way."⁴⁹

Second, the Louisiana tax and other state laws provided for Louisiana consumers both exemptions from and credits for the tax which were not uniformly applied to out-of-state consumers. Again, the Court was unequivocal, holding that, "The first-use tax is unconstitutional under the Commerce Clause . . . [because it] impermissibly discriminates against interstate commerce in favor of local interests. . . ."⁵⁰

The Court came to completely different conclusions one month later in the case of *Commonwealth Edison v. Montana*.⁵¹ The controversy involved the coal-rich state of Montana and its imposition of a severance tax on coal mined in the state, including that mined on federal lands. As much as 90% of Montana's coal is shipped to other states. Appellants—a number of Montana coal producers and their out of state customers—claimed, as in the Louisiana case, that the Montana tax was in violation of both the Supremacy and Commerce Clauses. The Supreme Court disagreed with the producers and utilities on both counts.

First, unlike the Louisiana tax, the Montana tax is figured at the same rate no matter what its destination. Thus, despite the fact that most of the coal goes to out-of-state customers, the Court declared that "the tax burden is borne according to the amount of coal consumed, not according to any distinction between in-state and out-of-state consumers . . . [and therefore] does not violate the Commerce Clause."⁵²

Second, the Court examined the tax to determine if it was in violation of the Supremacy Clause. On this point, too, it ruled for Montana. After weighing the state's statute against both the **Mineral Lands Leasing Act of 1920** and national energy policies generally, the six man majority found that the tax was neither inconsistent with the federal statute nor did it frustrate federal policy.

Given the very different conclusions reached in the Louisiana and Montana cases and the compelling nature of the issue involved, the Supreme Court will have ample opportunity in the future to reexamine interstate conflicts on severance taxes and other energy issues. In fact, it has agreed to consider in its 1981-82 term, a case pitting oil companies against the Jicarilla Apache tribe, as well as two cases in which Rhode Island and Massachusetts are contesting New Hampshire's hydroelectric policy. The

⁴²A. E. Dick Howard, "Judicial Federalism: The States and the Supreme Court," paper prepared for presentation at the Federalism Conference sponsored by the Institute for Contemporary Studies, Washington, DC, September 9, 1981, p. 18.

⁴³49 LW 4677 (June 15, 1981).

⁴⁴See for example, the Alabama prison system which the Supreme Court acknowledged as unconstitutional. *Pugh v. Locke*, 406 F. Supp. 318 (MD Ala, 1976), *aff'd as modified*, 559 F. 2d 283 (CA5 1977), *rev'd in part on other grounds* 438 U.S. 781 (1978) (per curiam).

⁴⁵49 LW 4677 at 4680.

⁴⁶49 LW 4562 (May 26, 1981).

⁴⁷Justice Powell did not participate in the consideration or disposition of the case.

⁴⁸The case was brought under the original jurisdiction of the Supreme Court.

⁴⁹49 LW 4562 at 4563.

⁵⁰*Ibid*.

⁵¹49 LW 4957 (July 2, 1981).

⁵²*Ibid* at 4958.

"battle" between the energy-poor and the energy-rich states is far from over.

Highlights: The First Ten Months

After only ten months, any assessment of the work of the Reagan Administration and the 97th Congress must be tentative. With this caveat, thus far it clearly appears that the Administration has had a profound influence on the direction of American federalism. In pursuit of the President's goal of curbing the size and influence of the federal government and establishing a clearer separation between the powers of the national and state governments, Reagan Federalism has altered the size and nature of grants-in-aid and the regulation of state and local activities. It has had other consequences for intergovernmental relations as well.

On grants-in-aid:

- While the upward trend of grants-in-aid, adjusted for inflation, reached its peak in FY 1978, the climb in nominal dollars continued uninterrupted through FY 1981. The first year of the Reagan Administration will see a sharp reversal of that trend: a drop of 9.5% in nominal dollars. The drop stems from merging 77 categorical grants into block grants, termination of some 60 additional categoricals, and funding cutbacks in many others.
- The conversion to nine new or modified block grants and the Administration's record to date in implementing the enacted legislation represents a real devolution of power and responsibility from the federal government to the states. This is despite the fact that, as enacted by Congress, the blocks do not grant as much flexibility to the states as the Administration originally had proposed.
- In terms of state-local relations, the move to blocks has strengthened the role of the states, particularly vis-à-vis counties, school districts, small cities and rural communities, and nonprofit organizations. Medium and large sized cities were less affected since they generally were involved in a direct federal-local relationship in few of the categoricals replaced by the blocks. The state role was made no stronger relative to localities, because Congress assured localities an opportunity to be heard on the allocation of block grant monies that formerly were distributed as direct federal-local categoricals.
- The Administration's intentions with respect to General Revenue Sharing are not clear at this point. During the election campaign the President said he would not disturb GRS. He indicated a possible change of mind when looking for places to make further budget reductions in September 1981, but the threatened cut was protested vigorously by state and local officials.

Whatever the President's inclinations, he will have to persuade Congress, which well may have other ideas.

On regulation of state and local governments:

- As part of its overall effort to curtail federal regulation, the Administration has made inroads toward reducing the regulatory burden on states and localities through the Task Force on Regulatory Relief, cost-benefit analysis, and alteration of enforcement policy. States and localities have benefited from changed approaches in such regulatory areas as bilingual education and access of the handicapped to mass transportation facilities. Yet, no package of reform legislative proposals has

been developed.

- Congress is intent on giving legislative sanction to cutting back on regulations, but executive-legislative tensions assure some differences in approach from that of the Administration. These differences are apparent on the issues of Congressional veto of agency regulations and legislation instructing the courts to cease the policy of resolving doubts in favor of regulatory agencies.

On other intergovernmental fronts:

- The eventual value of the Presidential Advisory Committee on Federalism as a forum for furthering the President's goal of devolving authority to states and localities is still unpredictable. Developing a consensus on turning back functions and revenue sources to the states may be a fruitful field for constructive action by the group.
- The Administration supports S. 807, the "Federal Assistance Improvement Act," for its authorization for the President to consolidate programs and other measures for improved grants management. On the other hand, there is some doubt about the Administration's backing for the A-95 evaluation and review process, which was established in response to a Congressional mandate to improve coordination of delivery of services under federal and federally assisted programs.
- There seems little doubt about the Administration's intention in regard to the federal government's past encouragement of the development and growth of sub-state regional and multistate regional organizations. Its initiation of actions to stop the funding of these mechanisms or of federal aid programs that supported them indirectly is a serious blow to the continued viability and growth of these intergovernmental bodies.

Whether the trends in federalism established in the first ten months of the Reagan Administration will continue or abate depends of course on a multitude of factors, such as the state of the economy and international affairs; future budget decisions; how block grants actually work out in practice in their effects on the delivery of services and federal/state/local shifts in political power; and the degree to which actions already set in motion generate legal challenges and how the courts decide them. Perhaps as much as anything, the long run outcome of these trends will depend on how avidly the President pursues his ultimate goal of transferring to the states not only responsibility for programs, but also the tax sources for financing them, and how vigorously the governors, state legislators, and local officials mount a counterthrust reflecting their deep convictions of the necessity for sorting out functions by level of government.

The true significance for federalism of the first ten months may well have been captured by the observer who said that the first year "is more likely to be the beginning than the ending of change."⁵³

⁵³Jule M. Sugarman, "State Reaction to Changes in Human Services Programs," paper presented at the National Issues Seminar on "Block Grants: The Continuing Evolution of American Federalism," October 28, 1981, The Brookings Institution, Washington, DC, p. 4.

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The New Formula for Fiscal Federalism: Austerity Equals Decentralization

by Susannah Calkins and John Shannon

1981 was clearly a year when intergovernmental finance moved from bit player to star billing in the theater of national public policy. In Washington, the Congress and the Administration focused their attention not just on Poland, and the Golan Heights, but also on the need to make far-reaching changes to strengthen defense and to hasten economic recovery. In this latter context, major tax and expenditure cutbacks were enacted with federal aid programs to state-local governments particularly hard hit. At the same time, there was the continuation of the slow retreat of state-local spending that started several years previously. That, too, was part of the intergovernmental picture in 1981, as governments at all levels applied the fiscal brakes to domestic spending (Chart 1).

The Great Slowdown In State-Local Spending

Events in 1981 provided new evidence of the continued contraction of the state-local sector. Again in 1981, state-local spending declined as a percentage of gross national product (GNP) and federal aid also dropped as a percentage of state-local revenue from own sources (Table 1). In relative terms, the state-local sector is becoming both somewhat leaner and less dependent on federal aid. Between 1975-81, total state-local spending (including federal aid received) has declined slowly from about 15% to 13% of GNP. Conservative values—efficiency, accountability, and fiscal discipline—are now exerting increasing influence in state-local tax and expenditure policies in this time of economic and fiscal austerity.

This recent contraction stands in sharp contrast to the long post-World War II period marked by rapid growth in state-local spending in general and in federal aid in particular. Between 1949 and 1975, the state-local sector grew at almost twice the rate of the economy, rising from about 8% of GNP to 15% during this 25-year period. The growing state-local reliance on federal aid was also clearly evident, increasing from 12% in 1949, to 35% of own source revenue by 1978 (Table 1).

The 1949-75 expansion era was characterized by both the presence of fairly easy access to additional resources and liberal concern about meeting "unmet social needs." The spirit of those times was best reflected in John Kenneth Galbraith's *Affluent Society* that made the case for diverting more resources into an "undernourished" domestic public sector, and in the Johnson Administration's War on Poverty.

The current five to seven year declining trend in state-local spending also stands in sharp contrast to the fairly dramatic and more recent rise in federal spending. The outlays of the federal government have increased from 21.4% of GNP for the calendar year 1978, to an estimated 23.4% for the calendar year 1981—the highest percentage for any peacetime year in United States history (Table 1). The sharp increases in defense spending, social security, and interest payments on the debt are primarily responsible for this rather dramatic development.

What caused this turnaround on the state-local front? The quick answer is the state-local tax revolt and federal aid cutbacks. A more precise but complex answer—set forth later in this article—points up that an array of factors composed of external shocks and underlying social changes had begun to push the pendulum to the right well before the new administration took office.

Is this great slowdown in state-local spending likely to continue? Again, the quick answer is yes. The golden era of federal aid expansion appears to be over and state officials seared by memories of the tax revolt are likely to be very selective in raising taxes to fill the void created by federal aid cutbacks. Several factors responsible for the earlier state-local expansion are apt to be conspicuous by their absence for at least the next several years, but some new ones, such as infrastructure replacement, are emerging.

What are the implications of this great slowdown in state-local spending and federal aid flows for our federal system? Two developments appear fairly certain. First, an era of scarce resources will sharpen the debate over which level of government should finance what—a pressing issue for our mishmash system of federalism. Second, no matter how the debate turns out, federal aid is likely to decline as a percentage of state-local own source revenue.

Basic Causes of the Turnaround

The great turnaround appears to be the result of the interaction of four shocks to the state-local system and three long range changes in American society and institutions. In fairly rapid succession during the mid-1970s, the state-local system received three major jolts:

- The 1974-75 recession represented the most severe decline since the Great Depression of the 1930s. For state and local leaders, especially in the northeast, this recession sent out a clear message—the days of wine and roses are over.
- The 1975 fiscal crisis of New York City was to municipal finance what the collapse of Penn Central and the teetering of Chrysler were to corporate finance. It painfully underscored the risks of creative accounting and caused many localities to reassess the nature of their long-term commitments, such as pensions.
- California's Proposition 13 in 1978, and its aftermath served as an additional warning that inflation-induced tax hikes and shifts in tax burdens can fuel the fires of taxpayer discontent.

Taxpayer economic distress and growing impatience with big, cumbersome government culminated with the election of a new national administration and a much more conservative Congress—a Republican Senate and a House to the right of center despite its Democratic majority. While all of these developments strengthened the hands of fiscal conservatives, some were more dramatic than others. The impact of the 1974-75 recession and the New York fiscal crisis were most certainly considerably less significant than the impact of Proposition 13 and the 1980 election

These events take on greater significance because they came at a time when great changes were taking place in our society and fiscal institutions.

- **Economic change**—from significant real growth with low rates of inflation to relatively low real growth and high inflation. Once the economic pie stops growing, public spending is seen as more "discretionary" because voters object to having their real standard of living reduced by taxes. When burdened with inflationary troubles, the citizenry is more apt to support those who promise to reduce government spending.
- **Demographic change**—from a baby boom and a high rate of population increase to an aging population. This means rising school enrollments are changing to declining enrollments. Most governors and local officials can no longer count on a powerful school lobby to run political interference for frequent tax increases. There is also pressure from the aging population for income security, medical benefits, and other programs benefiting the elderly, these demands competing for funds against handicapped education, environmental protection, and other types of domestic sector spending.
- **Public confidence change**—from relatively high public confidence in the ability of government to solve social and economic problems to a relatively low public estimate of this ability. Back in the late 1950s, about 75% of public opinion poll respondents indicated that they trusted government to do right always or most of the time. By 1976, that number had dropped to about 37%. The number who thought that government wastes a lot of tax money rose from 15% to about 80% during this same 25-year period.

Table 1

Government Expenditures¹ as a Percentage of Gross National Product, Selected Years, 1949-81

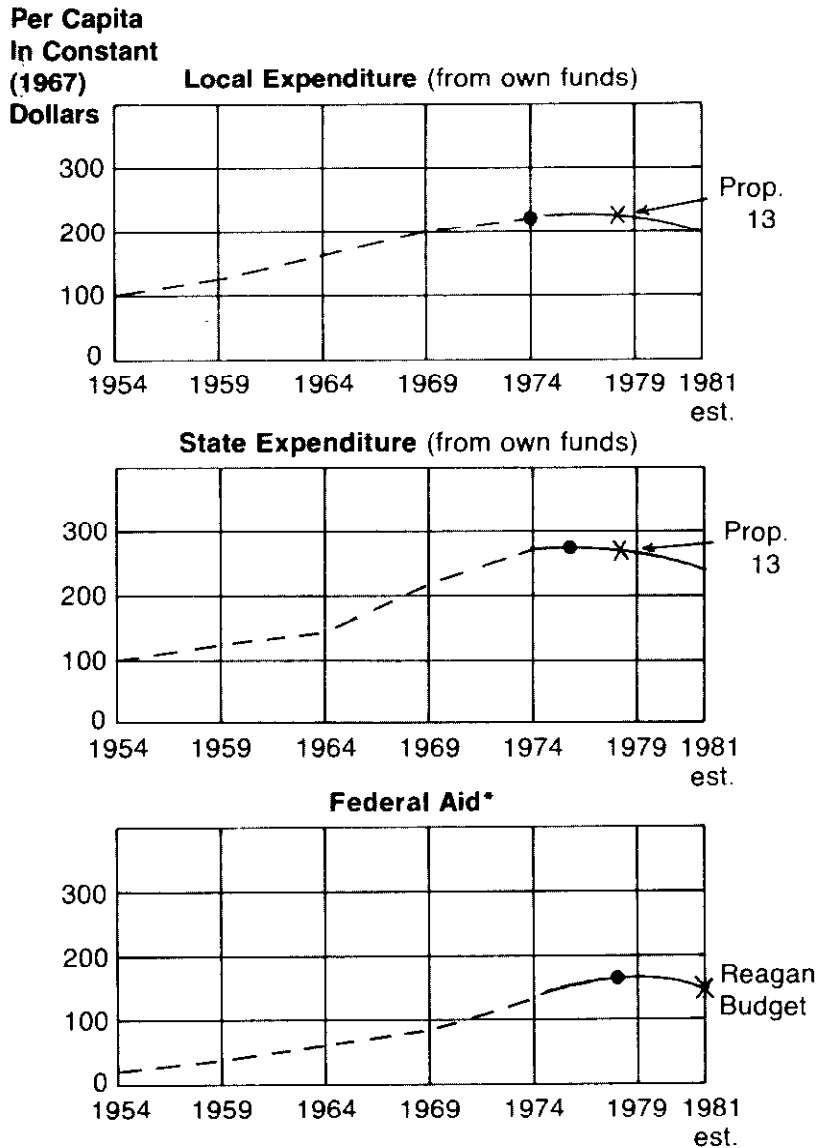
Calendar Year	Total Public Sector	Federal Expenditure		State and Local Expenditure		Exhibit: Federal Aid as Percentage of State and Local Revenues From Own Source
		Including Federal Aid	Excluding Federal Aid	Including Federal Aid	Excluding Federal Aid	
1949	23.0%	16.0%	15.2%	7.8%	6.9%	12.2%
1954	26.4	19.0	18.2	8.2	7.5	10.7
1959	26.8	18.7	17.2	9.6	8.2	17.0
1964	27.6	18.5	16.9	10.7	9.1	17.9
1969	30.4	20.0	17.8	12.6	10.4	20.6
1974	32.1	20.9	17.8	14.3	11.2	27.3
1975	34.5	23.0	19.5	15.0	11.4	30.7
1976	33.5	22.4	18.8	14.7	11.1	32.1
1977	32.5	22.0	18.5	14.0	10.5	33.3
1978	31.6	21.4	17.8	13.9	10.3	34.9
1979	31.2	21.1	17.8	13.5	10.2	33.0
1980	33.1	22.9	19.6	13.5	10.1	33.0
1981 Est.	33.4	23.4	20.4	13.0	10.0	29.9

¹National Income and Product Accounts.

Source: ACIR staff computations based on U.S. Department of Commerce, Bureau of Economic Analysis, **The National Income and Product Accounts of the United States, 1929-76; Statistical Tables and Survey of Current Business**, various years; U.S. Bureau of Census, **Budget of the United States Government**, various years; **Fiscal Year 1952 Budget Revisions**, unpublished budget data; **Economic Report of the President**, January 1981; and ACIR staff estimates.

Chart 1

State, Local Spending and Federal Aid Selected Years, 1954-81 Per Capita, In Constant Dollars



* Does not reflect the steep cut in federal aid for Fiscal Year 1982.
Source: ACIR. ● High points.

Growing Fiscal Stress at the Federal Level

The continued growth of federal spending in general and federal deficits in particular has riveted public attention on the need to control the federal budget. Gone are the days when policymakers could expand government outlays at little or no political risk. Instead, Washington hands have found that the fiscal trump cards which the federal government possessed in the past have been played out.

- **The Defense Trump Card.** The federal government's ability to finance expansion in social programs as well as some tax reductions by cutting defense has come to an end. Now there is growing sentiment that during

the 1970s, we "underinvested" in defense. The Reagan Administration has placed top priority on a greatly increased level of defense expenditures in real terms. The generals and admirals will be claiming an increasing share of the federal budget for the next several years.

- **The Social Security Trump Card.** For years Congress could increase social security tax rates with little opposition. Now there is concern that the social security trust fund may not have sufficient funds to meet retiree and Medicaid claims and also growing opposition to steadily rising social security taxes. Confronted with this situation, Congress will have to cut benefits or siphon off general tax revenue - or both - to maintain the solvency of the system.
- **The Taxflation Card.** In recent years Congress has allowed inflation to push taxpayers into higher and higher tax brackets; the result was an ever increasing tax take. Now Congress has enacted substantial tax rate reductions which will eventually turn into a tax indexation system. As a result, heretofore politically painless inflation-induced revenue increases will no longer be available.
- **The Deficit Finesse.** During the 1954-79 period, there was little public objection to federal policymakers covering revenue shortfalls with deficit financing, thereby avoiding the political pain caused by tax hikes or expenditure cutbacks. In 19 of the last 20 years, Congress spent more than it collected; these deficits cumulatively total about \$400 billion. Now, confronted with chronic inflation of major proportions, the deficit finesse can no longer be worked with the same ease as in earlier years. The Congress, the middle class, and the business community all regard perennial deficits as convincing evidence of poor fiscal discipline and a major contributor to two of the nation's most serious domestic problems: inflation and high interest rates.

Accentuating these changes was the shifting political climate of the United States, exemplified by the Reagan election in 1980. The new president was swept into office advocating a reduction in taxes, cuts in expenditures, reduced deficits, and increases in defense expenditures. He promptly seized the initiative; by the end of the summer, Congress at his urging enacted a major tax cut; expenditures for defense increased sharply; and expenditures for social programs, particularly in grants-in-aid to states and localities had been cut.

Fiscal Discipline—The Budget Control Act

The impact of the Administration program on actual programs and expenditures—especially federal grants—might have been considerably less impressive were it not for the skillful use which the Administration and its Congressional allies made of the **Congressional Budget Act** to push its programs and budgetary objectives through Congress.

Before the enactment of the landmark **Congressional Budget Impoundment and Control Act of 1974**, there was no process by which Congress could set overall budget policy. Once an administration's budget had been sent to

Congress, it was carved up into individual segments subject to the jurisdiction of the various appropriation committees and the segments were never put together again in the course of Congressional action. The 1974 Act established standing budget committees in both houses which were given the responsibility of developing and enforcing a target budget total by May 15 of each year and the final budget total by September 15. The bill also contained a little-noticed provision which gave authority to the budget committees to request the individual authorizing committees to make substantive changes in order to "reconcile" estimated spending levels with budget targets.

The new Reagan Administration made maximum use of these reconciliation procedures to realize its budget and program objectives. Because the cuts in spending which the new Administration contemplated were so drastic, changes in authorizing laws needed to be made. The Administration sidestepped the lengthy two-step authorizing and appropriating process by having the Budget Committees include in the first concurrent resolution, instructions to the authorizing committees to reduce existing programs in authorization language as well as in funding. **The Omnibus Reconciliation Act of 1981**, passed in July, made substantive changes in over 250 existing laws, ranging from changes in program administration and client eligibility to reduced spending levels. The Act also merged 77 smaller categorical grants programs into nine block grants in pursuit of the Administration's objective of simplifying the federal aid programs and giving states more discretion in their administration.

The extraordinary fiscal discipline exercised by the House and Senate Budget Committees during the early stages of the Congressional consideration of the 1982 Budget enabled the Administration to make severe cuts in the 1982 budget proposed by the Carter Administration. Because both houses of Congress were required to consider and vote upon the omnibus reconciliation bill as a whole, interest groups and Congressional supporters found it more difficult than at any previous time to protect their particular constituent interests.

Fiscal Prognosis: Continued Austerity

Fiscal pressures at the federal level and the legacy of the tax revolt at the state-local level will serve as powerful constraints on state and local governments.

Continued Stress at the Federal Level

At the present time, the federal tax system cannot generate sufficient revenue to cover Uncle Sam's expenditure commitments without the help of deficit financing. It will take one of the following unlikely developments to reduce the stress:

- a dramatic lessening of international tensions, thereby permitting a major reduction in federal defense outlays;
- a rapid and long-sustained economic recovery, with negligible inflation and modest interest rates, that would both generate substantial additional revenues and outlays, especially for income maintenance programs;
- a major increase in federal revenue yields either by deferring both the scheduled income tax reductions and indexation or by the imposition of a major new tax such as a value added tax; or
- renewed public acceptance of massive deficit financing.

Federal fiscal tensions may ease slowly because of mar-

ginal improvements on the expenditure, revenue, and deficit fronts. The Administration may decide to slow down the rapid growth of defense outlays; the revenue picture could improve modestly with slow economic recovery and with certain "revenue enhancement" actions and, most importantly, federal policymakers can postpone and, indeed already have postponed, promises to balance the budget by a date certain, replaced by a goal of **steady progress** toward a balanced budget.

Federal Aid—Most Vulnerable to Cutbacks

Aid to state and local governments is the low man on the federal fiscal totem pole. This explains why in 1981, funds going to state and local governments took the sharpest cut. The Administration had constantly emphasized that its program calls for substantial increases in real dollar terms for defense programs and that funds for social security and that other benefits for the truly needy would be protected. Interest on the public debt is, of course, fixed or growing in response to increased deficits or rising interest rates. The relatively fixed character of these segments of the budget cause the remainder of the domestic programs to be subject to proportionately greater stress. To sum up, federal aid is especially vulnerable because it consists of funds given to other governments; in times of cutback, charity begins at home. Congress feels that outcries caused by the cuts are more likely to be directed at state-local governments than at Congress.

States—Fiscally Conservative

There is no evidence that states will raise taxes sufficiently to fill the void left by the sharp cutbacks in federal aid, although many states are increasing taxes somewhat. Governors and state legislators have felt the heat of the tax revolt of the 1970s, in the form of restrictive actions ranging from relatively mild full disclosure requirements to draconian Proposition 13-type remedies. These fiscal constraints of the 1970s will not be swept aside easily.

In addition, many states are not in a position to undertake new spending for social programs, even if their citizens endorsed such moves. The big spenders of the past, such as New York and other northeastern and midwestern states, are pursuing very conservative tax policies in order to improve their competitive business climate. In the southern and western states, which are in a better economic position, both governors and their citizens have generally exhibited a conservative taste when it came to ordering and paying for public goods and services. Although some states are enjoying the plentiful revenues which severance taxes on oil or coal provide, most of them are acutely conscious that their wealth will last only as long as their oil reserves hold out. They have little enthusiasm for increasing current spending and, in many cases, are accumulating "rainy day" reserves. Only Alaska is showing a dramatic increase in expenditures.

Intergovernmental Prognosis: Less Federal Influence

Fiscal austerity will both stimulate a sharp debate about federalism—who should do what—and change the contours of the intergovernmental fiscal landscape.

Federalism: The Great Debate

The cutback in federal funds and the tax revolt at the state level have prompted renewed attention to the goals and nature of federalism in general and the need for a thorough overhaul of the federal aid system in particular. Increasingly, federal dollars and accompanying dictates

have invaded all phases of state-local operations. Instead of bringing clear-cut federal control, however, legislative and administrative directives have resulted in a mishmash of federal state-local authority with the resultant loss of efficiency, accountability, and public confidence. Thus, the federal aid system with its 500 programs and thousands of "strings" has become both highly intrusive in character and repugnant to state and local governments and many of the general public.

The Advisory Commission on Intergovernmental Relations has accorded the highest priority on its current agenda to a "sorting out" of responsibilities and resources among the three governmental levels and the ACIR staff has been analyzing alternative approaches. As **Chart 2** points up sharply, the debate focuses on three widely differing strategies—block grants, tax turnbacks, and program

swaps—for streamlining the congested federal grant system. The chart sets forth the advantages and disadvantages of each strategy and the leading proponents of each approach.

In short, the current concentration on needs for better management of scarce government resources has prompted a healthy interest in federalism which had been missing during the decades of ever-expanding national programs. Just at the end of 1981, spokesmen for the White House indicated that the upcoming federal budget would definitely incorporate proposals implementing President Reagan's oft-expressed hopes to return substantial resources and program responsibilities to the states and localities.

Cutbacks in Federal Aid

No matter how the debate on federalism is resolved, one

Chart 2

Decongesting An Overloaded Intergovernmental (Aid) System

(An Analysis of Three Alternative Strategies)¹

Decongestion Strategy	Block Grants or "Special Revenue Sharing" —Many categorical grants would be consolidated into lump-sum broad functional grants with most strings untied.	Resource Turnbacks —Federal aids for certain programs are eliminated and balanced by revenue or tax turnbacks (sharing of a federal tax, or sharing of a federal tax base).	Program Sorting Out —Assigns to the federal government complete responsibility for all major income maintenance/welfare type programs; freed of this responsibility, states would assume full responsibility in other areas for which federal grants would be eliminated.
Leading Advocate	Reagan Administration—Current Proposals	Reagan Administration—Long-term Objective	ACIR NGA/NCSL
Instrument of Choice When . . .	Primary objective is to build greater flexibility into the federal aid system while still preserving some Congressional control.	Diversity among the states is preferred and the primary objective is decentralization to return both overall taxing and spending responsibilities to state/local governments.	Primary objective is to combine more uniform benefits and fairer financing of welfare-type programs with more discretion and possible variation in areas of state-local responsibility.
Other "Advantages"	At least everyone's second choice. Allows federal budget cuts in trade for greater discretion for grantees. Allows better budget control by lump-sum rather than matching grants.	It becomes easier to contain the growth of the federal government in particular and of all levels of government in general.	If the federal government assumes responsibility for poor people and their needs, states will be in a far better position to take care of their "poor" local governments.
Sources of Opposition	Block grants criticized for lacking specific enough purpose, lacking guarantees that a national program interest is served, and for being vulnerable to recategorization.	Difficult to agree on programs to be returned back; fear of inadequate nonuniform public services; worry over adequacy of resource turnbacks and their solution to fiscal mismatch.	Strongly opposed because (a) centralization of welfare policy in Washington, (b) higher costs from leveling up benefits, and (c) disproportionate fiscal relief to the frost belt and California.

¹These strategies are not mutually exclusive, especially if only limited progress can be made on any one front.

Source: ACIR staff analysis

fiscal development is likely—there will be a progressive reduction in federal support to state and local governments.

As noted earlier, the period between 1954 and 1976, saw federal aid to states and local governments grow at a faster rate than any other major component of the state-local system. In addition, the stimulative effect of these grants was far greater than suggested by the dollar amounts. Equipped with matching ratios and expenditure maintenance requirements, many of the older federal grant programs were designed to increase state and local spending and to change their budgetary priorities.

Federal aid is estimated to drop to 25.7% of state-local own source revenues in fiscal 1982, and will probably fall well below 20% in the not-too-distant future (Chart 3). The quantitative decline in the federal fiscal presence is accompanied by an insistent state-local demand for a commensurate reduction in federal aid strings. Moreover, these demands certainly find a receptive audience in the Reagan Administration.

In short, no matter what form the reform—block grants, tax turnbacks, or program sort-outs—the federal government will certainly play a diminished role in recent and current grant-in-aid areas of domestic government, whether it relates to dollars or mandates.

A Bigger Role for States

Cutbacks in grant-in-aid programs and the trend toward block grants instead of a multitude of narrow categorical grants have pushed the states into assuming a more important role on the intergovernmental scene. Not only are the states compelled to be less dependent upon Washington for financing, but the transfer of a number of categorical programs to block grants and the Administration's efforts to relax federal mandates and release federal "strings"

gives the states increased freedom and greater responsibility to manage their own affairs and those of their political subdivisions.

Fortunately, over the past 20 years, the states have strengthened their revenue systems immensely. In 1960, 34 states made use of general sales taxes; by 1981, 45 states did. In 1960, 31 states drew revenue from personal income taxes, while in 1981, 40 states did. In 1981, there were 36 states which made use of both sales and personal income taxes and only two which used neither. For example, most states which choose not to impose an income tax are able to rely on powerful alternative revenue sources: severance taxes for Texas and Wyoming and sales taxes on tourist trade for Florida and Nevada.

Now, although states are restrained in raising taxes, the automatic growth of the two powerful revenue producers—income and sales taxes—should enable most of them as the economy improves to gradually replace the lost resources due to federal aid cuts. It should also be noted that states no longer face the continuous pressures for increased expenditures for education because school enrollments are no longer rising sharply.

As the states assume the enhanced role promoted by the current Administration, cities and other local governments will pay less attention to Washington and more to their state capitals. Although the federal aid cutbacks are painful for both donor and recipient governments, they may promote a leaner and more rational aid system, which should prove more responsive to the citizens it serves.

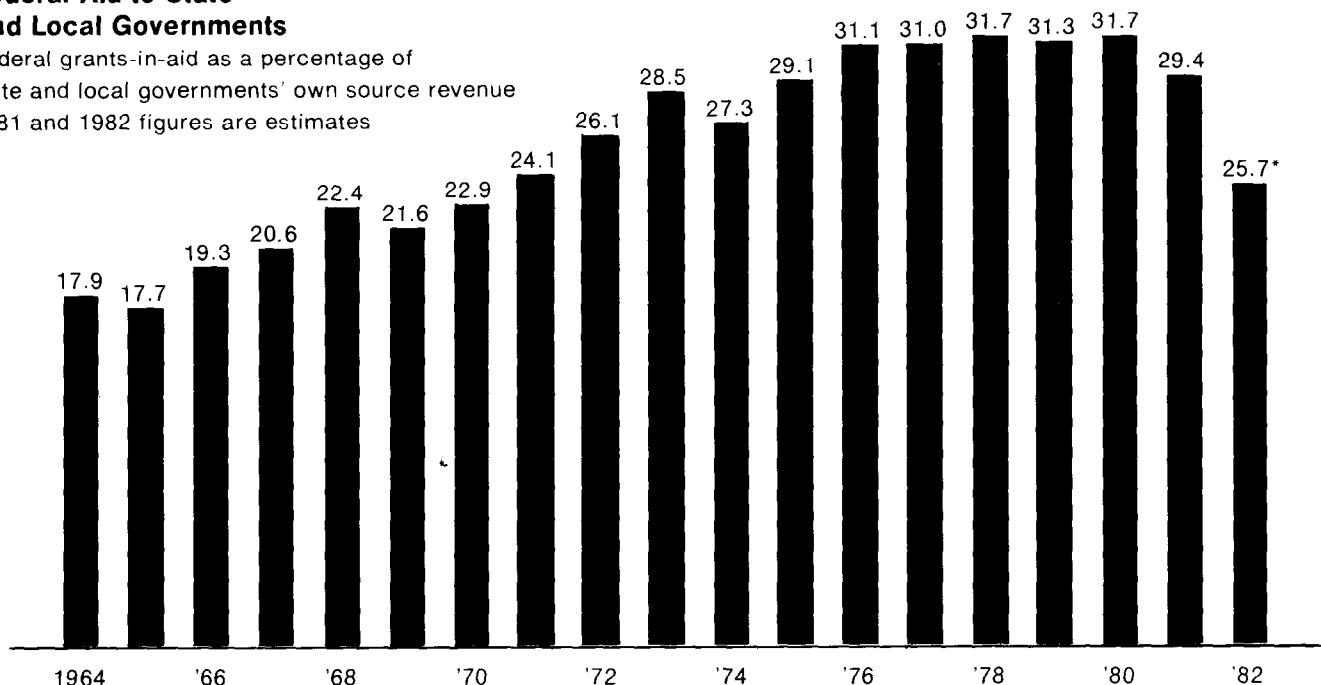
Political Prognosis: No Consensus

There are two sharply opposing interpretations of just what fiscal austerity means for America over the next several years. While labels are sometimes demeaning and often deceiving, major thrusts of current public opinion

Chart 3

Federal Aid to State And Local Governments

Federal grants-in-aid as a percentage of state and local governments' own source revenue
1981 and 1982 figures are estimates



* Estimates.

Source: Advisory Commission on Intergovernmental Relations.

can be explained in considerable measure through contrasting conservative and liberal viewpoints.

The Liberal View

Because of their equity concerns, most spokesmen for liberal causes take a rather dim view of what lies ahead. They argue that in our society only a rising domestic public sector tide helps the poor. When the domestic public sector reaches high tide and then begins to recede they predict that the ships of the poor and the disadvantaged will be the first to crash against the rocks of fiscal austerity.

The New Federalism proposals create another problem for many liberals who claim that middle and upper income taxpayers generally have more influence at the local and state levels than do the various underprivileged groups. In contrast, representatives of minorities, central cities, and social welfare groups still have fairly strong influence at the federal level. Thus, they argue that any major shift of resources and responsibilities from the federal government to the states should be opposed on the grounds that it would work to the disadvantage of the disadvantaged—especially the poor people living in poor central cities.

The difficulties in making shifts of responsibilities between levels of government have been intensified by the fact that there appears to be no real political consensus as to which level of government should perform which functions. Although the Reagan Administration has frequently announced its intention of returning both functions and resources to lower levels of government, public opinion is yet unformed on the issue. The most recent ACIR survey of public opinion (September 1981) asked from which of a series of enumerated functions should the federal government withdraw. The responses indicated that there was at that time no coalescing public support for complete public withdrawal from any specific program now partially funded by the federal government. If a commanding constituency is needed for achieving the sorting out objective, it will have to be molded from the general beliefs of many that the federal government has grown too big.

The Conservative View

Because of their efficiency and private market concerns, conservatives view the great slowdown in state-local spending as a most welcome development that was long overdue. They argue that the domestic public sector has steadily gained weight for decades and that it now will have to stop gaining and hopefully slim down a little. They are encouraged by the fact that first local governments, then state governments, and finally the federal aid programs have been put on more restrictive diets.

They argue that this leaner revenue diet will not do serious harm to the health of state and local governments or their constituencies. On the contrary, they predict that, as a result of the taxpayers' revolt and now the New Federalism, state and local governments will soon become more trim and less dependent on Washington than they have been for years. This, in turn, should make states and localities more accountable, innovative, and efficient providers of public services. They point out that the far-reaching civil rights and reapportionment reforms of recent years should allay fears of those who are concerned about the equitable treatment of the poor and the minority groups at the state and local levels. Finally, they contend that the federal government can best improve the fortunes of poor people and poor cities by restoring the nation to economic health.

The "Do It Yourself" Era

In retrospect, students of American fiscal federalism may well point to 1981 as the beginning of the "do it yourself" era of intergovernmental relations—a period to be marked by major and sustained constraints on federal fiscal resources with consequent reduction in federal ability to aid and direct state and local governments. To put the issue more directly, the federal government is now badly overextended. It can no longer finance an effortless expansion of domestic programs and still honor the Reagan Administration's commitments: to strengthen national defense and to stimulate a sluggish economy with major tax cuts.

The combined impact of substantial increases in defense outlays, major cuts in the federal income tax, and resulting large deficits forced the Congress to place federal aid programs on the chopping block. This action came at a time when state and local governments had limited ability to raise their own taxes—the legacy of the recent tax revolt.

The budgetary and political implications for states and localities appear fairly clear: until fairly recently most of them were doing more with more; for the next several years most are likely to do less with less. Where states and localities were relying increasingly on federal financial support, they will now be relying increasingly on their own revenue raising efforts. Fiscal austerity and budgetary cutbacks at the federal level are forcing inexorably a growing decentralization of our intergovernmental system.

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“Rebalanced Federalism:” The States’ Role and Response

by Jean Lawson and
Carl W. Stenberg

American federalism has taken on a new look for the 1980s. The changes are occurring, in part, as a result of actions by the Reagan Administration to decentralize, deregulate, and devolve the intergovernmental grant-in-aid system. They also are due to conditions of fiscal stress affecting all levels of government, including: reductions in the amount of federal aid to states and localities; inflation, high interest rates, and increased unemployment caused by a sluggish national economy; and tax lids and spending limits enacted by the states in response to the taxpayers’ revolt that began in 1978, with the passage of Proposition 13 in California.

This article examines the fiscal condition of the states and localities, the role of the states as intergovernmental middlemen under the New Federalism, and the changes that are occurring both in state-local and state executive-legislative relationships as a result of the fiscal crunch and the shift away from categorical to block grants.

Doing More With Less

During 1981, President Reagan’s New Federalism involved a three-fold effort:

- returning more program responsibility and discretion to the states by consolidating many of the narrow categorical grants into block grants with funds appropriated for broad, functionally related activities;
- turning back revenue sources to help fund the programs being picked up by the states; and,
- reducing the number and cost of federal regulations imposed upon states and localities.

The reduction in federal aid, an undeclared plank in the New Federalism platform, was a significant conditioner of the response to these initiatives by state and local officials. Sometimes it overshadowed the other aspects of New Federalism, especially the block grants.

Early in 1981, the President proposed consolidating about 85 categorical programs into seven block grants with a 25% reduction in total funding. The **Omnibus Budget Reconciliation Act of 1981**, enacted by Congress in late summer, provided for consolidating 77 categorical and two earlier block grants into nine new or altered block grant programs. Funding levels for most of the converted categorical programs were reduced and some 62 unblocked programs were eliminated. The block grant provisions target the states as primary grant recipients and decisionmakers. Whereas many of the superseded categorical programs had involved a federal-local relationship, all nine of the new programs are directed to the states. The states have wide latitude in allocation decisions; only two of the block grants carry passthrough guarantees for the benefit of local governments, although three others require earmarkings that help protect local funding for at least a limited period. Decentralization under the New Federalism means that states have more discretion in spending the federal funds they receive and that they have greater program responsibility, but the budget cuts mean that there are fewer federal dollars available and greater uncertainty as to who will receive them and how they will be used.

The President has labeled the block grants as an intermediate step in the process of returning to state governments both responsibility for certain program areas and the revenue sources to help them perform these functions. This shift would eliminate the need for the people’s money to make the trip to Washington and return to the states with “carrying charges.” President Reagan told delegates to the National League of Cities (NLC) convention in March 1981, that his Administration’s aim is “to recapture the bounty of vigor and optimism deTocqueville found in American cities” by “re-establishing the proper relationship between the federal, state and local governments. The block grant program in our package is the first step. . . . It is something we, in the years ahead, can build upon.”

Although the reaction to the Administration’s federalism proposals has been mixed—more positive in the beginning, less so when the extent of the budget cuts became known—on balance it has been favorable. Over the preceding few years the ACIR and other groups repeatedly had called attention to the need for grant system reform and for

greater prudence by the Congress and federal agencies in extending the national government's role into new areas of domestic affairs. The National Governors' Association (NGA), the National Conference of State Legislatures (NCSL), and NLC endorsed the idea of grant consolidation, but their feelings about the budget cuts were mixed. The governors felt they could absorb a 10 to 15% reduction without cutting back on essential services if they were allowed to set their own program priorities. State legislative leaders agreed that the added flexibility of block grants would cushion the impact of cuts. The U.S. Conference of Mayors (USCM) and NLC, along with other local-oriented organizations, however, were far more pessimistic about how the states would handle their new role. Mayor Richard Hatcher of Gary, IN, then president of USCM, pointed out that his group intended to draw a line between "real block grants and deep budget cuts dressed up to look like block grants and sent to state capitals where we'll have to go through another layer of bureaucracy to find them."

As Congress acquiesced in nearly all the President's requests for cuts in intergovernmental aid and it became apparent that the cuts would be far deeper than 10 or 15%, uneasiness began replacing the initial optimism at the state level. In early November, Vermont Gov. Richard Snelling, NGA Chairman and an early and vocal supporter of New Federalism, told a joint meeting of the House and Senate Subcommittees on Intergovernmental Relations that "... as state and local officials everywhere contemplate the deep funding cuts and limited flexibility in the current block grants, they ponder how far the block grant approach to federal funding is worth pursuing."¹ He reminded the members that state and local aid had absorbed nearly 33% of the federal cuts even though such aid made up only about 15% of the federal budget.

The Spotlight Turns to the States

States Respond to Block Grants

The federal budget cuts and the creation of nine new or revised block grants have combined to put the states in the spotlight for much of 1981. Issues of block grant implementation during the initial transition phase have generated nationwide interest. The states' responses are being studied by task forces within the federal agencies, OMB, and the major public interest groups.

The swiftness with which the block grant proposals moved through Congress, coupled with wide variations among the states in their ability to cope with budget and program management changes, were major obstacles to a smooth transition. While much of the administrative machinery was already in place for the federal-state categorical programs that were merged, first-year flexibility under the new block grants was limited. All but four states were operating on a July-to-June fiscal year, rather than the federal budget cycle of October 1 to September 30; tax rates had been set; the governors had already made their budget recommendations for FY 1982; and, in many instances, the legislatures had completed their sessions and adjourned *sine die*.

In spite of these constraints, nearly all the states had begun preparations to deal with the shift away from categoricals before the **Omnibus Budget Reconciliation Act** was passed. Only **California, New Hampshire, and**

New York did not assume responsibility for some or all of the block grants that became effective with the beginning of the federal fiscal year.

The table on page 32 outlines the actions taken by both governors and state legislatures in response to the block grants. Some of the states have established permanent, long-range processes and procedures. Others are concentrating on the short-run transition period, hoping to buy time before making final decisions. Basically, while the states have approached the challenges of implementation in a number of ways, certain patterns have emerged across the country. A two-step process involving an extensive information gathering/dissemination effort and the use of collected data to set priorities is the general rule. A special group, usually designated by the governor or by the affected agencies themselves, holds public hearings, makes formal recommendations to the chief executive on where adjustments might be made and on how the programs could be administered most efficiently, and serves as a liaison between the governor, the legislature, and local government representatives. This group helps develop plans for special sessions of the legislature and makes recommendations on legislative changes. It is also noteworthy that:

- Most states have established special task forces or commissions usually composed of the heads of the agencies most affected by program changes, the state's chief financial officer, the legislative leadership, and representatives from local governments and interest groups.
- Thirty states are using lead groups, either alone or in conjunction with task forces, to coordinate the work on block grant implementation.
- At least seven states—**Alabama, Florida, North Carolina, Tennessee, Vermont, Virginia, and West Virginia**—have held convocations, hearings, or workshops that dealt primarily with block grants and budget cuts.
- By the end of the year, six states had called special legislative sessions, and some others had dealt with block grant issues when their legislatures reconvened after summer vacations.

The (Fiscal) State of the States

The events that made federalism a talked-about issue in 1981—the election of Ronald Reagan and the Administration's proposals to revamp federalism while balancing the federal budget—were the culmination of trends that had begun several years before as the electorate became more disillusioned with all government and more reluctant to pay higher taxes or approve greater indebtedness in order to finance activities in the public sector. After rising dramatically through the 1960s and 1970s, federal aid (in "constant" dollars) to states and localities peaked in 1978, and then began a slow but steady decline over the next three years. Spurred by the \$2.3 billion loss of state General Revenue Sharing, aid to states and localities dipped sharply in FY 1982, as state-local spending also continued to fall. This decrease in the amount of federal aid has reversed a 30-year trend by changing the state-local sector from a fast-growth to a slow- or no-growth industry.

While these federal budget cuts have grabbed most of the headlines during 1981, they "pale by comparison with the cuts already going on across the country in states and localities," according to a **Washington Post** article in

¹Testimony of The Honorable Richard A. Snelling Before the Subcommittees on Intergovernmental Relations' Committee on Governmental Affairs, November 5, 1981, p. A 14.

**State Actions in Response to Federal Block Grants
as of December 15, 1981**

States	Executive Actions					Legislative Actions		
	Established Lead or Coordinating Agency	Created New Agency, Committee or Task Force	Conducted Public Hearings	Convened Con- vocations, Retreats	Called into Special Session	Established New Committee or Gave Existing Com- mittees Re- sponsibility to Oversee Block Grants	Made Changes in the Authority of the Governor (Over Block Grants)	Made Changes in the Authority of Legisla- ture (Over Block Grants)
United States, Total	30	32	31	7	6	29	7	15
Alabama	•	•	•			•		
Alaska	•							
Arizona		•	•	•				
Arkansas						•		
California						•	•	
Colorado		•				•		
Connecticut	•	•	•		•	•		•
Delaware		•	•					
District of Columbia	•	•						
Florida		•	•			•		
Georgia	•	•						
Hawaii		•						
Idaho		•	•					
Illinois	•	•	•					
Indiana	•	•	•			•		
Iowa	•	•	•	•		•	•	•
Kansas	•		•			•		
Kentucky			•			•		
Louisiana		•	•			•		
Maine	•		•		•			•
Maryland	•							•
Massachusetts	•							•
Michigan		•	•			•		
Minnesota	•	•	•			•		•
Mississippi	•	•	•			•	•	
Missouri		•	•			•		
Montana	•		•		•			•
Nebraska	•	•	•			•		
Nevada	•		•			•		
New Hampshire		•			•			•
New Jersey	•	•	•			•		
New Mexico	•	•	•			•		
New York		•	•				•	•
North Carolina			•	•	•	•		•
North Dakota	•		•			•		•
Ohio	•	•				•	•	
Oklahoma						•		•
Oregon	•	•	•	•		•		
Pennsylvania	•	•	•					
Rhode Island	•		•					
South Carolina	•					•	•	•
South Dakota	•	•						
Tennessee		•	•			•		
Texas		•						
Utah		•						
Vermont		•		•		•	•	•
Virginia	•			•				
Washington	•	•	•					
West Virginia	•		•	•				
Wisconsin	•				•	•		
Wyoming								

Source: ACIR staff compilations.

early May.² Caught between taxpayers' restiveness, rising interest rates, and high levels of inflation and unemployment, many states have had little choice but to cut back their budgets and bring their tax structures into line with citizen demands and expectations.

Between 1977 and 1980, largely in response to real or imagined after-effects of Proposition 13 fever, 36 states reduced their personal income tax rates, 22 cut sales taxes, and nine indexed their income taxes to protect citizens from "bracket creep" due to rising inflation. Today, a number of these states are suffering revenue shortfalls and are having to add rather than subtract taxes. Particularly targeted in 1981, were gasoline and various "sin" taxes such as on liquor and tobacco.

According to a survey conducted by NGA and the National Association of State Budget Officers (NASBO), the states, as a group, will be spending more than they take in during FY 1982, for the third consecutive year. Their aggregate general fund reserves will drop to a level sufficient to finance only four days of operations. This balance is expected to be less than 2% of expenditures or about \$2.3 billion by the end of FY 1981, down from 9% or \$11.3 billion at the end of FY 1980.³ Wide variations do exist among the states, however, with those dependent upon the automobile and housing industries showing signs of considerable fiscal strain, while energy-rich states that receive substantial revenues from severance taxes have been building large balances. For most of the states, however, the figures are overly optimistic, since they were compiled before the effects of the federal budget cuts and tax changes could be gauged. They are useful, however, as a measure of the states' fiscal health before the advent of the New Federalism. Clearly, many were already in serious fiscal trouble and their problems have been exacerbated—primarily by the continuance of serious inflation and unemployment and secondarily by the federal budget cuts. For example, a spot survey conducted by NGA in the fall of 1981, shows how the fiscal health of some states has deteriorated:

- In California, the governor issued an executive order reducing state agency budgets by 2% and delaying construction payments in order to reduce spending by \$460 million.
- Indiana agencies cut costs by 10% with further cuts expected before the end of FY 1982. A \$120 million emergency fund was used to alleviate cash-flow problems.
- The governor of Michigan issued an executive order to cut spending by \$270 million to cover an expected deficit. The state had a negative cash-flow balance of \$600 million and used its short-term borrowing power to alleviate the problem.
- In Washington, a revenue shortfall of \$655 million is expected for the biennium. All state agencies have been required to cut spending by 10.1% and tax increases may be necessary to avoid even deeper cuts from state programs.
- Wisconsin's governor cut state spending by 8% across-the-board. The state is using short-term borrowing to alleviate its \$150 million negative cash-flow balance.⁴

All states except Vermont are required by their constitutions to balance their budgets, and they are having difficulty in meeting that responsibility. Fortunately for state and local governments, however, tax-cut fever seems to be cooling. Voters in Massachusetts approved Proposition 2½ in November 1980, but other major tax limitation initiatives lost that year in both Oregon and Michigan. Tax-cut or spending-limit proposals also were defeated in Arizona, Nebraska, Nevada, Ohio, South Dakota, and Utah. Voters may have decided that, realistically, reductions in services and increases in taxes may well go hand-in-hand. For example, Gov. Al Quie of Minnesota, who came into office pledging to cut taxes and protect taxpayers against "bracket creep" through income tax indexation, found himself in May facing \$400 million in proposed new taxes and possible repeal of indexation. The box on page 34 describes this state's experience in performing its precarious balancing act.

State highway funding is another good example of state fiscal problems. The cents-per-gallon nature of most states' gasoline tax, coupled with reduced gasoline consumption, has produced fewer dollars for state highways. Meanwhile, inflation has driven up the cost of both maintenance and construction and the need for more money has put additional strain on the general revenue funds of many states. Some have had to make supplemental appropriations from general revenue to keep their highway departments solvent. Others, where certain functions such as the state police are paid jointly by general revenue and highway funds, find that reduced funding in one area puts tremendous pressure on the other. In addition, high interest rates and voter disapproval have combined to keep many states out of the bond markets. For example, voters in West Virginia turned down a \$750 million revenue bond amendment in November 1981. This defeat was noteworthy because it marked the first time in that state's history that voters had failed to ratify any road bond amendment appearing on the ballot. West Virginia has found that it must turn down some federal highway grant money, for it cannot meet the matching requirements. For that state, it has become a choice between completing highways already under construction or using available money to repair roads already built. In either case, the state must generate more revenue for the highway fund through increases in gasoline taxes or it must make supplemental appropriations from general revenue to cover the deficit.

Other trends for the states in the 1980s, are not fully developed in some areas, but certain patterns are discernible in others. Clearly the states' "middlemen" position in the federal system is growing as are the vertical and horizontal pressures that are being placed on state decisionmakers. State governments are being forced to raise taxes as well as cut levels of services, and this politically undesirable combination may well generate friction between the executive and legislative branches over policies, priorities, and programs. Balanced budgets require tradeoffs among vital services: education versus highways, social services versus capital improvements, general aid versus categorical programs. Budgeting is becoming even more of a zero-sum game where money channeled into one program will result in a like reduction in another program. States are under mounting pressure from local officials and interest groups to make decisions equitably and to fill holes in social "safety net" programs created by cutbacks at the federal level. While they have more authority over their own programs, there is not nearly enough money to satisfy all competing demands. And their actions

²"State Governments Facing Financial Crunch: Slack Economy, Tax Revolt Cited," *The Washington Post*, May 10, 1981, p. A 1.

³*Fiscal Survey of the States 1980-1981*, National Governors' Association and National Association of State Budget Officers, pp. 6-7.

⁴*Bulletin*, National Governors' Association, October 16, 1981.

will be scrutinized by Congressional committees, Washington-based interest groups, researchers, and others concerned about whether the states have the commitment and capacity to handle these responsibilities and eager to push for recentralization if they will not or cannot do so.

The Local Pinch

Fiscal problems facing some localities may well be even more severe than those bombarding the states. Many areas were feeling the pinch long before the federal budget cuts became reality. According to a Congressional Joint Economic Committee (JEC) survey, over 70% of the nation's largest cities were in deficit in 1980. Federal and state aid makes up 72 cents of every dollar of their revenue, and cuts in intergovernmental assistance will mean serious fiscal problems for some. The central cities of the northeast and the midwest may find it especially difficult to cope with the budget changes. They are suffering from a declining growth rate that has gradually eroded tax bases along with their credit ratings.

Ironically, these latest fiscal difficulties come at a time when some of the nation's largest cities have made considerable strides in putting their fiscal houses in order. The box on pages 36-37 describes the "boot strap" approach to solving the fiscal problems of three cities which have either defaulted or come dangerously close to default in recent years. It also details the impact of the budget cuts on these cities' precarious financial conditions. One of these, New York City, needs to spend about \$40 billion to repair and

rebuild its streets, sewer and water facilities, and bridges. Cleveland needs \$124 million just to repair its bridges.

Although the Sunbelt cities of the south and southwest are in better fiscal health, they are still feeling the pressure to upgrade infrastructures if they are to maintain growth rates and to continue. Cities have neglected to invest in sewer and support systems," according to a special report in *Business Week*. They have not maintained their investments in mass transit, and water and sewage treatment facilities necessary to sustain them. Dallas, Houston and Seattle, for example, have postponed building modern transit systems and are faced now with the reality of financing these improvements with little or no federal help.

Some cities are suffering under burdens imposed by tax bids or spending limitations. Boston lost \$100 million from its FY 1982 budget as a result of Proposition 2 1/2, passed last year, and it stands to lose another \$40 million as a result of the federal changes. Los Angeles, on the fiscal ropes because of high police and fire pension costs, will lose about \$80 million from the effects of Proposition 13.

For the past ten years state and local spending has been growing fastest in those areas now being most heavily cut back by the federal government: income support and social services programs, Aid to Families with Dependent Children (AFDC), Community Action Grants, Comprehensive Employment and Training Assistance (CETA) public service jobs and job training programs, housing assistance, food stamps, and school lunch programs are all being

Trends in the Fiscal Condition of Cities, 1979-1981, a Staff Study Prepared for the Use of the Joint Economic Committee, Congress of the United States, May 1981. Contact the Department of the JEC at Washington, D.C.

State and Local Government Finance, *Business Week*, October 1981, pp. 104-105.

State and Local Government Finance, *Nation's Cities Weekly*, August 1981, p. 10.

Minnesota and Budget Cuts

Overshadowing questions about the effect of federal budget cutbacks in Minnesota is a home-grown fiscal crisis that has defied resolution. Faltering economic conditions have repeatedly proven revenue projections wrong, with the result that three times in the past 18 months, the state's political leadership have been faced with the task of balancing a budget that won't stay balanced.

At the heart of Minnesota's problems are a sickly economy that is pushing tax revenues down and an indexed income tax that is keeping them there. The state's income tax was indexed in 1979, as part of a \$700 million package of income and property tax relief. Backers of the package included both Republican Gov. Al Quie, who made indexation an issue in his 1978 campaign, and the Democrats in the legislature, who pushed greater property tax relief for homeowners. Further tax cuts passed the legislature the next year, but by the middle of 1980, the bottom began to fall out of the state revenues that were the basis for tax relief.

Although the state's economy had long been considered highly stable, the new jobs added to it during the 1970s, in manufacturing and construction proved extremely vulnerable to economic downturns. Also hard hit by a nationwide economic slump were the state's mining and wood products industries. While the agricultural sector had taken up the slack in Minnesota's economy at other times, it, too, was lagging.

When budget cuts of \$195 million were needed in mid-1980, Gov. Quie made them unilaterally, making most of the reductions in state aid to education. Another \$500 million shortfall loomed at the end of the fiscal year in June 1981, though. The legislature took steps to balance

the budget, shifting certain state payments into the upcoming fiscal year, and, with the governor's approval, increasing the sales tax and adjusting the indexing formula to recover additional income. The lawmakers also raised the amount of short-term borrowing permitted to the state and voted to allow the budget to show a deficit during its two-year cycle.

The state was unable to extricate itself from its financial bind, however, as fresh revenue forecasts last fall projected a \$768 million deficit for the biennium that began Oct. 1. Gov. Quie called the legislature into special session in December, but vetoed a bill that relied on tax increases and further adjustments in indexation to ease the state's fiscal troubles. Given the financial pressures on taxpayers, he said, state expenditures should be cut by \$630 million, much of it in state payments to local governments for individual property taxes. The legislature was still seeking a solution at year's end, and some observers expected discussions to run until the regular session convened in January.

The fiscal uncertainty is taking its toll on local governments as well, since three out of four dollars collected by the state are returned to cities, counties, and school districts. Already local aid payments for November and December have been withheld. Local officials are especially concerned that failure to receive a legislative guarantee that the payments are forthcoming will leave them with deficits for the year. Such deficits could damage their bond ratings, a development that would mirror the state's difficulties. Standard & Poor's, the bond rating agency that last summer lowered Minnesota's rating, announced in December that ratings for the state's securities might be subject to yet another change.

—Robert Yeargin

The States' Capacity and Urban Policy: Cautious Optimism

State government, once described as "the weak sister" in the federal system, has transformed itself into a modern and capable unit of government.

The evidence for such an assertion is found in numerous constitutional and administrative reforms. One can point to dramatic contrasts between prevalent state institutional patterns of 1960 and 1980:

- Fifteen states in 1960, still saddled their governors with two-year terms, as against only four [in 1980], and 16 prohibited their chief executives from succeeding themselves, compared to five in 1980.
- While two decades ago 31 legislatures operated primarily on a biennial session basis, [in 1980] only 14 functioned in this fashion and these frequently were called into special session in the second year.
- Standing committee structures were a proliferating phenomenon in 1960, with the median combined figure for both houses standing at 48, but [in 1980] three-fifths of the state senates had 20 standing committees or less.

While state governments, indeed, have made substantial gains toward improving their capacity, uncertainty remains over how states will perform when their responsibilities are increased as the result of a reduced federal role. Such concerns are particularly acute when considering the states' historical performance in urban policy. Perhaps, the states' greatest programmatic failure in the last 20 years will become their most significant test in the next decade: providing adequate assistance to urban and distressed communities.

A reason for new concern over state aid to distressed communities is that the Reagan Administration, strong believers in the state governments' improved capacity, has attempted to replace the federal-local link with a new state-local partnership. President Reagan's philosophy is encapsulated in his "Principles of Federalism." Item number eight reads: "substitute, when appropriate, state government for the federal government in dealings with local government." As such, the small cities non-entitlement portion of the Community Development Block Grant (CDBG) has been reoriented away from a locally run to a state-administered program. At the same time, federal urban policies are being cut back: in job training, rent subsidy policy, and economic development. Federal budgetary and programmatic actions will challenge state policymakers to either begin new urban initiatives or leave the void created by federal program cuts.

The direction state governments choose may evolve largely from their existing urban policy capacity. In the forthcoming report, **The States and Distressed Communities: The 1981 Report**, ACIR attempted to measure the level at which states are currently assisting their distressed communities. The study reviews the progress states are making in housing, economic development, community development, fiscal reform, and local self-help programs. "Distressed communities" are defined as any areas (various types of general units of local government including rural, urban, and suburban places) which are declining or in need in relation to other areas of the state. Within the five program areas, 19 activities were identified

as significant indicators of state community assistance performance by state and local experts who responded to surveys conducted in 1979 and 1980. The survey findings revealed a consensus as to the most important actions that states might take.

In general, the ACIR research indicates that only a small number of the 50 states have made extensive use of the full range of powers and tools at their disposal. Only one state—**Massachusetts**—has adopted 15 of the 19 programs. Four states—**California, Connecticut, Michigan, and Pennsylvania**—have enacted 12 to 14 of the targeted aids. Nine states have nine to 11 of the programs; 27 states, five to eight; and nine states have one to four. In recounting these numbers, it should be emphasized that they include only those programs which are targeted according to the criteria which were developed for the ACIR report.

States, for obvious reasons, have been particularly slow in establishing urban programs in policy areas where there has been a traditional federal presence. For instance, states may have to respond quickly to fill voids left by federal budget cuts in the CETA and Section 8 rent subsidy programs. Currently, only three states have job training programs exclusive of federal funding, while eight states have multifamily housing programs independent of federal Section 8 monies.

Nevertheless, the ACIR data also suggest that those states with major urban populations or established urban strategies have created and maintained programs to assist distressed communities. For example, there is a high correlation between the extent of urbanization within a state and the adoption of the 19 programs. Conversely, those states with a largely rural population tend to have the least number of targeted programs. While the percentage of urban population within a state does not totally explain the adoption of targeted programs—other political and historical factors undoubtedly exert an influence—a relationship between urbanization and targeted state-local assistance nonetheless seems to be present. Of ten states that have adopted ten or more of the 19 programs, the median percentage of urban population is 80%, based on 1980 census data. In the 17 states which have adopted five or less of the 19 programs, the median percentage of urban population is a much lower figure, 54%. On the other hand, 11 states whose resident population is more than 70% urban have adopted only five to nine of the program indicators. States with predominantly urban political constituencies, because they tend to have a greater need for targeted programs, have been among the leaders in adopting aid for distressed communities.

Similarly, states which have adopted comprehensive urban strategies also tend to have enacted many of the programs in the 19 indicator areas. For example, of the eight state strategies described in the ACIR study, **California, Connecticut, Florida, Massachusetts, Michigan, and Pennsylvania** have policies in ten to 15 indicator areas, while **Oregon** offers eight of the targeted aids. Only **North Carolina** lags behind with programs in four indicator areas.

Therefore, while states prepare to test their capacity for handling block grants and other programs which traditionally have been a federal responsibility, there is some cause for optimism in the urban policy area. While on an aggregate level, the ACIR study demonstrates that the states' role in urban policy is largely unfulfilled, a closer examination indicates that in those states where significant needs exist urban programs have been established.

—Neal M. Cohen

reduced. Loss of funds in these assistance programs increases the pressures for additional services from local governments to the poor, the handicapped, and the elderly—many of whom live in the central cities.

When the local share of General Revenue Sharing was included in President Reagan's call for a 12% budget cut, local officials complained bitterly. This would have amounted to about a \$550 million reduction in local aid for FY 1982, beginning on October 1, 1981. These fears were allayed when Congress and the President reached an agreement to fund GRS through FY 1982, but the program's future beyond that point remains uncertain.

Given the uncertainty of federal aid levels and the taxing limitations that some localities face, many have sought to diversify their tax structures. According to the Municipal Finance Officers Association, user charges as a source of revenue increased by 19% between 1972 and 1979, and miscellaneous revenues jumped nearly 42% during the

same period. J. Richard Conder, a North Carolina county commissioner and first vice president of the National Association of Counties (NACo), pointed out the dilemma facing local officials who have only property taxes as their major source of revenue:

There is no way in the world we can continue to increase our property taxes on a local level and even live in a community, much less get re-elected. We had one case in North Carolina last year where one county commissioner got his necktie cut off. These people get hot down there. And they can find us. . . . So, we're the ones who are on the firing line. We've got to face these people every day.

Several trends emerge from the analysis of the role of local governments in the coming decade. Local govern-

Quoted in American Federalism in the 1980s: Changes and Consequences. Conference Summary, Staff Report 1981-82.

Three Cities Apply the "Bootstrap" Approach to Recovery

For three cities whose past financial troubles have put them in the national spotlight, last year's federal budget cuts pose yet another stumbling block on the road to fiscal stability. While recent reports have emphasized the progress of New York, Cleveland, and Detroit in handling their economic and financial hardships, how the cities will overcome this latest hurdle is not yet known; undoubtedly their responses will vary.

No one doubts that the cities' strides in dealing with their problems—both those that have been thrust upon them and those of their own making—are real:

- New York City, which weathered its fiscal crisis in 1975, last year balanced its budget according to generally accepted accounting principles for the first time in more than a decade, a year ahead of the schedule mandated by the state-established Financial Control Board.
- Cleveland voters approved a city income tax increase last February, the second since the city defaulted on short-term notes in 1978, and the city's budget director is projecting a \$4 million surplus for the current fiscal year.
- In Detroit, voters boosted the local income tax last June, and public workers have foregone pay raises to keep the Motor City dependent on the stricken auto industry, rolling.

The budget cuts will make it more difficult for the three cities to hold their own from here on, though. New York City expects to sustain losses of about \$700 million, of which \$177 million supported public service employment under the Comprehensive Employment and Training Act (CETA). Also lost will be federal dollars for AFDC, Medicaid, mass transit, highways, and wastewater treatment facilities. In Cleveland, officials must plan around a \$36-million hole left by the cutbacks to achieve the balanced budget required by the city's state-established fiscal commission. CETA salaries accounted for approximately \$18 million of the total loss. Public service employment cuts put Detroit in a bind as well. When city officials

decided to put 1,800 CETA workers on the city payroll because their work was essential, the result was to add \$36 million to a deficit for the last fiscal year that at one point reached a projected \$200 million.

The reductions in federal aid that the cities have absorbed are modest compared to their total budgets: \$15 billion in New York, \$1.5 billion in Detroit, and \$550 million in Cleveland. Yet balancing these budgets has required both skill and luck under the best of circumstances recently. And when a city is flirting with a deficit, a few million dollars make a difference, as Detroit's experience with lost CETA funds illustrates. A major difficulty is that both Detroit and New York depend on state and federal help for as many as 40% of the dollars they spend each year. And funds that are available one year may not be the next. In fiscal 1980, for example, Detroit supplemented its own tax revenues of \$870 million with \$620 million in state and federal aid. Of that total, CETA funds, General Revenue Sharing, and countercyclical aid accounted for approximately \$170 million, while community development block grants and urban development action grants provided another \$100 million. Gone now is countercyclical aid, which helped cities weather economic downturns in the 1970s, while CETA, community development block grants, and urban development action grants have all been scaled down in varying degrees by the Reagan Administration.

Between federal cutbacks and adverse economic conditions, local leaders will not be able to depend on state aid, either. In Michigan, for example, observers note that the state government is in even worse financial straits than Detroit. State revenue sharing has been among the programs trimmed as continually slipping revenue projections have forced a series of budget cuts over the last year. The fiscal year that began last October has already seen state spending reduced by \$270 million, and another quarter-million-dollar cut is projected for the spring of 1982.

More than ever, then, cities such as Detroit, New York, and Cleveland will be thrown back on their own resources. But long-term trends and short-term reverses in the economy are sapping local resources. While Detroit's business community has played an active role in helping rebuild the city, the ever-deepening slump in car sales is taking its toll on the auto manufacturers. The Ford Motor Company's plan to occupy a large portion of the expanded Renaissance Center, for example, has fallen victim to losses of \$2 billion over the past 21 months. And the company is reported willing to sell all or part of its 65% interest in the main complex.

ments and nonprofit organizations are apparently losing much of their special relationship with Washington and being compelled to develop a closer working partnership with their state governments. Cities are focusing on providing traditional essential services—fire and police protection and education, and are exploring the roles that volunteers or the private sector can play.

Many have begun looking for areas where spending can be cut without jeopardizing essential services. In his March 2, 1981 speech to NLC delegates, the President pointed out the need for cities to make wise choices about how their money will be spent.

We're giving local government the power to decide what will be done with the money. Handled efficiently, the level of benefits may not suffer as might be suggested at first glance, however, there could well be something in local government that can, and should be, cut back

Even a revival in auto sales, though, is unlikely to reverse the trends of the last 30 years. Detroit has been losing population for three decades and, for much of that time, manufacturing jobs as well. Providing almost half of the area's employment in 1960, manufacturing accounted for less than a third two decades later. Contributing to that slide in the future will be the auto industry's shift to smaller cars, which will not require as many workers to assemble.

Many of the forces at work in Detroit may be found in Cleveland as well. Now with 576,000 citizens, the city lost almost a third of its population between 1970 and 1980. During the same period, about 20% of its manufacturing jobs were lost and the property tax base dropped 37% in real dollars after being adjusted for inflation.

As befits the nation's largest city, the case of New York is more complex. To a great extent, its economy has made a transition from manufacturing to one that is largely service-based. Service-related employment now accounts for 40% of the city's work force, up from 25% two decades ago, while manufacturing jobs have slipped from a quarter to 15% of the total. The loss of 600,000 jobs between 1969 and 1975, included many in manufacturing, and more than half of the 110,000 jobs that have been created in the past three years have been in the service and finance areas, such as banking, advertising, consulting, law, and data processing.

This transformation has served New York well at a time when recession has hit manufacturing centers particularly hard. The city's employment picture has remained healthy, and inflation has provided windfall receipts from sales, income, and business taxes. This extra income—and more generated by rapidly rising property values in Manhattan—enabled the city to balance its budget a year earlier than required. Reduced state income taxes have also stimulated the city's economy, helping to stem the outflow of private sector jobs.

This picture of relative fiscal health is misleading, however, because the city's economy generates only 60% of the funding New York needs. Most of the rest must be obtained from Albany or Washington. But state and federal governments, facing their own financial difficulties this year, certainly will not be able to give New York City all its wants or needs. What city officials cannot get in long-term intergovernmental assistance, then, they will seek out in "one-shot" revenues that help balance the budget, such as \$100 million the city received from Washington last year to purchase land for the Westway highway

during times of economic hardship. If so, (cities) will decide where cuts will be made if cuts are necessary.

Changes in State-Local Relations

Coupled with the effects of a sluggish economy and the taxpayers' revolt, the federal block grants and budget cuts are causing dramatic changes in state-local relationships. The heavy cutback in federal aid and the designation of states as prime block grant recipients have made local officials decidedly uneasy. As administrators of the new block grants, the states must now make the painful choices—which programs should be continued, which should be cut, and by how much. They must also decide how to deal with cities facing bankruptcy, how to target funds so they will reach those areas and citizens most in need, and how to respond to increased political pressure from interest groups and local elected officials as well as from a middle class fed up with too many federal and state

project. Budget officials, who have been criticized in the past for forecasting revenues too conservatively, say that because the economy has slowed, the city should not expect revenues beyond those projected this year. For the longer run, there are fears of a \$1 billion shortfall in fiscal 1983.

In a sense, the three cities exemplify the "era of limits" that has arrived for local governments across the country. Cleveland and New York, working out their fiscal salvation under state supervision, have illustrated the hard lesson that cities, like individuals, must live within their means or suffer the consequences. Elected officials and voters alike have responded to the cities' financial crises by taking steps that were not feasible before. In New York, approximately 75,000 municipal jobs, a quarter of the total, were eliminated from the payroll. The process claimed 20% of the police force, 19,000 teachers, and 2,000 of the city's 2,500 street sweepers. Cleveland had to default in 1978, before voters would increase the municipal income tax, which at 1% was among the lowest in Ohio. They balked at another hike—from 1.5% to 2%—in November 1980, before finally accepting that one last February. But a new atmosphere, illustrated by \$200 million in new construction downtown, has replaced the open antagonism between city hall and the business community that led up to the city's default.

Detroit, on the other hand, is demonstrating how strong political leadership can keep a city from sliding into insolvency. Public employment there has been trimmed as the population has dropped over the last 30 years, but the city's current financial weakness has called for strong medicine to ward off potentially terminal problems. That medicine took the form of a three-part fiscal package with a city income tax increase—on both residents and commuters—as its centerpiece. Playing a large part in the voters' approval of the increase last June was enthusiastic support from Detroit's corporate community, which donated almost a half million dollars, far more than its goal, to pay for the referendum. Before the city could collect the tax, though, public unions had to agree to forego wage increases already in their contracts and the city had to sell \$113 million in bonds to cover its deficit for the last fiscal year. Mayor Coleman Young used muscle where necessary to make the package work; when one union balked at giving up its raises, he did not hesitate to pass out 600 layoff notices to underscore his point that failure to agree would mean lost jobs.

—Robert Yeargin

programs and accompanying regulations. How are these issues affecting the relationships between states and localities? In a climate of growing scarcity, when local governments rely on federal and state aid for nearly 80% of their own-source revenues, local officials are more than a little reluctant to end their special relationship with Washington and trust their fiscal fate to state officials.

Local officials feel they have had good cause to fear negotiating with their state leaders. Governors and mayors of the larger cities have been traditional rivals for power within a single state and this may be their greatest reason for distrusting one another. Presidents often have their favorite big city mayors, but governors seldom do.

The mayors are not alone in looking toward the state capitols with a jaundiced eye. Columnist Neal Peirce points out that the states' past record

makes many minority and poor people's groups anxious about reform of the system. And they remain nervous even if they are shown studies by the National Governors' Association and others which purport to demonstrate that state aid is now, in fact, more responsive on the average, to geographic areas of poverty and need than are federal programs.⁹

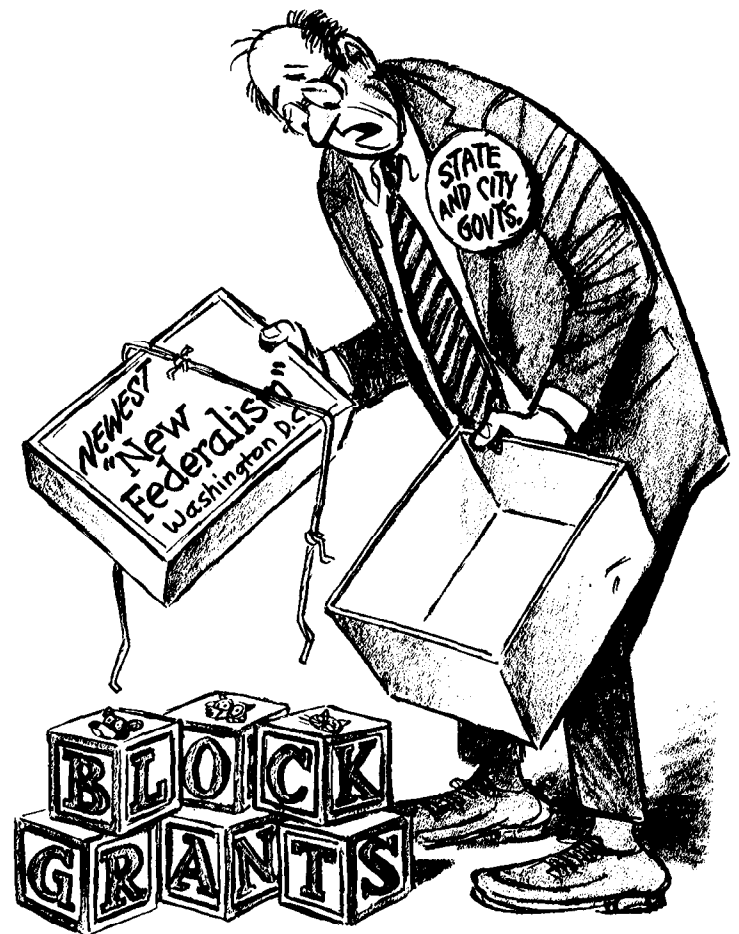
Gov. George Busbee of Georgia, past president of NGA, reminds states and localities that their mutual interests should be closer together, but he admits past mistakes by state leaders have made cooperation more difficult.

You might think that a state-local alliance would be the most natural thing imaginable, and in fact, I do think our differences have been somewhat exaggerated. Still, the anxiety expressed by so many local officials over the new authority of the states in administering block grants is an indication of a sad reflection on state-local relations when so many mayors and county officials seem to trust an anonymous federal bureaucrat on the other end of a telephone line, more than they trust their elected state officials. . . . In part, I believe that this deterioration of trust and communication can be attributed to mistakes the states made in the past in looking after the needs of our cities and towns.¹⁰

For some states the problems grow more acute, since they cannot afford to help their local governments now even if they would like to. For example, Colorado had expected a surplus of nearly \$150 million at the end of FY 1982. Instead, it is experiencing real difficulty in balancing its budget after federal budget cuts went into effect. Tensions are mounting between the state and the City of Denver whose officials argue that they should not have to pay for providing health care, museums, a zoo, and other cultural facilities to people who come to the city from all over the state. Randy W. Harrison of the Colorado Commission on State and Local Government Finance warned that "we are going to have to live with these kinds of arguments on a continuing basis."¹¹

Colorado's experience calls into question the ability of the states to respond to pressures from the federal government to accept more responsibility for state and local programs and from localities to handle the block grants and budget cuts so there will be no major cutbacks in

"NOT QUITE THE BUILDING MATERIALS I WAS HOPING FOR"



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services at the local level. The answer involves more than the fiscal conditions of the states. What is their capacity to respond politically and institutionally?

Recent studies indicate that they may be in better shape than ever before. While attention has been focused on Washington, the states have been involved in a "quiet revolution" that has left them much changed from the weak partners they were a quarter of a century ago. A recent ACIR report indicates that "state governments have been transformed. Continuing a reform period unparalleled in their history, they are emerging, for the most part, as competent, vigorous, and assertive government. They are more open, more responsible, more accountable than they were in the past." Most have modernized their constitutions, strengthened the role of their chief executives, and provided more and better trained staff for their legislatures, most of which now meet annually.

While addressing the Council of State Governments' Governing Board on December 11, 1980, Gov. Robert List (NV) pointed out that states have obligations as well as rights:

⁹"A Look At Our Flawed Federalism—Bypassing the States," Neal Peirce, *Education Times*, March 3, 1981, p. 2.

¹⁰Quoted in *The States and Distressed Communities: The 1981 Annual Report*, Advisory Commission on Intergovernmental Relations, Washington, DC.

¹¹*Business Week*, p. 163.

We have begged for a chance to "come to bat," and I believe the president-elect is receptive to our plans. It is now time for us to accept this offer and to show the nation we understand that states' rights also means states' responsibilities.

A question remains, however, about the connection between a state's move toward modernization or reform and its ability or willingness to perform its role as middle-man in the intergovernmental system. While it is far too early to tell how well states will perform, there is some concern that whatever flexibility is provided by the new block grants may never reach the local level. One of local officials' greatest fears is that states will administer the new block grants much like categoricals. If so, localities will receive fewer state and federal dollars and those dollars may well be tied up with more state strings.

A second source of potential conflict between the states and their local governments stems from state-imposed constraints placed upon localities' ability to raise revenue. If localities are hampered by tax lids, expenditure limits, debt limitations, and/or fixed boundaries that handicap the cities from expanding their territories in order to draw upon the more affluent suburban fiscal base, then it will be even more difficult for them to deal with the current fiscal crunch or to meet block grant matching requirements imposed by the states. A related area of disagreement involves state mandates which require certain actions by local governments without providing funds to cover the cost of carrying them out. For example, states often set pension levels, wages, and working conditions for municipal or county employees or grant collective bargaining rights without fully weighing the consequences for local officials. One 1981 example, recently struck down by the courts, was a Massachusetts law requiring cities and towns to maintain certain levels of police and fire protection in spite of severe revenue reductions resulting from passage of Proposition 2½. Some progress has been made in this area for currently, at least 30 states have enacted legislation calling for fiscal notes on the cost of state-imposed requirements. Localities still have cause for concern, however, since only 14 states have mandate reimbursement laws.

Even though local officials, accustomed to taking their problems to Washington, are not optimistic that they will receive the same sympathetic hearing when they visit their state capitols, there is mounting evidence that shared problems may finally bring them and their state counterparts to the bargaining table. The peace initiative has come primarily from the nation's governors, who, after supporting the move to free more grant money from federal strings, found themselves saddled with deeper budget cuts than they had anticipated. Responding to the need to discuss common problems, NGA, for the first time in its history, invited a panel of mayors and county officials to appear at its 1981 annual meeting in Atlantic City. The local officials aired their grievances with the governors in what has been described as a "strained but polite" discussion. They reminded the governors that cities must have broader authority from the states to levy local taxes if they are to maintain basic services in the face of mounting economic pressure. Mayor William H. Hudnut, president of NLC, pointed out to NGA that if the present era "... signals a ... shift in American politics—toward a far more parsimonious federal government over years to come then the states, cities, and counties will either sink or swim together. This is a new day when we're all poor together.

So we'd better get together."¹²

As the first step of "Operation Olive Branch," the governors at that meeting established a new standing committee on state-local relations. A similar cooperative effort was undertaken by the International City Management Association (ICMA) which created a state-local "network" to "ensure a responsible and fair implementation of the President's New Federalism, including the nine new block grant programs."

Changes in State Executive-Legislative Relations

The same pressures that are driving states and localities closer together, may also convince governors and legislatures that the time has come for greater cooperation between their branches of government. Clearly, federal agency officials working with state representatives on block grant transition questions were unprepared for the strength of the legislative-executive battles that quickly developed in the wake of block grant passage: Their previous experience had been primarily with state executive agency personnel. In the early 1960s, as the intergovernmental grant system expanded, governors began applying for aid directly through their agencies and many state legislatures were completely bypassed in the process. There are now indications that the state legislatures are beginning to take their policymaking responsibilities more seriously. At least 11 have assigned themselves formal roles in dealing with the new block grants. These range along a continuum of involvement from joint legislative-executive committees formed especially for the purpose of handling block grant money to interim committees empowered to allocate funds when the legislature is not meeting to laws passed requiring that block grant funds be divided in the same proportions as the categoricals they replaced or requiring that the legislature be called back into session if Congress approved the grant changes.

The legislatures have become more concerned in recent years with their role in providing oversight of federal funds, often through the appropriations process. The renewed emphasis on block grants has speeded up the trend toward more involvement in this area, and 1981 was a banner year for passage of bills dealing with state legislative oversight of federal money. According to an NCSL survey, about 40 states have instituted procedures that give their legislatures more control over federal funds entering their states. In addition, states are establishing "tracking" systems to determine how many federal dollars are coming into the state and how they are being used. They also have enacted measures calling for legislative approval of federal grant applications. The box on page 57 examines 1981 actions of state legislatures in this area.

State legislators will be under more pressure from local officials and interest groups as the focus shifts from Washington to the states. They will also be pressured by governors seeking their cooperation in making program decisions and distributing the blame for cuts. Private nonprofit groups like United Way of America are pushing for strong legislative oversight of the block grant funds, for they feel they can gain access more readily to the legislative branch. Federal agencies have been pushing both legislatures and governors to pick up administration of the new block grants as soon as possible. The agendas of state legislative bodies will undergo radical change in the coming decade as they face the fundamental decisions involved in cutback man-

¹²"Olive Branch From the Governors: State-Local Relations Panel Formed," Neal R. Peirce, *Nation's Cities Weekly*, August 31, 1981, p. 1.

agement. The changes in executive-legislative relations, especially the struggle for control of reduced federal dollars, may well be one of the most important consequences of the New Federalism, second only to the reinforcing of traditional state-local ties and the eroding of many direct federal-local contacts and "leapfrog" tendencies. In short, much more than in decades past, the states' actions and reactions will be under the intergovernmental spotlight during the 1980s.

The Road Ahead

As the preceding discussion indicates, intergovernmental relations in the United States are undergoing dramatic and rapid change unparalleled in recent history. The latest

A Banner Year For Legislative Oversight of Federal Funds

Although increased state legislative oversight of federal dollars was recognized as a trend by ACIR and others during the late 1970s, 1981 was clearly a banner year for legislative action in this area with four states, **New York, Massachusetts, Oklahoma, and Iowa** enacting strong oversight measures calling for legislative involvement in applications procedures, the appropriations process and "tracking" federal dollars coming into their states.

Probably the most interesting action took place in **New York** where for a while the issue was under consideration in both the courts and the legislature.

The court battle was initiated by the legislative leadership which claimed that the current system where the legislature did not appropriate federal funds was unconstitutional. Following two differing opinions, the New York Court of Appeals, the state's highest court, sided with the lowest court that the state's constitution requires "specific legislative appropriation each time the monies in the state treasury are spent."

The day after the final decision was handed down, the governor signed into law the **Accounting, Financial Reporting and Budget Accountability Reform Act of 1981**, which overhauls and streamlines the state's financial management practices as well as setting forth specific procedures for legislative appropriation of federal funds and approval of federal grant applications.

The measure says that no state monies may be expended except through state appropriation and generally prohibits transfer of money between funds without specific authorization by statute. It gives the governor the right to make "emergency" appropriations from various funds if the revenues exceed the appropriation authority.

Under the application review procedures set out in the law, the chairman of the Senate Finance Committee and chairman of the Assembly Ways and Means Committee approve, modify, or disapprove agency applications for federal grants.

The 1981 Massachusetts enactment, drawn in large measure from ACIR's model bill, requires legislative approval of all federal grant applications as well as providing for legislative appropriation of federal funds. It says that no state agency may establish new, or expand existing, programs involving federal monies beyond the scope of those already established, recognized, and approved by the General Court and that no state agency may make expenditures of any federal grant funds unless such expenditures are made pursuant to specific appropriations. If federal grant funds become available after the appropriations

effort to "rebalance" federalism could well have drastic and lasting effects on the role, functions, and powers of all three levels of government. As the "keystones of the governmental arch," however, the states will bear much of the burden for keeping a balanced intergovernmental system in place during the 1980s.

While the states' institutional modernization scorecard is well-known, their capacity to absorb and compensate for federal aid cutbacks will be demonstrated over the next few years. The extent of executive, legislative, and judicial reforms over the past two decades suggests that the states as a whole are more representative, more responsive, and more responsible than ever before. But how each will actually adjust to this period of fiscal retrenchment and

measure has been enacted, the treasurer may accept those monies and the governor may spend them for one fiscal year after submitting to the chairman of the house and senate committees on ways and means a statement describing the proposed expenditures and explaining why they were not available and could not have been anticipated as part of the budget process.

A veto of the Massachusetts bill was overridden by the legislature.

In 1981, **Oklahoma** enacted, also over the governor's veto, a measure outlining detailed procedures for legislative involvement in agency applications for federal funds and setting up a tracking system for federal funds coming into the state.

The new law established a Joint Committee on Federal Funds made up of ten members of the Oklahoma legislature who approve, disapprove, or recommend amendment of grant applications and comprehensive state plans. The Committee's role as set out in the measure is a strong one. No agency, board, or commission can apply for federal financial assistance or expand federal block grant funds after action to amend or disapprove as provided in the law.

Although the measure did not deal with appropriating federal dollars, a November 1981, attorney's general opinion may well prompt the legislature to tackle appropriations as well. It said, in part, that "federal funds received by agencies of state government are subject to the provisions of the Oklahoma Constitution . . ." including the appropriations process. The attorney's general opinion has the effect of law unless overturned by the courts.

appropriate all block grant funds and sets forth a procedure for legislative review of applications for categorical grants for FY 1982, ending in Iowa in June 30, 1982.

In order to better "track" federal funds, the legislature asked the comptroller to prepare a list of federal funds anticipated to be received and expended by state agencies during FY 1982 and 1982, including for each amount anticipated the agency designated to administer the funds, the program for which the funds will be used, and the amount of any state funds that will be used to match or supplement the federal funds.

In addition, federal funds should be included in the governor's budget, including how the federal funds will be used and the program to which they will be allocated. The amount of state funds required to implement the program to which the federal funds will apply shall also be indicated. If some federal funds were not included in the governor's budget because of time constraints, a supplemental statement should be sent from the governor listing federal funds received and including how those funds will be used and the programs to which they will be allocated.

—Carol Weissert

administrative decentralization remains to be seen.

At this point it is possible only to speculate about the states' response to the New Federalism. However, at least three areas will receive close attention in the months ahead as implementation progresses.

First, some observers question whether the states will give local units what the latter consider to be a "fair share" of federal block grants. Even where mandatory passthrough requirements are contained in federal law, officials of local governments or nonprofit agencies which previously enjoyed a direct relationship with Washington worry that their state might not be as sympathetic and responsive as Congress and the federal bureaucracy, or might accord statewide needs top priority over individual local needs.

On the other side of the coin, supporters of the Administration's proposals point out that by designating the states as prime recipients the block grants are helping to re-establish and reinforce traditional state-local ties. This new partnership should promote greater state understanding of and sensitivity to local problems—a development recently underscored by the outreach efforts of some state and local public interest groups. Another encouraging sign is the demonstration by a growing number of states of their recognition of local needs and willingness to take remedial actions by targeting their funds on economic development, housing, education, and social service undertakings in distressed communities.

A related area of doubt concerns whether the discretion that the block grant and regulatory relief initiatives seek to give subnational units will be reinforced or thwarted by the states. This is especially a concern of local officials, who fear that state "strings" will replace federal rules, regulations, and requirements as the states attempt to ensure their accountability for the proper expenditure of public funds. In some of the block grants, for example, this tendency could mean that increased discretion over the use of federal monies would be enjoyed only by the states; for substate and local units, categorical relationships would persist with a state rather than a federal agency making award decisions. Similarly, if the states do provide increased aid to localities to help fill program gaps resulting from federal funding reductions, it is possible that the dollars will be accompanied by additional administrative and fiscal strings.

On the other hand, undoubtedly administrative deregulation and program retrenchment will trigger suits by individual and jurisdictional recipients of former categorical funds and interest groups associated with previously regulated activities. Detailed procedural requirements are one way in which the states can protect themselves, and perhaps local governments, against charges of discriminatory practices. It is also noteworthy that over the years, the states as well as the courts have granted more and more discretionary authority to local governments over structural, functional, personnel, and fiscal matters. In a retrenchment environment where flexibility is vital, this willingness could extend to local use of federal funds.

A third area of interest has to do with the states' institutional capacity to shoulder more "middlemen" responsibilities. Despite modernization, or perhaps because of it, while governors now have more control over the executive branch, state legislatures have strongly asserted themselves in federal aid matters. Given the political repercussions of program cutbacks, it is likely that legislatures will use the power of the purse to assure themselves a prominent role in reallocating federal funds. This could well generate

friction between the branches, and make the transition from categorical to block grants, or the phase-out of categorical, both controversial and lengthy. This is especially the case, of course, in states where a different party controls each branch. Compounding the problems of this situation is the possibility that some legislatures may find their zeal far exceeds their capabilities. The budget is a continuous process, yet many legislatures still meet for relatively short periods of time and a few still meet biennially. Even those which use interim committees for fiscal matters often find budgeting to be a complex and time-consuming task which has little appeal to many legislators. Hence, reviewing and making decisions on federal aid appropriations could become a fairly superficial exercise.

At the same time, over the past decade most states have moved to establish machinery to "track" federal dollars coming in to the state, review federal aid requests, and/or appropriate federal funds. They are acquiring the professional staff and program experience to exercise effective oversight. These assets will prove valuable during the current cutback period, and should help ensure responsible legislative actions on federal aid matters.

In the final analysis, while the jury will be out for some time on the foregoing issues, clearly state and local governments have reached what may well be a watershed for federalism. After years of concern and complaints about a "congested" federal system, a significant and more than likely sustained effort is underway to relieve congestion. The fiscal effects of denationalizing activities are and will be unpleasant for many jurisdictions. The new administrative and allocative responsibility may well rest uncomfortably on the shoulders of some state and local officials, particularly since they may become defendants in court actions. And for many individuals as well as governments, "doing more with less" will be a reality rather than a slogan.

Yet, perhaps never before have state and local officials been challenged to do things that otherwise would not or could not have been done. The New Federalism gives them a chance to make their operations more efficient, effective, equitable, and accountable—in short, to fully exercise the powers and resources they have acquired over the years in response to the reformers' pleas for institutional modernization. Programs which have served their purposes or are ineffective can be eliminated or retooled, new priorities can be set, opportunities for shifting functions to other levels on a contractual or permanent basis can be explored, partnerships with citizen volunteers and neighborhood groups can be forged, and privatization of certain services can be accomplished. This opportunity to develop creative solutions to public sector problems could well be one of the most exciting consequence outcomes of the New Federalism. Both practitioners and academicians will be keeping a close watch on the states to see how they respond to this challenge in the years ahead.

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And Briefly: Books

In 1981, the Advisory Commission on Intergovernmental Relations issued 18 reports, ranging from assessments of federal, state, and local governmental roles in the federal system to studies on comparative federalism; from an analysis of state-local relations bodies to a compendium of data on the fiscal aspects of federalism. It produced five volumes of its study, **The Federal Role in the Federal System** and three in a series on comparative federalism. In addition, the Commission published four issues of **Intergovernmental Perspective**, three **Information Bulletins** and two **In Briefs**.

Single copies of the reports described below are available from ACIR, 1111 20th Street, N.W., Washington, DC 20575.

The five volumes in the Commission's work on **The Federal Role in the Federal System** published in 1981 are:

The Condition of Contemporary Federalism: Conflicting Theories and Collapsing Constraints (A-78).

This volume examines the historical, Constitutional, fiscal, political, and other forces that have shaped our federal system for 200 years and which continue to exert influence at the present time. Since 1937, the report documents, Constitutional limits on the size and scope of the federal government have been greatly diminished. Further, political constraints have yielded in the face of public opinion which now expects the federal government to play an active role in a wide variety of areas. Fiscal constraints have limited the growth of state and local governments while the federal government with its strong personal income tax system continued to grow at a greater rate. This report finds that changes in public opinion, judicial decisions, and the relatively strong fiscal position of the federal government for many years all contributed to the increased role for the federal government.

Intergovernmentalizing the Classroom (A-81).

This case study on federal aid to

elementary and secondary education revealed that, although the federal contribution to total elementary and secondary educational expenditures is only about 8%, the federal role in basic education is an important one, much more so than it was just 20 years ago.

The Evolution of a Problematic Partnership: The Feds and Higher Ed (A-82).

This volume traces the federal role in higher education from land grants made to the states in the 19th Century to the formation of the U.S. Department of Education. Federal Financial aid for higher education, very modest until the 1940s, skyrocketed to about \$11.75 billion in 1977, constituting about one-third of total private school funds. In addition, federally imposed rules and regulations, ranging from health and safety to affirmative action, have stirred considerable controversy in higher education.

Protecting the Environment: Politics, Pollution, and Federal Policy (A-83).

This report looks at the dramatic expansion of the federal government's activities designed to protect the environment. Interestingly, the study revealed that the effect of increased federal intervention has been to increase the states' role in environmental protection as well.

An Agenda for American Federalism: Restoring Confidence and Competence (A-86).

The centerpiece of ACIR's federal role study is this volume which explores where the federal system stands today, how it has changed, particularly over the past 20 years, and what can be done to improve it. Many types of policy producing and policy shaping variables were found to contribute to the growth of the federal role, but it was the individual member of Congress, either acting alone or in concert with others, who stood out as having the single most profound and

constant influence.

Based on the findings of the study, the Commission adopted a series of recommendations for restoring balance to federalism. These recommendations are contained in this volume.

The Federal Influence on State and Local Roles in the Federal System (A-89).

Washington's influence on the day-to-day roles and responsibilities of states and localities is documented in this report, one of a two-volume study entitled **State and Local Roles in the Federal System**. Two kinds of federal actions are looked at: those intended to affect "who does what" at the state/local levels and those unintended, but nonetheless influential, actions.

Payments in Lieu of Taxes on Federal Real Property (A-90).

This report contains major conclusions and Commission recommendations relating to whether the federal government's exemption from state and local real property taxes should be modified or eliminated. ACIR estimates that states and localities lose some \$3.5 billion in property taxes due to this exemption on property such as office buildings, post offices, and military bases.

Fiscal Management of Federal Pass-Through Grants: The Need for More Uniform Requirements and Procedures (A-102).

This study focuses on requirements imposed by OMB Circular A-102 from the national level through the states to the ultimate recipient and includes the Commission's recommendations for improved administration.

Regional Growth: Interstate Tax Competition (A-76).

This report, the third volume of ACIR's series on regional development, looks at the effect of interstate competition on regional growth. The Commission found that although variations in state and local tax levels do exist, tax differences are not a major cause of

regional competition for people, capital, and jobs. However, the Commission noted that within a region—and particularly between states in the same metropolitan area—interstate tax differentials can become the “swing” factor in industrial decisions.

State-Local Relations Bodies: State ACIRs and Other Approaches (M-24).

The various approaches states have taken to studying and improving state-local relations are documented in this report. State and local officials have, in recent years, become more sensitive to intergovernmental issues and their approaches to addressing these issues were found to take five basic forms.

The States and Distressed Communities: The 1980 Annual Report (M-125).

This report, a joint product of ACIR and the National Academy of Public Administration (NAPA), reviews five policy areas and 20 state activities selected as priority community assistance items from surveys of state and local officials.

The Future of Federalism in the 1980s: Reports and Papers from the Conference on the Future of Federalism (M-126).

The papers commissioned for the Conference on the Future of Federalism convened by ACIR on July 25-26, 1980, are contained in this report. In addition, papers by ACIR staff examine the problems of forecasting the future and review the fundamental changes in American federalism over the past 20 years.

Studies in Comparative Federalism: Canada (M-127), Australia (M-128), and West Germany (M-129).

The Commission issued three reports on comparative federalism, studies requested by Congress in 1976. Each examines how other countries with federal systems, Canada, West Germany, and Aus-

tralia, have dealt with current issues of fiscal federalism.

Measuring Local Discretionary Authority (M-131).

A new composite index to measure the degree to which states allow localities to conduct their own affairs is presented in this report. The index was developed to give a general indication of the relative standing of the 50 states in the critical area of discretionary authority.

Significant Features of Fiscal Federalism 1980-81 Edition (M-132).

This year's edition contains a wealth of information about federal, state, and local taxing and spending, both historically and currently. For the first time, state-by-state fiscal profiles are also included allowing the reader to grasp at a glance the fiscal landscape by state and region.

1981 Changing Public Attitudes on Governments and Taxes (S-10).

ACIR's tenth annual survey of public opinion on governments and taxes revealed that public preference as to what programs belong at which level of government is heavily influenced by terminology. The question asked was “From which functions would you like to see the federal government withdraw?” When the choice presented was welfare, 39% felt Washington should give it up; but, when the choice was listed as “aid to the needy,” that percentage dropped to 17%.

In response to the question, from which level of government do you get the most for your money, a plurality of 33% of the respondents chose local government, followed by 30% selecting the federal government. This was only the second time in a decade that local governments received the highest proportion of public support.

In Brief: State and Local Roles in the Federal System (B-6).

This In Brief summarizes the Commission's research findings and lists recommendations from the

Commission's two-volume series on state and local roles in the federal system, a companion series to its work entitled **The Federal Role in the Federal System: The Dynamics of Growth.**

The In Brief describes the states' movement from “fallen arches” to “arch supports” and local governments' role as federalism's work-horse. It describes the fiscal picture of both state and localities and describes ACIR's blueprint for strengthening state-local relations.

In Brief: Payments in Lieu of Taxes on Federal Real Property (B-5).

An executive summary of the Commission's two-volume study on tax-exempt federal property is available.

The three **Information Bulletins** published by ACIR in 1981 are:
Urban Enterprise Zones: An Assessment of their Deregulatory Components.

State Efforts to Prevent and Control Local Financial Emergencies.

Federal Block Grants: The States' Early Responses

The four **Intergovernmental Perspectives** issued in 1981 are:

“1980 Spotlights Rebalancing Federalism,” Winter 1981

“From Washington to States and Localities: Decentralization Via Block Grants and Turnbacks,” Spring 1981

“Washington's Regulation of States and Localities: Origins and Issues,” Summer 1981

“The Courts as Umpires of the Intergovernmental System,” Fall 1981.

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