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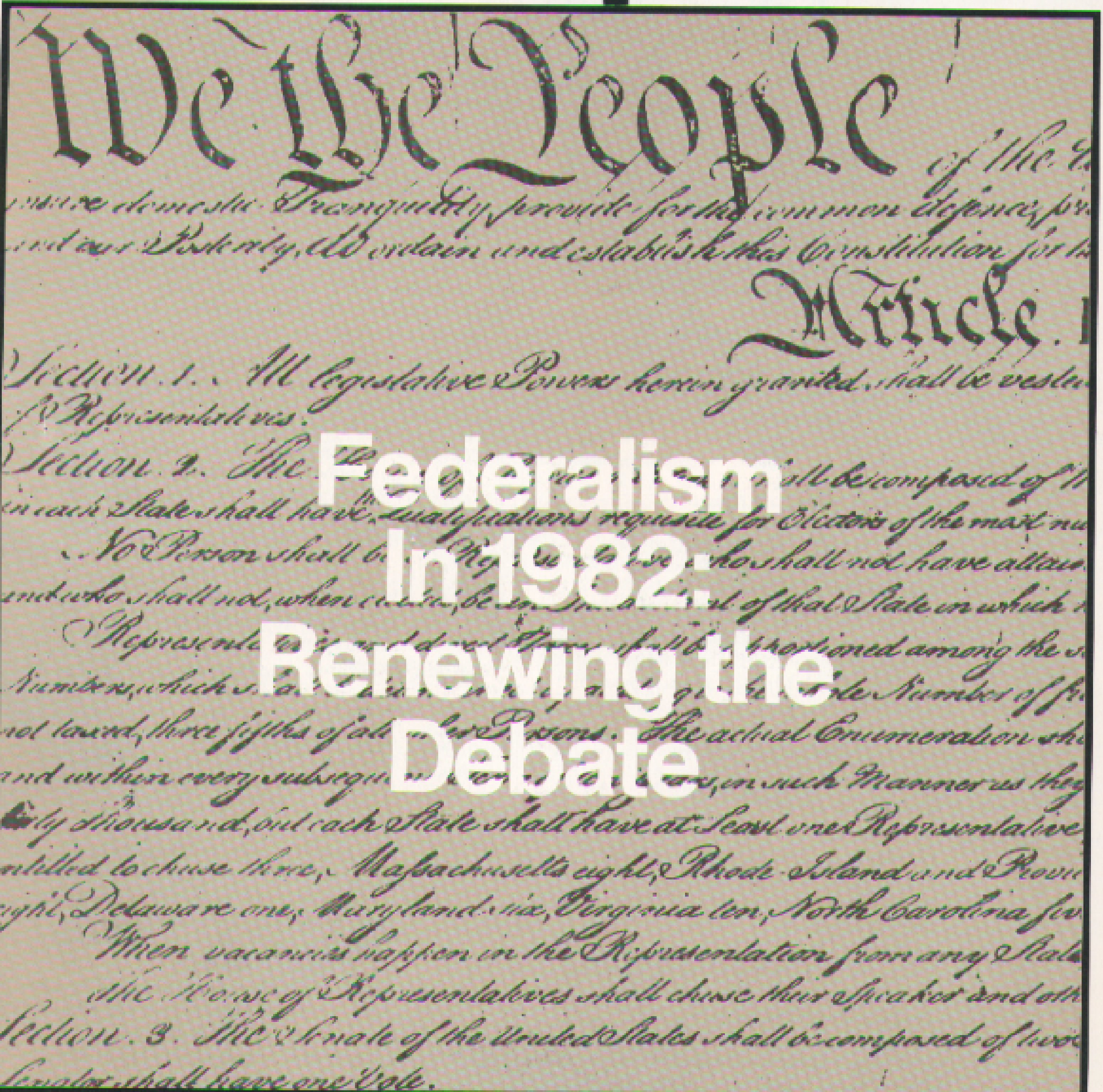


# Federalism In 1982: Renewing the Debate

ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS

# View From The Commission

*Representative L. H. Fountain of North Carolina responds to questions from* ***Intergovernmental Perspective*** *Editor Stephanie Becker on ACIR's past accomplishments and future challenges. Rep. Fountain sponsored the Commission's enabling statute in 1959 and served continuously as a member since its founding. He was elected to Congress in 1952 and retired on January 3, 1983.*

**I.P.:** In its 23 years of operation, has the ACIR met your original expectations?

**Fountain:** Yes, the Commission has met my expectations. While no institution is perfect, I believe ACIR has done an outstanding job over the years in working diligently and effectively to accomplish its mission.

**I.P.:** How has the Commission changed since its founding in 1959?

**Fountain:** In responding to your question, it is important to keep in mind that the Commission came into existence at the beginning of a 20-year period of enormous and sustained public sector growth at all governmental levels. During its early years, ACIR tended to focus its attention on fairly narrow program areas that provided targets of opportunity for achieving practical results. Some of those problems had been identified earlier by the Kestnbaum Commission, while others—the metropolitan area studies in particular—were new areas of research emphasis. I think it is accurate to say that the Commission gave increased attention in later years to broader policy issues in keeping with the increasing complexity of intergovernmental relations as the federal government expanded its grant programs and regulatory activities.

**I.P.:** What has been ACIR's most important contribution, in your opinion, to improving intergovernmental relations?

**Fountain:** It is difficult to single out any one contribution as the most important. Certainly the Commission has made an extremely valuable contribution in raising the visibility and importance of intergovernmental relations, not only in governmental circles but also in our colleges and universities where ACIR publications serve as course texts, and for the press and public generally.

**I.P.:** What do you foresee as the Commission's most important challenges in the years ahead?

**Fountain:** One thing we can be certain of is that the Commission will never run out of problems. Among those already with us or on the horizon are such thorny issues as how to meet public service needs in an era of scarcer resources and devising practical approaches for bridging the gap in fiscal capacity between our energy-rich and energy-poor states. Another difficult problem involves sorting out the roles of the various levels of government in the very costly task of maintaining and rebuilding our roads, bridges, water and sewer systems, and other major public facilities. I am confident that ACIR will meet these and other future challenges if it remains true to its origins as an independent, objective and bipartisan monitor of our federal system.

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# Federalism in 1982: Rhetoric v. Reality

**by S. Kenneth Howard**

In 1982, talk about federalism far outdistanced action. Discussions received a tremendous initial push in the President's State of the Union Message a year ago. Negotiations over the exact proposals to include in the President's New Federalism became protracted and, although one new block grant was adopted, no comprehensive implementing legislation was ever introduced. For critics, New Federalism was just a code phrase for budget cuts. However, when the hue and cry quieted and spending actions were finally worked out between the Congress and the President, some "cuts" proved nonexistent; others were far less than originally proposed; and a few new intergovernmental aid programs were in place.

One late entrant, the **Surface Transportation Assistance Act of 1982,** said a good deal about federalism, most of it counter to the ideas of devolution advocated by the President. Congress increased a national tax on the same item that 27 states had deemed it necessary to tax more heavily during the preceding two years. The national action could readily upset bruisingly resolved state spending and taxing plans. Furthermore, the act's provisions on truck weights and sizes clearly preempted state standards on these matters, using the typical "noncoercive" technique: meet our standards or you don't get any transportation aid money. The bill was justified on other merits, but it did not bode well for those who believe devolution is an important element in strengthening American federalism.

Despite the incongruity between action and rhetoric, the debate was hearty, cathartic and overdue. Not since the Great Depression had we, as a people, given such high visibility to the issue and problems of federalism.

As the articles in this **Perspective** discuss in detail, the President's New Federalism made little headway in 1982. Why did year-long negotiations between the White House and state and local officials end at a seeming impasse? Although disappointing to some, the apparent stalemate over restructuring our federal system should come as no surprise. After all, as the Advisory Commisson on Intergovernmental Relations has documented, it took 20 years for the grant-in-aid system to reach its present point of complexity and confusion. It will undoubtedly take more than one year to straighten it out given the underlying value conflicts involved. The issues raised by the New Federalism remain worthy of intensive examination, particularly as we continue on a path of prolonged fiscal stress, straining the resources of each level of government and potentially putting them on a collision course, as the **Surface Transportation Assistance Act** illustrates.

## ISSUES OF FEDERALISM: ECLIPSED BY FISCAL REALITIES

No sooner had the President's initiative been placed on the table than a chorus of questions arose. Can the states, long condemned as "horse and buggy" governments, handle the responsibility? Will they be responsive to their cities and to people in need? Which level of government should bear primary responsibility for the poor? And, which level can afford to shoulder or share in the program costs?

However difficult it might be to answer these questions during the best of times, they proved to be particularly troublesome in the second year of a major recession. The decentralizing thrust of New Federalism rests on the belief that the states are ready for additional responsibilities. It depends upon the states' ability to pick up the service delivery, revenue and political "slack" a diminished federal domestic role would create.

As the past year wore on, it became increasingly apparent that the states had indeed come a long way. ACIR's research revealed, and public perception generally supported, the view of the states as better armed and more assertive "middlemen" in our federal system. Their relatively smooth transition to the new block grants passed in 1981 showed that the states are no longer federalism's weak links.

The states, however, faced what was probably the most serious threat to their fiscal stability since the Great Depression. While not all states suffered equally, most were beset with moderate-to-severe financial problems. How did they react? First, they engaged in belt tightening, cutting the fat from their operations. Next they tried accounting gimmicks and drew down surpluses. Many states were then left with little choice but to raise taxes, a tough move during an election year. As *Table 2* in the article on fiscal federalism shows (see page 27), the favored revenue-raising method by far was hiking the so-called "sin" taxes on alcohol, cigarettes and gambling, and the excise taxes on gasoline. Only as a dire last resort did states increase their general sales or income taxes, the two major sources of state revenues. The "last resort" description seems appropriate. In the post-taxpayers'-revolt environment, states raised taxes to stay in place, not to launch another high rolling era in public spending. In fact, combined state-local spending, when adjusted for inflation, declined on a per capita basis in 1982 for the fourth year in a row.

## WILL THE NATIONAL GOVERNMENT TURN TO LAST RESORT TAXES?

At the national level, too, the debate over restructuring federalism soon fell victim to larger problems. Congressional reaction was not unlike that of their state-level brethren. Federalism was placed on the legislative backburner and the federal budget dominated deliberations. In 1982, Congress took the path of least taxpayer resistance. Programs were cut when possible and other expenditure belt tightening moves were made. User fees were raised—e.g., the price of a passport trebled—the federal cigarette tax was doubled and the federal excise tax on gasoline was increased by 5¢ a gallon.

The question for 1983 and beyond is two-fold. First, will the national government, having pretty much exhausted the taxes of "first resort," now raise taxes of last resort, namely the income tax or some variant of a tax on consumption? This question will undoubtedly assume paramount importance even if the recession begins to abate in 1983.

Secondly, will the three levels of government collide in their rush to raise revenues? Many observers think that Washington has already preempted the states' ability to increase gasoline and cigarette taxes further. Undeniably, the same citizens pay taxes, regardless of which level of government levies them. An issue for the remainder of this decade may well be whether the taxpayers find too many levels of taxing authority reaching into their pocket too often.

In retrospect, 1982 was a year when important issues were raised but few were resolved. The President's personal commitment to these issues probably means that federalism will remain high on the nation's agenda. But solutions are not readily available. These problems, after all, were not created in one year, nor will they be resolved in another. For the ACIR, the questions of how responsibilities should be distributed and who should pay how much of which bill are still pertinent and paramount.

*S. Kenneth Howard*
*is ACIR's Executive Director*

# Reagan's New Federalism: Design, Debate and Discord

by Timothy J. Conlan and David B. Walker

**Two years ago, a new President set out to reduce the growing federal role in domestic affairs. Substantial progress toward this goal was made in 1981 as Congress and the President cut levels of federal aid, enacted nine new block grants, and launched a comprehensive program of deregulation. As 1982 began, it looked as though this transformation would continue. The President made a bold new initiative for sorting-out governmental responsibilities the centerpiece of his domestic program. Several new block grants were also proposed, and dramatic changes in urban policy were anticipated. But the response to these initiatives in 1982 differed sharply from that of 1981. Protracted negotiations between state, local and national officials on specific sorting-out legislation failed to produce agreement, and the future of the federalism initiative lay in doubt by year's end. Controversy also swirled around the Administration's urban policy proposals, and only one new block grant was enacted.**

This article will examine these and other significant intergovernmental events of 1982, summarizing the President's "New Federalism" proposals and reviewing the political reactions to them. Overall, two themes seemed to characterize the politics of federalism in 1982. First, the troubled state of the economy and fiscal pressures at every level of government tended to overshadow federalism concerns and undermine the capacity of many actors in the system to take a long-range view of intergovernmental reforms. Second, signs of "politics as usual" began to surface with increasing regularity as the year progressed and Congressional resistance to federal aid reforms and spending cuts mounted. For all their political difficulties and lingering uncertainties, however, the President's federalism proposals succeeded in one important respect: they placed federalism issues high on the nation's policy agenda and they sparked a nationwide dialogue on how our federal system should—and does—operate.

## THE NEW FEDERALISM INITIATIVE: PROPOSALS, REACTIONS AND NEGOTIATIONS

In his 1982 State of the Union address, President Reagan condemned the existing "maze of interlocking jurisdictions and levels of government" and the "jungle of grants-in-aid." He proposed restructuring the intergovernmental system in a "single bold stroke." Although the general outlines of his federalism plan are now familiar to many, a review of the proposal and the reactions to it may help place New Federalism in perspective and indicate possible future directions.

### The Initial Proposal

Although the President left many of the details open for discussion with state and local government officials, his initial federalism plan had two basic elements. First, he proposed a $20 billion "swap" in which the federal government would return to states full responsibility for funding AFDC and food stamps in return for federal assumption of state contributions to Medicaid. Second, the President proposed a temporary $28 billion trust fund or "super revenue sharing" program to replace approximately 40 federal programs "turned back" in the fields of education, health, social services, community development and transportation. Revenues for this fund would come from proceeds of the federal windfall profits tax on oil and from federal excise taxes on gasoline, tobacco, alcohol and telephones. Initially, each state would have the choice of retaining specific programs in categorical form or accepting equivalent unrestricted monies from the trust fund. After four years, however, both the trust fund and the federal taxes supporting it would begin phasing out, leaving states the option of replacing federal taxes with some of their own to continue the terminated programs or allowing the programs to cease entirely. (For more details on the proposal, see *Figure 1* and *Table 1*.)

## Reactions To The Federalism Initiative

Reactions to the federalism initiative varied widely. Many governors and state legislators welcomed the concept of sorting-out functions, an approach they had previously endorsed. (For a history of recent sorting-out proposals, see the box on p. 8.) They spent much of the year negotiating with the Administration on a mutually acceptable proposal. Reactions from other quarters generally were less supportive. Many local government officials expressed concern about diminished federal aid and the severing of direct federal ties. Considerable controversy also focused on proposed reductions in the federal role in public assistance. Looming over all responses were the shadows of a lengthening recession.

**Responses from the States.** Most state officials—Republicans and Democrats alike—applauded the thrust of the President's proposal but questioned specific provisions of the plan. Vermont Governor Richard Snelling, then Chairman of the National Governors' Association (NGA), said the President "deserves enormous praise for putting the subject on the table,"[1] and Governor Bruce Babbitt of Arizona called the proposal "elegant and imaginative."[2] Both governors raised a series of critical questions about appropriate federal-state roles, however. New York Governor Hugh Carey was less positive, calling the proposal "hastily conceived and poorly designed."[3]

The Administration was sensitive to these concerns and actively negotiated with governors and state legislators on a compromise proposal. These discussions produced some modifications in the initiative, but no consensus was reached by year's end.

Much of the controversy over the President's proposal focused on its public assistance provisions. Giving states full responsibility for food stamps and Aid to Families with Dependent Children (AFDC) was a long standing goal of the President. In a 1975 speech, he declared that: "If there is one area of social policy that should be at the most local level of government possible, it is welfare. It should not be nationalized—it should be localized."[4] Seven years later, in his State of the Union address, he reiterated this position, arguing that full state responsibility for AFDC and food stamps "will make welfare less costly and more responsive to genuine need because it will be designed and administered closer to the grassroots and the people it serves."

[1] "Two State Leaders Respond to Reagan's Plan," **State Government News,** March 1982, p. 14.

[2] Governor Bruce Babbitt, "His Plan Deserves a Chance," **The Washington Post,** 28 January 1982, p. A25.

[3] Governor Hugh Carey, "'New Federalism' Yes, But Reagan's Proposal Needs Major Revision," **New York Times,** 14 March 1982, p. E23.

[4] Ronald Reagan, "Conservative Blueprint for the 1970's," reprinted in **Congressional Record,** Vol. 121, 94th Cong., 1st sess., 1975, p. 31186.

*Figure 1*

### Major Features Of President Reagan's Initial Federalism Proposal

| I. SWAP COMPONENT | PROVISIONS |
|---|---|
| A. Governmental Roles | |
| Medicaid | Federalize |
| Food Stamps | Full State Assumption |
| AFDC | Full State Assumption |
| B. Assurances for Medicaid or Public Assistance Beneficiaries | Maintenance of state effort 1984-87 for public assistance; Medicaid provisions to be determined. |
| **II. TURNBACK COMPONENT** | |
| A. Governmental Roles | Turnback over 40 federal grant programs to states.[1] |
| B. Resource Return for States[2] | |
| 1. Transition Period (1984-91) | Trust Fund |
| Dollar Amount | $28 billion |
| Full Protection | 1984-87 |
| Partial Protection | 1988-91: excise phase-out occurs |
| Trust Fund Growth | None |
| 2. Post-Transition Period | |
| Amount and Method[3] | $11 billion via excise repeal |
| Federal-State Balance as of 1988 | For the states, a loss more likely than a gain[4] |
| Distribution | By excise tax bases |
| 3. Assurances for Local Governments, Other Former Grantees | Two part pass-through requirement 1984-87; 100% for former direct federal-local grants; 15% for former non-ed. federal-state grants. No provision for other former grantees. |

[1] Counted as of FY 1982.

[2] States also would obtain fiscal relief via federalization of Medicaid. Distribution of this relief depends both on amounts states would have spent on Medicaid and changes in federal spending on Medicaid.

[3] Neither the phase-out of the oil windfall profits tax nor reduced federal budgets implying lower federal taxes are counted as resource returns to the states.

[4] Beyond 1988, a gain for the states becomes possible, assuming that Medicaid costs lifted from the states would show greater growth than the cost of meeting responsibilities turned back.

SOURCE: ACIR staff.

## Sorting Out Governmental Responsibilities: The Evolution Of An Idea

Although it represents a bold departure from current policy, President Reagan's federalism initiative did not spring spontaneously onto the political scene. It followed a series of related proposals that differed in their specific provisions but shared a common theme.

As early as 1969, for example, the ACIR recommended that the national government assume full financial responsibility for public assistance programs—including Medicaid and general assistance—in return for state government assumption of virtually all fiscal responsibility for local education.[1] Eight years later, the Commission expanded this sorting-out proposal, recommending—as part of a comprehensive strategy for simplifying the federal aid system—that the national government consider federalizing certain programs while terminating or forestalling involvement in others. Finally, in June 1980, the ACIR reaffirmed and expanded upon these earlier positions. Although it recognized that certain program areas would remain intergovernmental, the Commission recommended a comprehensive sorting-out of state and federal roles in the federal system, including federal assumption of financial responsibility for income maintenance programs and reductions of federal involvement in areas of primary state and local concern.

Similar recommendations were advanced by other organizations as well. Following the ACIR's lead, the National Governors' Conference (now the National Governors' Association) endorsed greater national responsiblity for welfare programs in 1969. In 1980, the governors again endorsed full federal assumption of financial responsibility for income maintenance programs in exchange for states assuming more responsibility for public safety, education, and transportation programs.[2] The following year, a similar sorting-out strategy was jointly recommended by the Governors' Association and the National Conference of State Legislatures. Finally, President Carter's Commission on a National Agenda for the Eighties called for "clarification of the present confused division of labor in the federal system," endorsing reforms along the lines advocated by ACIR and state officials.[3]

A variety of policy concerns have prompted these recommendations. Beginning in 1969, both the ACIR and many state officials identified several significant advantages to federal financing of income maintenance programs including:

- narrowing interstate disparities and providing more equitable service levels;
- reducing incentives for potential welfare recipients to *migrate to* high benefit states and for individuals and businesses *to leave* high benefit states with high tax burdens;
- recognizing that many variables affecting income maintenance lay beyond state and local government control, such as national economic forces and judicial decisions prohibiting state residency requirements; and finally,
- achieving equity advantages by shifting public assistance financing from less progressive state and local revenue sources to the federal income tax, thus freeing up revenues for greater state assumption of education costs and reducing pressures on the local property tax.

To many, these arguments for federal assumption of income maintenance financing were reinforced in the 1970s by growing dysfunctions in the intergovernmental system. By 1980, the federal grant system merited poor marks on each of the principal criteria for assessing its performance: efficiency, effectiveness, equity and accountability.[4] On the one hand, the grant system served as a vehivle for unprecedented levels of federal involvement in, and regulation of state and local government activities.[5] On the other hand, all branches of the federal government were becoming overloaded with new demands and responsibilities. Federal court dockets had grown exponentially, while many participants feared that Congress had lost the capacity for careful deliberations of proposed legislation.[6] Finally, increasing budgetary constraints precluded the federal government from attempting to absorb additional costs for income maintenance without making commensurate reductions elsewhere in the budget. The growing need to define governmental priorities more carefully lent renewed force to the sorting-out strategy.

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[1]Advisory Commission on Intergovernmental Relations (ACIR), **State Aid to Local Governments,** A-34, p. 16.

[2]National Governors' Association, "Agenda for Restoring Balance to the Federal System," **Policy Positions,** 1981-82, Washington, DC, National Governors' Association, 1981, pp. 15-18.

[3]President's Commission for a National Agenda for the Eighties, **A National Agenda for the Eighties,** Washington, DC, U.S. Government Printing Office, 1980, pp. 69-72.

[4]See ACIR, **An Agenda for American Federalism: Restoring Confidence and Competence,** A-86, Chapter 3.

[5]See, for example, Catherine Lovell, et. al., **Federal and State Mandating on Local Governments: An Exploration of Issues and Impacts,** Riverside, CA, Graduate School of Administration, University of California, Riverside, 1979.

[6]ACIR, **An Agenda for American Federalism,** pp. 81-88.

*Table 1*
**Illustrative List Of Programs For Turnback To The States Under Reagan's Federalism Initiative**

| PROGRAMS BY CATEGORY | ESTIMATED FY 1982 EXPENDITURE[1] |
|---|---|
| **Education and Training** | $ 4.4 billion |
| Vocational Rehabilitation | |
| Vocational and Adult Education | |
| State Block Grants (ECIA Ch.2) | |
| CETA | |
| WIN | |
| **Income Assistance** | $ 1.9 billion |
| Low Income Home Energy Assistance | |
| **Social, Health and Nutrition Services** | $ 8.7 billion |
| Child Nutrition | |
| Child Welfare | |
| Adoption Assistance | |
| Foster Care | |
| Runaway Youth | |
| Child Abuse | |
| Social Services Block Grant | |
| Legal Services | |
| Community Services Block Grant | |
| Prevention Block Grant | |
| Alcohol, Drug Abuse, and Mental Health Block Grant | |
| Primary Care Block Grant | |
| Maternal and Child Health Block Grant | |
| Primary Care Research and Development | |
| Black Lung Clinics | |
| Migrant Health Clinics | |
| Family Planning | |
| Women, Infants, and Children (WIC) | |
| OSHA State Grants | |
| **Transportation** | $ 8.5 billion |
| Grants-in-Aid for Airports | |
| Highways - | |
| Primary | |
| Rural | |
| Urban | |
| Bridge | |
| Construction Safety | |
| Other | |
| Interstate Transfer | |
| Appalachian Highways | |
| Urban Mass Transit | |
| Construction | |
| Operating | |
| **Community Development and Facilities** | $ 6.3 billion |
| Water and Sewer | |
| Grants | |
| Loans | |
| Community Facilities Loans | |
| Community Development Block Grant | |
| Urban Development Action Grants | |
| Waste Water Treatment Grants | |
| **Revenue Sharing** | $ 4.6 billion |
| General Revenue Sharing | |
| **Grand Totals** | |
| Programs | 43 |
| Estimated expenditures, FY 1982 | $34.4 billion |

[1]Budget authority.

SOURCE: ACIR staff compilation, based on Congressional Budget Office data and the White House, "Fact Sheet, Federalism Initiative," Press Release, 27 January 1982, Appendix A.

To counter state opposition to a smaller federal role in welfare, Administration officials argued that the federalism initiative made a major concession to the states by offering to assume the full costs of Medicaid. This move would benefit states, they said, because Medicaid costs were rising much faster than AFDC expenses. Moreover, because Medicaid serves large numbers of elderly persons, they argued that the move would also benefit program users by consolidating federal responsibility for programs aiding senior citizens.

State officials strongly supported nationalizing Medicaid, but they opposed picking up the full costs of AFDC and food stamps. In keeping with their earlier position, they maintained that all income maintenance programs should be funded by the national government. As Governor William Winter of Mississippi declared, "True federalism in this enlightened time must recognize that . . . we cannot split ourselves up into 50 states, contending regions, rich and poor, skilled and unskilled, white and black."[5] State officials also noted that some form of national public assistance program had been advanced by recent Presidents of both parties, including Nixon, Ford and Carter.[6] Finally, they questioned the rationale for dividing responsibilities for AFDC and medical assistance to the poor. According to Wisconsin State Representative Tom Loftus, this would mean that "you would be an American when you are

[5]Quoted in Fred Jordan, "New or 'No Federalism,' It's a Hot Topic in Seattle," **Nation's Cities Weekly,** 30 August 1982, p. 6.

[6]For a history of these proposals, see ACIR, **Public Assistance: The Growth of a Federal Function,** A-79, Washington, DC, U.S. Government Printing Office, 1980; for a justification of this position by a prominent member of the Ford Administration, see Paul H. O'Neil, "Back to Basics," **Commonsense** 3, Winter 1980, pp. 24-30.

poor and sick, but a Texan when you're just poor."[7] States especially were concerned about federal termination of the food stamp program because of its unique role in narrowing disparities among state welfare benefit levels.

Dire economic conditions and resulting state budget problems only magnified the fiscal aspects of the New Federalism for concerned state officials. Even some potential supporters feared the proposal may have come "at the worst possible time." "We may all be so anemic by the end of the year that the states won't be able to function as partners," said Governor Scott Matheson of Utah.[8]

Although the President described his initiative as a financially equal swap, many state officials feared that it would cost them more money in the long run, at a time when growing fiscal problems left less and less room to accommodate additional expenses. The Administration had correctly anticipated such resistance and had worked hard to minimize financial winners and losers among the states under its proposal. For example, the cost to some states of assuming the total burden of food stamps and AFDC would outweigh their savings from national assumption of total Medicaid costs. Other states, however, would gain from this exchange. These disparities were to be evened out by contributions from the federalism trust fund. States gaining from the welfare-Medicaid swap would have their trust fund allocations reduced by that amount. Loser states would receive additional allotments from the fund equal to their losses. The Administration claimed that, eventually, states would gain slightly from the federalism initiative because Medicaid costs were projected to rise faster than those assumed by the states.

Despite these assurances, the fiscal consequences of the plan remained unclear because Administration estimates of the costs states would bear if they took on AFDC and food stamps assumed that these programs would be scaled back as the Administration proposed in its FY 1983 budget. Without those program changes, the Congressional Budget Office estimated that states as a whole would initially pay more to assume public assistance programs than they would save from federalizing Medicaid. States also raised questions about the Medicaid portion of the swap. Currently, Medicaid benefits vary enormously from state to state. A single national program would presumably have more uniform benefit levels—higher than low benefit states but lower than high benefit states. Some states in the latter category would probably feel compelled to continue supplementing federal Medicaid payments, thereby reducing the fiscal dividend of the swap in such states.

Finally, state officials raised questions about the trust fund portion of the initiative. Gov. Carey questioned its adequacy, maintaining the programs suggested for inclusion into the trust fund would total $37 billion by 1984, not $28 billion as proposed.[9] Moreover, both the trust fund and the federal excise taxes supporting it were to begin phasing out in FY 1988. Although states would have the option of levying these taxes themselves, the distribution of "tax room" would not be uniform throughout the country. Per capita revenues from cigarette excise taxes would be much smaller in Utah than in neighboring Nevada, for example, and only a fraction of states would have access to the sources of the windfall profits tax on oil. For these reasons, the National Governors' Association and the National Conference of State Legislatures (NCSL) argued for a financing scheme that would use general revenues rather than specific federal taxes and would include some degree of equalization among states with differing needs and taxing capacities.

**Other Reactions and Concerns.** State officials were not alone in questioning the federalism initiative. Although public opinion polls showed considerable support for the New Federalism concept,[10] the plan encountered a barrage of criticism from members of Congress, local governments, affected interest groups, and the press. As with state officials, the bulk of the controversy focused on the "swap" elements of the plan.

Immediately on its announcement in the State of the Union address, the plan was criticized in newspaper editorials. The **New York Times** likened the plan to "turning back the clock." Although it acknowledged the need for some sorting-out of functions, it questioned: "(w)here is the logic in Federalizing one poverty program but turning back others? Do poor people get equally sick in different places but not equally hungry?"[11] **The Washington Post** called the proposal "an alarming retreat" from Washington's responsibilities for basic income maintenance and concluded that "poor people are sure to be worse off under it."[12]

To no one's surprise, many advocates of social programs felt threatened by the plan. The AFL-CIO charged the new federalism initiative would "cripple

[7]Quoted in David Broder, "White House is Warned on its Federalism Plans," **The Washington Post,** 29 July 1982, p. A10.

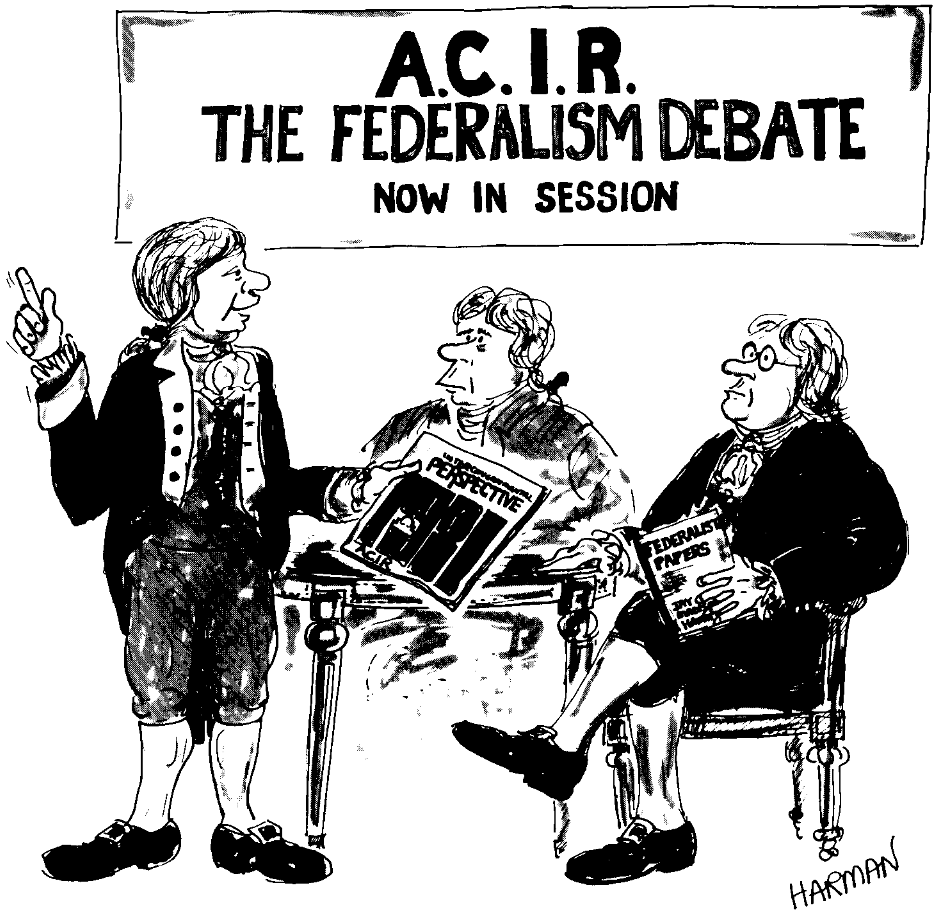
[8]Quoted in William Schmidt, "Three Western Governors Seem to be Potential Allies of 'New Federalism,'" **New York Times,** 18 February 1982, p. A1.

[9]Governor Hugh Carey, "'New Federalism' Yes," p. E23.

[10]For example, one review of opinion surveys on the new federalism concluded that it "fit the public's image of the respective roles of the federal and state governments." Government Research Corporation, **Opinion Outlook Briefing Paper,** 12 February 1982, p. 6.

[11]"The New Old Deal," **New York Times,** 28 January 1982, p. A27.

[12]"A Great Swap Masks a Great Danger," **The Washington Post,** 27 January 1982, p. A20.




facilities and services on which all Americans depend and jeopardize the health and welfare of millions of the poor."[13] "The worst thing you can do," according to Andrew Mott of the Coalition on Block Grants and Human Needs, is to decentralize "responsibilities you know will be neglected because of lack of political will."[14]

Local officials were also wary. Many local governments were deeply suspicious of turning major program responsibilities over to the states, thereby severing their direct funding link to Washington. "The pass-through [issue] is the No. 1 problem" with the President's plan, said one urban representative.[15] A state legislator from New York observed that county governments in his state "are clearly afraid of being bankrupted in the name of the new federalism."[16]

All of these opposing views were fully represented in Congress, where one observer reported that "long knives are out," ready to kill the initiative.[17] Even some strong Congressional supporters of the sorting-out concept were troubled by specific features of the President's proposal. Senator David Durenberger, Chairman of the Senate Intergovernmental Relations Subcommittee, openly questioned the programmatic logic of the swap initiative, even after the Administration agreed in June to retain food stamps at the federal level: "I am not happy with the outcome. . . . What sense does it make to have Social Security, Medicare, Medicaid, Food Stamps and housing assistance all at the federal level and leave dependent children with the states?"[18] In addition to supporting full federal responsibility for basic income maintenance programs, the Senator proposed allocating trust fund revenues on an equalizing basis. "It is time for the federal government to recognize a responsibility for equalizing the fiscal capacity of places," he observed.[19]

The most serious obstacle to the federalism initiative may have been worsening economic and budgetary conditions, however. Many Congressmen dismissed the proposal as a diversion from more pressing economic problems or perceived it as a backdoor means of cutting social programs. Within days of the President's address, a Congressional newsletter reported the federalism plan was "sinking into a sea of economic problems of greater importance."[20] A few months later, the **New York Times** reported the proposal had "become entangled in the [budget] stalemate."[21] "Budgetary problems are taking more and more of Congress' attention, and elections are coming on," agreed one Administration adviser.[22] With the fate of the economy affecting almost

[13]American Federation of Labor and Congress of Industrial Organizations, "Statement Submitted for the Record," in U.S., Congress, Senate, Committee on Governmental Affairs, **President's Federalism Initiative, Hearings,** 97th Cong., 2nd sess., 1982, p. 482.

[14]Quoted in Neqal Peirce, "The States Can Do It, But Is There The Will?" **National Journal,** 27 February 1982, p. 377.

[15]Quoted in Rochelle Stanfield, "A Neatly Wrapped Package with Explosives Inside," **National Journal,** 27 February 1982, p. 360.

[16]Richard Brodsky, quoted in Howell Raines, "President Seeking Counties' Support," **New York Times,** 14 July 1982, p. A21.

[17]Richard Cohen, "Meanwhile, in Congress, the Long Knives are Out," **National Journal,** 27 February 1982, p. 381.

[18]Quoted in Broder, "White House is Warned," p. A10.

[19]Quoted in David Broder and Herbert Denton, "Reagan's Aides Push Program Swap," **The Washington Post,** 29 January 1982, p. A4.

[20]**Congressional Insight,** 29 January 1982, p. 1.

[22]Robert Pear, "Prospects for the 'New Federalism' Plan, **New York Times,** 5 May 1982, p. B11.

[22]Quoted in *ibid.*

every federal, state and local official and distorting fiscal estimates on which the federalism plan was based, the plan's timing became a hurdle in itself.

## Negotiations On Federalism

From the beginning, the President described the details of his federalism initiative as tentative and subject to consultation with state and local officials. Subsequent strong disagreements aroused by the initiative heightened the need to present a united front before Congress, and the Administration launched a series of negotiations with the Governors' Association and the Conference of State Legislatures to formulate a joint legislative proposal.

Prior to the start of these meetings in March 1982, the governors attempted to refine their position on sorting-out while making some concessions to the President's position. They dropped their bid for the immediate nationalization of all income maintenance programs, suggesting instead that consideration of changes in AFDC and food stamps be deferred. They announced support for the creation of a federalism trust fund and a willingness to negotiate over the President's list of programs for termination. They also emphasized their support for federal assumption of Medicaid costs. But the governors' position differed with the President's in several respects. Because they removed AFDC and food stamps from the plan, their proposal was more limited in scope and contained a much smaller trust fund component. They also urged that trust fund allocations be made on the basis of state fiscal capacity.

Despite substantial areas of agreement, the positions of the states and the Administration were sufficiently distant that the talks between them were arduous, protracted and ultimately unsuccessful. Initially, the two sides had hoped to produce a specific legislative proposal by early April 1982. This target date passed, however, amidst a flurry of reports that the negotiations were in danger of collapse. Continuing talks produced some further narrowing of differences, and there were indications in July that agreement might be reached on a revised federalism plan. In a speech to the National Association of Counties, the President described the outlines of a modified proposal, containing several key concessions by the Administration:

- Food stamps would be retained at the national level rather than devolved to the states.
- The federal government would assume the full costs of "routine" medical care for the poor, and it would give block grants to the states to provide long-term care to the poor. This minimum level of care could be supplemented by the states.
- Several programs initially scheduled to be turned back to the states would be retained at the national level, including Urban Development Action Grants, grants for migrant health and black lung clinics, the Women, Infants, and Children (WIC) nutrition program, and several highway programs (including interstate and primary highways and bridge construction).
- A 100% pass-through of trust fund monies to local governments would be assured in amounts equal to direct federal funds provided through terminated categorical grants.
- Finally, the windfall profits tax was eliminated as a trust fund revenue source, replaced by an \$8.8 billion contribution from general revenues.[23]

In return, several state leaders indicated a willingness to reverse their earlier position and to accept full financial responsibility for the AFDC program.[24] Encouraged, Administration officials hoped for a quick resolution of remaining differences so that a legislative proposal could be sent to Congress over the summer.

These hopes soon faded. No final agreement was reached before the Governors' Association annual meeting in August, and disappointed governors decided to develop their own federalism proposal. Gov. Snelling, the outgoing Chairman of the NGA, reported to the organization's Executive Committee that "it no longer seems prudent to pin our hopes for a new federalism on the outcome of any negotiations with the White House."[25] He laid much of the failure to reach final agreement on remaining differences over how to implement the federal takeover of Medicaid. Nevertheless, the governors agreed to continue discussions with the White House while developing their own federalism proposal.

In a letter to the President on November 19, 1982, the Executive Committee of the National Governors' Association outlined the governors' current position on federalism reform. As before, the governors would defer action on AFDC and food stamps, proposing that the federal government assume full responsibility for Medicaid in exchange for state assumption of up to 18 existing federal grant programs. (See *Table 2.)* To ease

[23]For details on this revised proposal, see U.S., Executive Office of the President, "Remarks at the [National Association of Counties] Annual Convention," **Weekly Compilation of Presidential Documents, Administration of Ronald Reagan,** 13 July 1982, p. 899; and Timothy Schellhardt, "Reagan Revamps 'New Federalism' Plan for Welfare to Enhance Appeal to States," **Wall Street Journal,** 23 June 1982.

[24]Bill Peterson, "White House Agreement on 'New Federalism', Announced by Governors, **The Washington Post,** 6 May 1982, p. A4.

[25]Governor Richard Snelling, Chairman, National Governors' Association, "The Governors' Federalism Initiative—Report to the Executive Committee," unpublished statement, National Governors' Association, 8 August 1982.

passage of this proposal, the governors suggested that Medicaid could be divided into three components: acute care for Supplemental Security Income (SSI) eligible recipients, acute care for AFDC eligible recipients, and long-term care. The national government could choose to assume any or all of these components, turning back a specific group of federal programs with each component. A revolving fund for balancing winners and losers among individual states was also proposed, but no method for dealing with fiscal disparities was indicated.[26]

For its part, the Administration has delayed developing a legislative proposal on New Federalism until early 1983, pending further modifications in its proposal or agreement with state leaders on a revised plan. Current indications suggest the President's proposal may be substantially altered, focusing almost totally on the trust fund mechanism linked to the renewal of General Revenue Sharing and the consolidation of other leading intergovernmental programs.

## BLOCK GRANTS: OVERWORKED AND UNDERPAID?

Grant consolidation, although displaced by the turnback proposal as the center of attention, remained an integral part of the Administration's federalism reform agenda in 1982. The President's FY 1983 budget proposed a total of ten new or substantially revised block grants in such areas as education, health and social services. In stark contrast to the Administration's earlier block grant successes, however, little progress was made on this new round of proposals. Only one block grant was enacted in 1982: a new job training program for state and local governments to replace the expiring **Comprehensive Employment and Training Act (CETA)** program.

### The President's Block Grant Proposals

Among the new consolidations in his FY 1983 budget, President Reagan proposed expanding three existing block grants in the social service area:

- *Primary Care:* expand the existing primary care block grant to include black lung and migrant health clinics and family planning grants. No funding cuts were proposed from 1982 levels for individual programs.[27]
- *Services for Women, Infants and Children:* expand the maternal and child health block grant to include the women, infants and

**Table 2**
**Governors' Revised Federalism Proposal: A Focus On Medicaid**

| Federal Responsibility | State Responsibility | Program Cost (billions) |
|---|---|---|
| **Component A:** | | |
| Acute Care Medicaid Benefits for SSI eligibles ($4.1 billion) | Vocational and Rehabilitation | $ .952 |
| | Vocational and Adult Education | .740 |
| | State Block Grants (ECIA Ch. 2) | .537 |
| | Small Cities Block Grant | 1.020 |
| | CSA Block Grant | .348 |
| | Preventive Health Block Grant | .082 |
| | ADMHA Block Grant | .432 |
| | | $4.111 |
| **Component B:** | | |
| Acute Care Medicaid Benefits for AFDC Eligibles ($5.3 billion) | Social Services Block Grant | $2.400 |
| | Waste Water Treatment Grants | 2.400 |
| | Water and Sewer Grants | .125 |
| | Water and Sewer Loans | .375 |
| | Community Facilities Loans | .130 |
| | | $5.430 |
| **Component C:** | | |
| Long term care ($8.4 billion) | *Turnback Option 1* | |
| | CETA | $2.858 |
| | Child Nutrition | 3.212 |
| | DCBG (entitlement) | 2.419 |
| | | $8.489 |
| | *Turnback Option 2* | |
| | GRS | $4.566 |
| | Transportation Programs | |
| | Urban | .800 |
| | Secondary | .400 |
| | Bridges | .900 |
| | Highway Safety and Safety Construction | .390 |
| | Primary | 1.500 |
| | | $8.556 |

SOURCE: Governors Scott Matheson and Richard Snelling, Letter to President Reagan, 19 November 1982.

[26]Governors Scott Matheson and Richard Snelling, Letter to President Reagan, 19 November 1982.

[27]The primary sources of information for this and other block grant proposals are U.S., Office of Management and Budget, **Special Analysis H, Federal Aid to State and Local Governments,** Washington, DC, U.S. Government Printing Office, 1982, pp. 6-8; and U.S., Office of Management and Budget, **Budget of the United States Government, 1983,** Washington, DC, U.S. Government Printing Office, 1982, part 5.

children nutrition program (WIC), with budget authority reduced $300 million below 1982 levels for these two programs.

- *Energy and Emergency Assistance:* combine the existing low income energy assistance block grant with the emergency assistance program, reducing budget authority $400 million for these programs.

In each of these three proposals, the new programs recommended for consolidation had been included in the Administration's 1981 block grant proposals. Congress, however, had refused to incorporate them in the first round of consolidations.

In addition, the President proposed establishing seven new or substantially modified block grants including:

- *Vocational and adult education:* consolidate eight existing programs into one block grant to the states, including basic grants and grants for program improvement and support services, programs of national significance, special programs for the disadvantaged, consumer and homemaker education, state advisory councils, state planning, and adult education. Funding would be reduced $134 million from 1982 levels.
- *Education for the handicapped:* consolidate 13 grants for handicapped education authorized by the **Education for All Handicapped Children Act** and chapter one of the **Education Consolidation and Improvement Act of 1981,** with funding reduced $54 million below 1982 levels.
- *Rehabilitation services:* consolidate project grants and basic state grants into a single block grant for rehabilitation services, with budget authority reduced $211 million below 1982 levels.
- *Child welfare block grant:* consolidate current programs for foster care, child welfare services, adoption assistance, and child welfare training into one grant with a $185 million cut in funding.
- *Combined welfare administration:* combine grants for state administration of Medicaid, AFDC and food stamps, with funding reduced by $100 million.
- *Rental rehabilitation:* consolidate rehabilitation loans and the Section 8 moderate income housing rehabilitation program, with increased budget authority totaling $101 million.
- *Employment and training:* consolidate four CETA programs (Youth Community Conservation Projects, Summer Youth Employment, formula block grants, and discretionary grants) into a new block grant to the states, reducing funding from $2.2 billion in FY 1982 to $1.8 billion in FY 1983.

### The New Employment Block Grant

Out of all these proposals, only three were actually introduced in Congress, and only the last—**The Job Training Partnership Act**—was enacted. The new law (PL 97-300) combined major elements of the President's proposal with features from the existing CETA program. Unlike CETA, the new program eliminated public service employment, sharply reduced paid subsidies and allowances for trainees, and expanded the roles of state government and, especially, the private sector. Other provisions of the new law:

- abolished the system of local prime sponsors and instead designated local units of government (or consortia of governments) with populations of 200,000 or above as service delivery areas (SDAs).
- established new private industry councils (PICs) in each SDA to develop a training plan and to determine the use of training funds, subject to approval by the local chief elected official(s) of the SDA. A majority of PIC members must be representatives of the private sector, nominated by a local general business organization and appointed by the local chief elected official(s). In cases of disagreements among local officials (in a consortium) or between a local official(s) and the private industry council, the governor is given power to arbitrate.
- provided funding estimated to range between $3.2 billion and $3.7 billion, of which 78% will be distributed to state and local governments for training purposes and 7% will be set aside for national programs, like that for seasonal and migrant farm workers. An additional $618 million has been earmarked for the Job Corps program. Seventy percent of the funds allocated to SDAs must be spent on training activities; 30% may be spent on administration and support services. Funds will be distributed to the states, and within them, by a three-part formula, with one-third allocated on the basis of the number of persons unemployed where the unemployment level exceeds 4.5%, one-third based on the number of unemployed persons in excess of 6.5% unemployment, and one-third based on the number of low income residents.
- maintained, for transition purposes, existing CETA rules during FY 1983. Prior to October 1, 1983, SDAs are to be established, PICs must be appointed, and a plan must be developed.

New program operations begin October 1, 1983, and all carryover CETA activities must be phased-out by July 1984.[28]

The new training program stemmed from widespread disillusionment with CETA. Ironically, when first enacted in 1973, CETA was considered a crowning achievement of President Nixon's original "New Federalism." It consolidated 17 highly fragmented categorical programs into a single job training block grant; created a new program of public service employment; and established a new system for delivering job training services at the local level. During the 1974-75 recession, a large additional public service employment title was added.

Although CETA provided jobs for over a million unemployed persons and job training and work experience for thousands more, by 1978 the program had become, in the eyes of many, "a four letter word." Stories of corruption and mismanagement—directed mainly at CETA's public employment titles—undermined support for the job training block grant. Moreover, careful evaluations of CETA training programs often failed to detect significant improvements in the future earnings of trainees.[29] In response to these problems, Congress substantially amended the CETA program in 1978, reducing funding and tightening up program controls and eligibility. These changes were largely successful in curbing the most flagrant abuses and in directing more employment assistance to the neediest clients, but they also diminished support for the program among clients and local officials.

[28]PL 97-300.

[29]These and other problems are discussed in ACIR, **Reducing Unemployment: Intergovernmental Dimensions of a National Problem,** A-80, Washington, DC, U.S. Government Printing Office, 1982, pp. 82-100.

## Regional Organizations Hang On

**Despite major withdrawals of federal support for both multistate and substate regional organizations, most such organizations continue to exist.**

At the multistate level, as 1981 ended, the federal government "decommissioned" the eight active and three still-born economic development regions established at the request of the governors under Title V of the **Public Works and Economic Development Act of 1965.** It also closed down the six federal-state river basin commissions that had been established under Title II of the **Water Resources Planning Act of 1965.** Then, effective September 30, 1982, it disbanded the staff of the region-supporting and state-supporting federal interagency Water Resources Council. In addition, the budget of the independently established Applachian Regional Commission was substantially reduced for FY 1982 (and further reduced for FY 1983) as that organization was set to phase-out with the agreement of Congress and the participating governors.

In response to these federal withdrawals, however, state initiatives have arisen. Five of the Title V economic development commissions have incorporated as Councils of Governors; one merged with a preexisting organization of states devoted to regional growth policies; and the other two active ones are still in transition, pending the outcome of a larger revamping of the organizations representing governors in the western states.

A similar pattern has emerged with respect to the Title II river basin commissions. Four have been reborn as nonprofit corporations operating as regional associations of state water resources officials; another merged into a preexisting multistate commission concerned with transportation and commerce on the Great Lakes; only one went completely out of business.

At the substate level, federal budget cutting and the termination of several planning assistance programs for councils of governments and other regional planning bodies has caused fewer such organizations to go out of existence than anticipated. A 1981 survey of substate regional councils conducted by the National Association of Regional Councils (NARC) estimated that federal withdrawals of support might cause over 30 to go out of existence in 1982, about a 10% drop. By December 1982, however, only five such organizations were gone. Holdover funds from 1981 and somewhat less drastic cuts in federal funds for 1982 than had been expected might have been partly responsible for this reprieve. A new NARC survey initiated in December 1982, is expected to provide a fuller explanation.

In another major development affecting substate regions, the federal government rescinded **OMB Circular A-95** and replaced it with **Executive Order 12372.** Regulations implementing the new order are expected to go into effect on April 30, 1983. Their emphasis is to be on state determination of appropriate processes within the state for intergovernmental consultations with federal agencies that provide financial assistance to state and local governments or that pursue other activities affecting these governments. The states will be urged to cooperate with each other in providing consultation processes in interstate areas, but the federal regulations are not expected to influence the states toward, or away from the use of areawide and regional organizations. The federal intent is that the 550 existing areawide clearinghouses providing consultation services under A-95 would continue that role only if the states determine that they should. A number of unresolved issues under the new Executive Order remain to be worked out during 1983. It is clear at the end of 1982, however, that this reform of intergovernmental consultation processes, like the federal block grant reforms, is placing a higher premium upon state-local relations—Bruce McDowell

## The Supreme Court in 1982: Retolling The Tenth Amendment Death Knell?

In 1976, the Supreme Court unearthed the remains of the Tenth Amendment. Although interred for nearly four decades, the resulting legal autopsy revealed the Constitutional provision to be alive and kicking.

The case, of course, was **National League of Cities v. Usery,** a milestone in the judicial resolution of intergovernmental disputes. Fought over Congressional extension of the federal **Fair Labor Standards Act** to state and local employees, the case resulted in the admonition that "Congress may not exercise power in a fashion that impairs the states' integrity or their ability to function effectively in a federal system." Thus, it both resurrected the long-neglected Tenth Amendment and placed some restrictions on Congressional use of the commerce power as a vehicle for regulating states and their political subdivisions. It was, needless-to-say, hailed as a major victory for state and local governments. The victory however, was to be extremely short lived.

If the years between 1976 and 1982 witnessed some judicial backing away from the so-called **NLC** doctrine, 1982 may have tolled the Tenth Amendment's death knell a second time. In two decisions arrived at last term, the Court refused to overturn federal policies alleged to impinge on integral state activities. Although one decision was relatively easy (and not altogether unexpected), the other provoked one of the most acrimonious dissents of 1982.

The "easy" case, decided in early spring, was **United Transportation Union v. Long Island Rail Road.** At issue was the State of New York's contention that its **Taylor Law,** forbidding strikes by public employees, rather than the permissive **Federal Railway Labor Act** should govern employer-employee relationships on the Long Island Rail Road. The railroad had been acquired by New York State in 1966. Based on that ownership, the state challenged the federal law as inconsistent with **NLC v. Usery,** alleging that operation of the line was an integral governmental function; that the **Railway Labor Act** displaced New York's essential decisionmaking prerogatives; and that state interests in the railroad outbalanced the federal interests in having the labor act apply.

That the Court unanimously disagreed with the state was a deep disappointment to New York and other subnational jurisdictions hoping for a revival of **NLC.** However, as noted previously, it was not a complete surprise, for in the 1976 case, the Court had alluded to the fact that the operation of railroads would not be considered an integral governmental activity.

More disquieting to many states—and obviously more difficult for the Court—was its decision in **Federal Regulatory Commission v. Mississippi.** In that case, the State of Mississippi challenged Titles I and III and Section 210 of the **Public Utilities Regulatory Policies Act (PURPA).** Titles I and III compel states to *consider* using six approaches in structuring utility rates and to report and explain the results of their consideration to the Secretary of Energy. Section 210 requires states to implement certain federal rules encouraging co-generation and small power production facilities. The act, then, is a peculiar blend of Congressional direct order and partial preemption.

Just as the unanimous railroad decision was not a complete surprise, the deep split occasioned by the Mississippi case was not altogether unpredictable. One year earlier, a federal district judge found PURPA so intrusive that he ruled it "a clear usurpation of power that the federal government simply does not have under the Commerce Clause." Although a few members of the Supreme Court agreed with the district judge, the majority did not.

The Court held the challenged provisions to be "within Congress' power under the Commerce Clause" and found that they did "not trench on state sovereignty in violation of the Tenth Amendment." An unusually vigorous four-justice dissent, however, demurred at the Court's Tenth Amendment analysis. Claiming that Titles I and III "conscript state utilities commissions into the national bureaucratic army," Justice O'Connor writing for herself, the Chief Justice, and Justice Rehnquist,* attacked the Court's judgment as being "contrary to the principles of **National League of Cities v. Usery,** antithetical to the values of federalism, and inconsistent with our Constitutional history."

Strong words whose very strength has caused those seeking a revivification of the **NLC** doctrine to believe that just such a revival may ultimately occur. Indeed, the Court will have, in its 1982-83 Term, yet another opportunity to review a federal law contested on Tenth Amendment grounds. At issue in **Equal Employment Opportunity Commission v. Wyoming** is application of the **Age Discrimination in Employment Act** to state and local employees. That act forbids mandatory retirement before age 70. A lower court struck down the law on Tenth Amendment grounds and 18 states have joined with Wyoming in asking the Supreme Court to uphold that decision. Whether the death knell has been sounded for the Tenth Amendment for the second time this century may depend on the success or failure of the **Mississippi** minority in convincing at least one colleague of the efficacy of its arguments—**Cynthia Colella**

*Justice Powell agreed with the dissenters but presented his own opinion.

## 1982 In A Nutshell: Intergovernmentally Significant Supreme Court Decisions

***UNITED TRANSPORTATION UNION v. LONG ISLAND RAIL ROAD***

The **Federal Railway Labor Act** preempts New York's *Taylor Law* on the issue of strikes by employees of the state-owned Long Island Rail Road.

***FEDERAL ENERGY REGULATORY COMMISSION v. MISSISSIPPI***

Titles I and III of the **Public Utilities Regulatory Policies Act,** compelling states to consider the use of certain approaches in structuring utility rates, do not trench on state sovereignty in violation of the Tenth Amendment.

***EDGAR v. MITE***

*The Illinois Business Takeover Act* violates the commerce clause by being overly broad in its reach.

***FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION v. de la CUESTA***

A Federal Home Loan Bank Board regulation allowing the use of "due-on-sale" clauses preempts a California law restricting "due-on-sale."

***ASARCO, INC. v. IDAHO STATE TAX COMMISSION***
***F. W. WOOLWORTH v. TAXATION AND REVENUE DEPARTMENT OF NEW MEXICO***

When taxing nonresident corporations doing instate business, a state may not include dividends and interest received from foreign subsidiaries of those companies if the subsidiaries do not have any other connection with the state.

***COMMUNITY COMMUNICATIONS CO., INC. v. BOULDER***

In the absence of specific, "clearly articulated and affirmatively expressed state policy," home rule localities are not exempt from scrutiny under the **Sherman Antitrust Act** nor from liability for antitrust violations.

***VILLAGE OF HOFFMAN ESTATES v. FLIPSIDE***

Local governments possess fairly wide-ranging powers to regulate the sale of drug paraphernalia.

***NEW YORK v. FERBER***

A New York State criminal law prohibiting the production, direction, or distribution of material depicting sexual conduct by individuals under the age of 16 does not violate the First Amendment.

***ROSE v. LUNDY***
***ENGLE v. ISAAC***

Prisoners wishing to file habeas corpus petitions in federal court as a means of redressing state court convictions must first "totally exhaust" all state remedies. Moreover, to obtain habeas corpus relief for state procedural default, state prisoners must demonstrate both cause for default and actual prejudice even if the claimed constitutional error influenced the factfinding function of the court.

***PATSY v. FLORIDA BOARD OF REGENTS***

Exhaustion of state administrative remedies is not a prerequisite to an action under Section 1983 of the **Civil Rights Act of 1871.**

***RENDELL-BAKER v. KOHN***
***BLUM v. YARETSKY***
***LUGAR v. EDMONDSON OIL COMPANY, INC.***

When allegedly violating Constitutional rights, private facilities and businesses contracting with state or local authorities or heavily regulated by those authorities do not necessarily act "under color of state law" for the purposes of Section 1983 suits nor do their violations necessarily constitute "state action" for the purposes of Fourteenth Amendment actions. However, private actions that are determined to be "state actions" in violation of the due process clause will support suits under Section 1983.

***PLYER v. DOE***
***TEXAS v. CERTAIN UNDOCUMENTED ALIEN CHILDREN***

Under the Fourteenth Amendment, states may not deny free public education to the children of illegal aliens.

***WASHINGTON v. SEATTLE SCHOOL DISTRICT #1***

A Washington State voter initiative drafted to terminate the use of mandatory busing to achieve racial integration violates the equal protection clause.

***CRAWFORD v. LOS ANGELES BOARD OF EDUCATION***

An Amendment to the California State Constitution providing that state courts may not order mandatory busing unless a federal court would be permitted to do so does not violate the Fourteenth Amendment.

**Enacting the Block Grant.** Against this backdrop of disillusionment with CETA and propelled by its scheduled expiration on September 30, 1982, three major replacements were introduced in Congress in 1982. The bills all featured improved linkages between the private sector and government training programs and diminished reliance on public employment. But they differed widely on other issues, from funding levels to how services would be delivered.

The Administration's bill, unveiled on March 10, 1982, contained sharply reduced funding for training programs and a much narrower range of services and eligible clients. At the same time, the measure dramatically increased the role of states and private industry councils in designing and delivering training services. Only localities with populations above 400,000 would have been permitted to operate their own programs under the bill (S 2184).

On the opposite extreme was HR 5320, sponsored by Representative Augustus Hawkins, Chairman of the Employment Opportunities Subcommittee. This proposal retained many CETA services and much of the existing operating structure. It also raised authorizations for training programs above 1982 levels and included a new $1 billion public jobs program for areas with high unemployment.

The bipartisan Senate bill, S 2036, sponsored jointly by Senators Dan Quayle and Edward Kennedy, occupied a middle ground. It provided more resources for older and displaced workers than the President's bill and permitted the continuation of some stipends for disadvantaged trainees. It also retained more local government participation than the President proposed, although state and private industry roles were substantially enhanced.

The final enactment reflected elements of all these proposals. Eligibility for local designation as a service delivery area was increased to 200,000 population (compared to 100,000 for CETA prime sponsors) and a roughly equal partnership between industry councils and local elected officials was established. Although stipends and wages remained eligible expenditures, support services and administration were limited to 30% of program costs and some of the least efficient uses of training funds were restricted or prohibited.

There is hope that the enhanced roles of private industry and state governments will make job training more relevant, smooth the transition from training to employment, and improve coordination among related programs. Nevertheless, caution is advisable. Earlier attempts to increase private-sector participation in training programs have generally produced meager results. Furthermore, the forces that spurred creation of public employment programs in the early 1970s—high unemployment and the difficulties of placing trainees in a depressed economy—persist and may rekindle pressures for yet another round of public service jobs.

## URBAN POLICY STALEMATE?

The Administration's urban policy was intrinsic to the federalism initiative. Ultimately, the President would like to phase out most direct federal-urban aid programs and return almost exclusively to federal-state relationships in those remaining areas where federal aid, in his view, remains appropriate. State and local governments would be expected to solve their mutual problems without federal interference or intervention. Accordingly, the list of programs first suggested by the President for turnback to the states encompassed virtually all of the major direct federal-local programs, including urban mass transit, community development, CETA, General Revenue Sharing, waste water treatment, and Urban Development Action Grants (UDAG). (UDAG was later dropped from this list, however, and the President frequently assured local officials that, initially, states would be required to pass through certain funding from the transitional trust fund.) Indeed, an early draft of the President's semiannual urban policy report—statutorily required by the **Housing and Development Act of 1970**—raised a furor among local officials by suggesting that federal intervention in urban areas "can do more harm than good" by insulating communities and individuals from changing market forces and by distracting cities from turning to state governments for assistance. The draft report also suggested that, over time, federal programs have undermined city government by transforming mayors "from bold leaders of self-reliant cities to wily stalkers of federal funds."[30] Although these phrases were modified in the final version of the report, its philosophic thrust remained unchanged.[31]

### Enterprise Zones

Although the urban policy report received considerable attention by the media, local government officials, and Congress, the President's major urban policy initiative was an experimental program of "urban enterprise zones." Building upon earlier enterprise zone legislation proposed by Representatives Jack Kemp and Robert Garcia, the President proposed legislation modifying federal tax and regulatory policy in defined areas of distressed communities.

The enterprise zone concept sought to create a climate in depressed areas conducive to private business investment and the employment of disadvantaged workers. In the President's words, the legislation would utilize "the market to solve urban

[30]Quoted in John Herbers, "Administration Seeks to Cut Aid to Cities, Charging it is Harmful," **New York Times,** 20 June 1982, p. A1.

[31]See U.S. Department of Housing and Urban Development, **The President's National Urban Policy Report,** Washington, DC, U.S. Government Printing Office, 1982.

problems, relying primarily on private sector institutions."

Specifically, the President asked Congress to enact a variety of payroll and investment tax credits, reductions in personal and corporate income taxes, and certain regulatory relief provisions. Over a three-year period, state and local governments could apply to have 75 distressed areas designated as enterprise zones where firms would be eligible for these benefits. As a condition for federal designation, state and local governments would be expected to supplement federal tax and regulatory relief measures with similar actions of their own.[32]

The President's proposal attracted considerable support in Congress. One hundred twenty-nine House Members cosponsored the bill, as did 28 Senators. Nevertheless, the legislation made slow progress, moving one supporter to complain that it "languished" on Capitol Hill.[33] After considerable delay, the Senate Finance Committee reported an enterprise zone bill in October, but the 97th Congress adjourned without full Senate approval. Progress was even slower in the House, where formal hearings have yet to be held.

This hesitant response stemmed in part from concerns expressed about the fiscal consequences of the program. Although it would cost relatively little in terms of direct expenditures, the Administration estimated the cost in taxes lost during just the first year could run as high as $310 million. Disappointed supporters accused the Treasury Department of "footdragging" because of these revenue losses. However, analyses by independent sources like the General Accounting Office also have questioned the effectiveness and cost of the enterprise zone concept.[34]

## REGULATORY DEVELOPMENTS

In contrast to the difficulties that frustrated its federalism and urban policy initiatives, the Administration reported considerable progress last year implementing one of its primary goals: regulatory relief. Although much of the regulatory relief effort has focused on the private sector, heavily burdened state and local governments have benefited as well.

Nowhere has this progress been more evident than in the implementation of the nine block grants enacted in 1981. According to figures compiled by OMB, the relief promised by the consolidation of 77 programs last year has been substantially realized. For example, the regulations implementing the seven health and human service block grants were reduced from several hundred pages prior to consolidation to just seven pages. OMB estimates that the paperwork burden imposed on state and local governments in complying with the new grants fell by over 83%, from 6,500,431 paperwork hours in FY 1981 to just 1,086,056 paperwork hours in FY 1982.[35] These figures do not include additional paperwork burdens that states may have imposed on local governments in implementing the new grants, however.

Intergovernmental mandates also comprised about 25% of the federal regulations initially selected by the President's Task Force on Regulatory Relief for review and possible modification.[36] As of August, action had been completed on 13 of the 27 intergovernmental regulations targeted for consideration, and modifications resulting from these reviews were estimated to save state and local governments $4-$6 billion in one-time expenses and an additional $2 billion in annually recurring costs.[37] The task force also estimated that these regulatory actions would reduce state and local governments' paperwork burdens by nearly 12 million work hours each year. Prominent examples of regulatory relief actions cited by the Administration thus far include:

- withdrawal of proposed regulations requiring bilingual education and related services for students whose primary language is not English; estimated savings of $900-$2,950 million in investment costs and $70-$155 million annually.
- revised rules to permit local authorities more discretion in providing access to mass transit for the handicapped; estimated capital savings of $2.2 billion.
- simplified cost accounting rules for national school lunch program; estimated savings of 11.7 million paperwork hours.
- simplified and reduced duplication of Army Corps of Engineers dredge and fill permit program; estimated potential savings through reduced delay and processing costs of $1 billion annually.
- changed rules implementing the **Davis-Bacon Act** governing determination of prevailing wage rates in federally aided construction costs; estimated savings of $585 million annually.

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[32]Details of the plan are provided in "Excerpts from the President's Message to Congress on Urban Enterprise Zones," **New York Times,** 24 March 1982, p. B8; and in HR 6009 and S 2298, "The Enterprise Zone Act."

[33]Stuart Butler, "Enterprise Zone Update," **Heritage Foundation Issue Bulletin** 89, 29 November 1982, p. 1

[34]U.S. General Accounting Office, **Revitalizing Areas Through Enterprise Zones: Uncertainties Exist,** CED 82-78, Washington, DC, U.S. Government Printing Office, 1982.

[35]U.S. Executive Office of the President, Office of Management and Budget, **Information Collection Budget of the United States, Fiscal Year 1982,** Washington, DC, Office of Management and Budget, 1982, p. 16.

[36]U.S. President's Task Force on Regulatory Relief, **Reagan Administration Achievements in Regulatory Relief for State and Local Governments: A Progress Report,** processed, August 1983, p. ii.

[37]**Ibid,** pp. 2-4. The report indicates that individual federal agencies completed 11 additional actions benefiting state and local governments.

Despite these impressive accomplishments, the Administration's regulatory relief effort also encountered several setbacks. New rules easing Davis-Bacon requirements were rejected in U.S. District Court and have yet to take effect pending appeal.[38] One of the most complex and burdensome regulations affecting state and local governments is the **Clean Air Act of 1970,** but efforts to modify its provisions in Congress have been stalemated thus far, and the Reagan Administration has been accused of "fumbling" the ball on this issue.[39] Similarly, administration proposals to modify handicapped education regulations created such a furor on Capitol Hill and elsewhere that the proposed rules had to be withdrawn. Even in the block grant area, Congress has exerted pressure on the Administration to retain certain federal requirements. When proposed rules for implementing the new "Small Cities Block Grant" were first published in November 1981, both Congressional Democrats and the National League of Cities vigorously objected to certain provisions in the regulations, demanding:

- a stricter definition of low and moderate income persons to be served by the program;
- stronger auditing and recordkeeping guidelines to prevent misuse and disruption of the program; and
- clarification of crosscutting requirements applying to the program, like Davis-Bacon and uniform relocation.

Under threat of a House Resolution to disapprove the Small Cities rules, a compromise was worked out in early 1982, strengthening each of the above provisions.[40]

In addition to these disputes over regulatory reform, a series of recent regulatory actions and proposals—emerging from both ends of Pennsylvania Avenue—has caused increasing concern among state and local officials. Indeed, some critics claim that there has been a centralizing undercurrent in many of the Administration's recent regulatory and preemption decisions, consistently favoring private industry over state and local interests whenever the two have come in conflict. Examining the Solicitor General's arguments before the Supreme Court, Alan B. Morrison has maintained that:

> Since actions speak louder than words, a look at what the Administration has done makes it clear that it doesn't hesitate to give states' rights a back seat. Three examples . . . illustrate the conflict between New Federalism and the realities of government. They involve mortgage rates, the building of nuclear power plants and corporate takeovers. . . . In each instance the Administration argued that federal regulation should prevail.[41]

Citing Administration attempts to override California's opposition to expanded off-shore oil drilling and its opposition to legislation permitting states to regulate pesticides more strictly than the federal government, another observer concluded that "some moves initiated or encouraged by the Administration would take powers away from states, rather than return them."[42] Another recent case involved Administration support for legislation preempting state regulation of product liability.[43] Finally, provisions preempting state regulation of truck size and weight were enacted as part of the President's proposal to raise the federal gasoline tax.[44]

The Administration has not been alone in supporting new federal regulations and preemptions. Serious proposals have surfaced in Congress for a series of equally intrusive provisions, ranging from limits on local regulation of cable television to withholding federal housing funds from jurisdictions that utilize rent controls. Moreover, initial Congressional proposals to limit drunk driving sought to withhold federal funds from states that failed to enact mandatory sentencing laws meeting federal standards. Although none of these proposals has yet been enacted (the sanctions in the drunk driving legislation were replaced by incentive grants in the final version), they illustrate continuing support for new intergovernmental regulations and preemptions, whether the aims be conservative or liberal in their orientation.

## 1982: CONTINUING THE REAGAN "REVOLUTION" OR RETURN TO "POLITICS AS USUAL?"

History suggests that grand Presidential strategies for government reform are very difficult to accomplish. The bold departmental reorganization efforts of Presidents Nixon and Carter and the Nixon Administration's original "New Federalism" proposals

[38]See Michael Wines, "Administration, Critics Play Legal Cat and Mouse Game on Agency Rules," **National Journal,** 18 December 1982, p. 2159.

[39]"How the Administration Fumbled Clean Air Reform, **Regulatory Eye,** December 1981, p. 5.

[40]See "National League of Cities Mounts Lobby Effort to Change State Small Cities CD Rules," **Housing and Development Reporter,** 4 January 1982, p. 619; and "State Small Cities CD Rules Go Into Effect Under HUD Agreement With House Panel," **Housing and Development Reporter,** 15 March 1982, p. 819.

[41]Alan B. Morrison, "N*w Fed*ral*sm Holes," (sic) **New York Times,** 20 September 1982, p. A15.

[42]Felicity Barringer, "U.S. Preemption: Muscling in on the States," **The Washington Post,** 25 October 1982, pp. A11.

[43]Caroline E. Mayer, "Product Liability Dispute is Settled," **The Washington Post,** 16 July 1982, p. D3.

[44]Douglas Feaver, "Road Tax Plan Would Raise Truckers' Levies," **The Washington Post,** 30 November 1982, p. A9.

met disappointment in Congress. An even more discouraging fate befell President Eisenhower's earlier attempt to return federal programs and tax sources to the states. He appointed several leading members of his cabinet and ten prominent governors to a "Joint Federal-State Action Committee," instructing them to identify federal programs suitable for turn-back to states. The committee could agree on only two modest programs, however, and neither was acted on by Congress.

Seen in this light, the difficulties encountered by the President's New Federalism initiatives in 1982 were not surprising. In fact, the Administration's 1981 accomplishments in Congress were exceptional; the frustrated progress of reform and the continued pressures for new regulations and preemptions last year were more characteristic of "politics as usual." Other recent political developments suggest a "return to normalcy" as well, although continued fiscal stringency in Washington makes unlikely any return to rapidly growing federal grants and grant outlays.

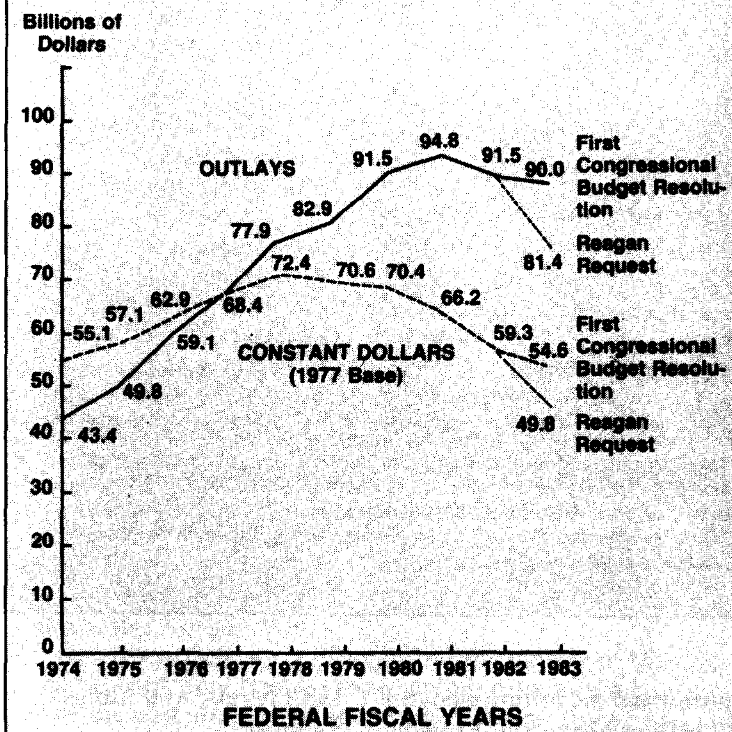
### Congressional Resistance to Further Federal Aid Reductions

Congressional budget actions in 1982 stalled President Reagan's efforts to reduce further the overall level of federal grants-in-aid; some individual appropriations were actually increased. For example, if federal grant outlays are used to measure the state of intergovernmental relations in FY 1983, then federal spending has been rolled back thus far only to about FY 1980, not to the 1920s or 1950s which some analysts suggest is the President's goal. (See *Chart 1.*) Although federal aid levels have fallen more steeply when inflation is taken into account, constant dollar aid outlays for FY 1983 will still be only slightly lower than the FY 1974 level.[45]

These figures indicate that, thus far, there has been no real "Reagan Revolution" in fiscal federalism, in large part because the President's efforts to reduce the federal aid budget by additional substantial margins in 1982 were throttled by Congress. In his FY 1983 budget, President Reagan requested federal aid outlays totaling $81.4 billion—a $10 billion drop below FY 1982 levels. As *Chart 1* demonstrates, however, Congress refused to accede to this request. The first budget resolution for FY 1983 cut federal aid outlays only $1.5 billion below 1982 levels. An even more dramatic departure occurred in budget authority[46] where Congress authorized federal aid spending levels

*Chart 1*

**FEDERAL AID TO STATE AND LOCAL GOVERNMENTS**




SOURCE: ACIR staff compilation based on OMB and CBO data and National Governors' Association computations.

of $88 billion in FY 1983, almost $23 billion above the President's budget request.

Three particular events in 1982 symbolized Congress' growing reluctance to accept President Reagan's budgetary proposals. On September 10, Congress overrode the President's veto of a supplemental appropriations bill that increased social program spending by $900 million while cutting military and foreign aid appropriations by even larger amounts. Less than one month later, the House rejected a proposed Constitutional amendment requiring a balanced federal budget. Although a majority of House members supported the amendment, it fell 46 votes short of the two-thirds required to initiate the Constitutional amendment process. Finally, during the lame duck legislative session, Congress raised FY 1983 appropriations for health and human service programs

[45]The actual mix of federal programs, regulations, and spending levels in the 1980s will likely be unique, thwarting any simple historical comparisons. For example, the major civil rights, environmental, and health and safety statutes enacted in the late 1960s and early 1970s remain in place, despite shifts in administrative details and enforcement patterns.

[46]Newly released figures in the FY 1984 budget now estimate that federal aid outlays will total $93.5 billion in FY 1983 rather than the $90 billion indicated in *Chart 1*.

Budget authority is legal authority to spend a given amount of federal funds, currently or possibly in future years. Budget outlays are actual monies expended by the government in any given year, some of which may have been authorized in earlier budgets.

*Table 3*

**Estimated Percentage Of Federal Aid Outlays For General Purpose, Broad-Based, And Other Grants FYs 1981 And 1982-85 (est.)**

| | Actual 1977 | Actual 1981 | Est. 1982 | Est. 1983* | Est. 1984* | Est. 1985* |
|---|---|---|---|---|---|---|
| **General Purpose** | | | | | | |
| General Revenue Sharing | 9.9% | 5.4% | 5.0% | 5.5% | 5.6% | 5.4% |
| Other | 4.0 | 1.8 | 2.1 | 2.4 | 2.8 | 3.0 |
| Subtotal | (13.9) | ( 7.2) | ( 7.1) | ( 7.9) | ( 8.4) | ( 8.4) |
| **Broad-Based** | | | | | | |
| Block Grants | 10.2 | 9.8 | 13.4 | 11.2 | 10.3 | 10.1 |
| Proposed Consolidations | | | | 4.4 | 6.1 | 6.4 |
| Other | 1.9 | 0.8 | 0.7 | 0.4 | 0.4 | 0.4 |
| Subtotal | ( 12.1) | ( 10.6) | ( 14.1) | ( 16.0) | ( 16.8) | ( 16.9) |
| **Other (Categoricals)** | 74.0 | 82.2 | 78.8 | 76.1 | 74.8 | 74.7 |
| TOTAL | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |

*Figures do not take into account required reductions in total budgeted outlays of $4.1 billion, $2.4 billion and $3.0 billion for FYs 1983, 1984 and 1985, respectively, some undetermined part of which may be applied against grant outlays.

Source: Office of Management and Budget, Long Range Grant Outlays By Function, 7/30/82, and ACIR staff adaptation.

more than $2 billion above FY 1982 levels, and almost $7 billion above the President's request.

### Modest Changes in the Composition of Federal Aid

At the same time that federal aid levels remained relatively constant, the overall structure of federal assistance is also estimated by OMB to remain relatively stable between now and FY 1985. Although the block grant portion of federal aid increased sharply from 9.8% in 1981 to 13.4% in FY 1982, this percentage is expected to slide back almost to the 1981 level by 1985 if additional consolidation proposals are not enacted—as was the case this year (see *Table 3*). Even if federal aid levels are reduced and additional consolidations are enacted, as OMB projects based on the President's proposals, categorical grants will continue to make up nearly 75% of the federal aid budget—slightly higher than the level reached in 1977. On the other hand, the number of individual categorical grants has been reduced approximately 25% over the last two years—from an all-time high of 534 programs in January 1981, to an estimated 398 programs in December 1982. Practically all of this reduction took place in 1981, when 77 programs were consolidated into block grants and another 62 were terminated.

### New Federal Grant Programs

1982 also demonstrated that the federal appetite for establishing new grants has not been totally satiated. Despite a flurry of state-initiated actions strengthenin drunk driving laws, the President endorsed and Congress enacted a new program of incentive grants promoting state adoption of drunk driving legislation consistent with federal standards (PL 97-364). To qualify, states must adopt the federal definition of intoxication, suspend drivers' licenses and provide mandatory sentencing for repeat offenders, and increa enforcement of drunk driving laws. Under rules recently proposed for implementing this program, no state currently would be eligible to receive these fund without making changes in its laws.

In addition, the President proposed and Congress passed a 5¢ per gallon increase in the federal tax on gasoline, substantially increasing federal grants for highways and mass transportation. As noted earlier, this legislation also preempts certain state restriction on the size and weight of trucks on primary and secondary highways. Although the federal gas tax increase has been condemned by some state officials f preempting a needed source of state revenues, for misallocating funds, and for regulating state decisionmaking in a manner contrary to the objective of New Federalism, Congress hurriedly passed the measure as a job-creating program and as a partial cu for the infrastructure "crisis."

### UNCERTAINTIES AHEAD

For federalism, the year 1982 ends on a note of uncertainty. Will 1983 bring a renewal of the President's federalism initiative—perhaps in a new o modified form? If so, will it prove more successful tha the 1982 version? Will the President renew his attempts to achieve further reductions in federal aid t state and local governments and to consolidate additional programs into block grants? Will the new Congress, with 26 additional Democratic members in the House, continue or accelerate the recent trend toward politics as usual? How will the lingering recession affect these outcomes? Will economic troubl and chronic high unemployment continue to overshadow federalism issues and fuel renewed feder job-creating efforts, or will rising deficits require new cuts in federal aid and a more careful ordering of intergovernmental priorities? In the final analysis, th big question is whether the events of 1981 and 1982 will be viewed as "the Reagan revolution" in federal policy, or merely as an interlude between tides of continued federal growth and centralization.

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# Federal and State-Local Spenders Go Their Separate Ways

by John Shannon and Susannah E. Calkins

**1982 stands out as the year of the big revenue short-fall when the most severe economic downturn since the Great Depression cut federal, state and local tax receipts and forced painful fiscal responses at all levels of government. With expenditure cutbacks unable to make up for the falloff in tax revenue, several states were forced to balance their budgets by increasing their sales or income taxes or both—actions that had become almost unthinkable since the 1978 tax revolt. (That tax revolt was marked by the passage of Proposition 13.) The national government also reacted with some belt tightening and limited tax hikes in 1982, but recourse to massive deficit financing constituted Washington's primary response to the revenue declines caused by the deep recession.**

## A MAJOR CHANGE

The year 1982 also provided decisive evidence that the contours of our intergovernmental landscape are being changed by a significant new trend—expenditure acceleration at the federal level and expenditure deceleration at the state-local level. For the fourth year in a row, state-local per capita expenditures (including federal aid and adjusted for inflation) declined slowly. During this same 1978-82 period, federal expenditures in per capita deflated dollars (exclusive of aid to states and localities) kept rising at an almost unprecedented peacetime rate.

This growing gap between federal and state-local expenditures contrasts boldly with earlier experience *(Chart 1)*. From the end of the Korean War to the 1978 tax revolt, state-local spending consistently grew at a faster rate than did federal expenditures. In fact, by the early 1970s, it appeared to be only a matter of time before state-local spenders would overtake the federal government—by the mid 1980s at the latest.

Starting in 1978 and continuing through 1982, the intergovernmental spending patterns have changed radically *(Chart 2)*. Seared by the memory of the taxpayers' revolt, state and local spenders have dropped back in the expenditure race leaving the federal government to set for itself the fastest spending pace since the Korean War.

In this article we will examine the causes of this significant new trend—the growing divergence in federal and state-local spending patterns since Proposition 13.

## THE GREAT STATE-LOCAL SLOWDOWN

### The Three Rs

What caused the great slowdown in state-local outlays after 1978? For the first time since the end of World War II, it became much easier for most state and locally elected officials to say "no" rather than "yes" to proposals calling for true expenditure increases because of the restraint dictated by the three Rs—revolt of the taxpayers, reduced federal aid flows, and recessionary pressures on state and local governments that foresaw little prospect for major federal aid increases.

These three fiscal shocks came in fairly rapid succession and powerfully strengthened the backbones of elected officials in most state and local jurisdictions.

### Revolt Of The Taxpayers (1978-80)

The taxpayers' revolt not only imposed many tax and expenditure limitations but it also sent a powerful message to state and local policymakers, most of whom escaped highly restrictive fiscal limitations. The message was clear: If you want to avoid Proposition 13-type restrictions, make sure that the increase in public spending does not exceed the growth of the private economy.

The braking effect of the tax revolt is clearly evident when state-local expenditure behavior is analyzed on a

**"A state government now extracts a major tax transfusion from its citizenry only when it is clearly apparent that the state is suffering a severe fiscal hemorrhage—a large and unanticipated revenue shortfall due to the economic recession."**

"before and after" basis. During the long and for the most part affluent period that started with the end of the Korean War and that ended with Proposition 13, state and local spenders chalked up a hefty 4.4% average annual increase in per capita expenditures when adjusted for inflation *(Table 1)*. Between 1978 and 1981, the average annual increase has been only 0.5%. While most of the 50 state-local systems applied the expenditure brakes, a few energy-rich states—i.e., Alaska and Wyoming—still kept their feet on the accelerator.

The same braking effect has taken place on the state-local employment front. In the pre-Proposition 13 era, states averaged about a 3% annual increase in public employment adjusted for population. After the tax revolt (1978-81), state and local governments reversed that trend, annually decreasing employment by about 1% *(Table 1)*.

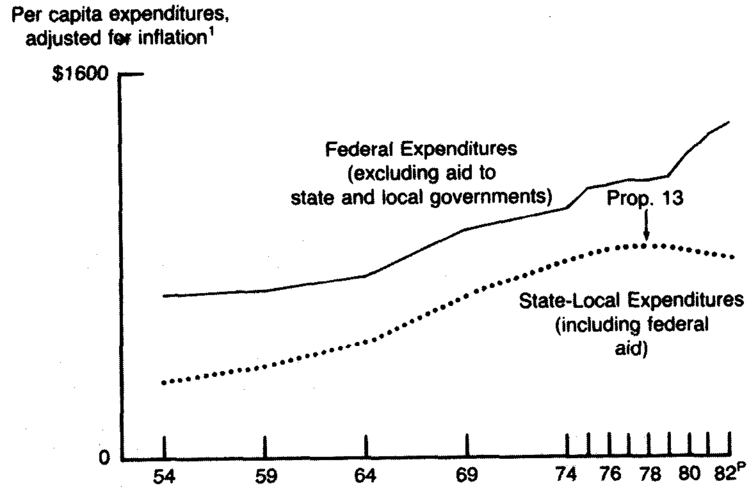
To a casual observer, many state tax increases adopted in 1981 and 1982 might suggest that the tax revolt is just about over. However, the evidence suggests a different interpretation—a major state tax increase in the post-Proposition 13 era is more likely to signal fiscal desperation than that the big spenders are once again in office. A state government now extracts a major tax transfusion from its citizenry only when it is clearly apparent that the state is suffering a severe fiscal hemorrhage—a large and unanticipated revenue shortfall due to the economic recession.

Since the tax revolt, state governments have followed a fairly predictable course when unanticipated revenue shortfalls induce tax increases *(Table 2)*. If belt tightening will not balance the budget, the jurisdiction then goes to user charges and to its half-brother—the gasoline tax. If the revenue shortfall still persists, the next stronger prescription calls for hiking "sin" taxes—levies on alcoholic beverages and cigarettes. Only when confronted with a truly severe revenue shortfall does the state take the most painful action, increasing its general sales or individual income tax or both in order to sustain existing programs. In most cases, these recent major state tax increases are scheduled to self-destruct in six months to a year—clear evidence that the memory of the tax revolt and public opposition to government expansion still shape state legislative behavior.

*Chart 1*

**After The Tax Revolt—Growing Divergence In Federal, State And Local Spending Levels**

*(Federal and State-Local Expenditures After Intergovernmental Transfers)*

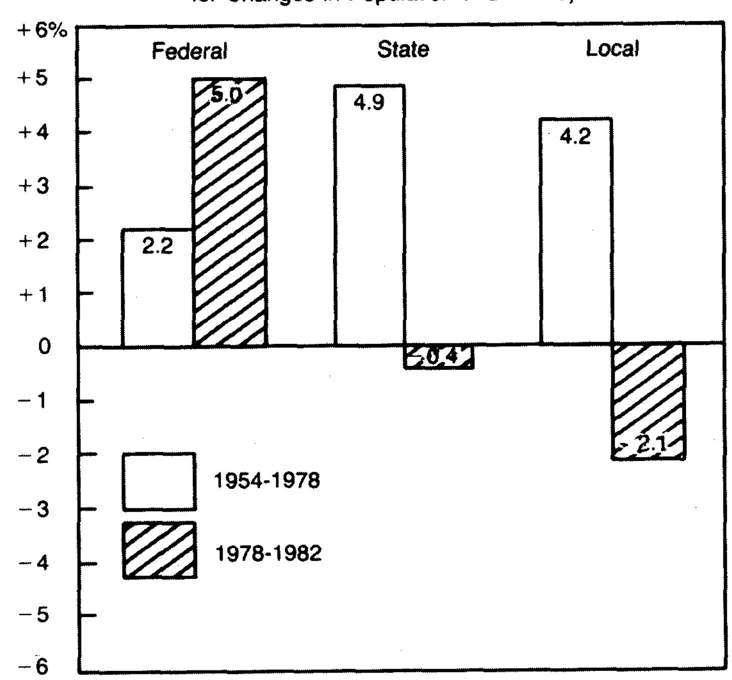



[1]Inflation adjustment by GNP Implicit Price Deflator, 1972 = 100.
Source: ACIR staff computations based on U.S. Dept. of Commerce National Income and Product Accounts.

*Chart 2*

**Federal, State, And Local Government Expenditure Behavior Before And After The Taxpayers' Revolt**

(Average Annual Rate of Change in Expenditures After Adjusting for Changes in Population and Prices)




Note: All expenditures are *after* intergovernmental transfers.
Source: ACIR staff computations based on U.S. Department of Commerce National Income and Product Accounts.

### Reductions in Federal Aid Flows—1979-82

Hardly had the taxpayers revolted in California before state and local authorities received a second major jolt, federal aid programs—the fastest growing items in state-local budgets prior to 1978—quickly became a fiscal drag after Proposition 13.

**Federal Aid Outlays To States And Localities Before And After The Tax Revolt**
(Per Capita, Adjusted for Inflation)

| Before | | After | |
|---|---|---|---|
| **1954** | $30 | **1979** | $218 |
| **1965** | 74 | **1980** | 218 |
| **1974** | 178 | **1981** | 195 |
| **1978** | 231 | **1982** | 174 |

Source: ACIR. GNP Price Deflator. Calendar years.

As clearly revealed above, federal aid to states and localities began to decline during the second half of the Carter Administration due both to the ending countercyclical aid programs and to the growing federal budget squeeze.

This squeeze on federal aid was greatly intensified in 1981 when Congress approved the Reagan Administration's plan to raise defense outlays sharply while simultaneously granting major tax cuts. Fearful that the resultant increase in the deficit would once again release strong inflationary forces, Congress had no alternative but to trim back low priority items in general and federal aid programs in particular *(Chart 3)*.

When adjusted for inflation, the reductions in federal aid flows have not been offset by equivalent increases in state and local fiscal effort. In the past, the proliferation of federal categorical aid programs with their "matching" provisions whetted state-local tastes for various public goods and services and accelerated state-local tax effort. In the post-Proposition 13 era, federal aid cutbacks and capped block grants combined to have the opposite effect—dampening the demand for public sector goods while removing a powerful external pressure for higher state and local taxes.

As 1982 drew to a close, there was evidence that the dollar level of federal aid flows might actually increase somewhat in 1983, helped in part by larger grants for highways and bridges. However, when these per capita aid outlays are adjusted for inflation, federal aid will probably continue to show a slight downward trend in 1983.

### Recession—No Bailout

Just when it appeared that states and localities had taken their worst lumps at the hands of the tax revolters and federal aid cutters, they received their third big jolt, the major recession that began in 1981.

The current recession will be seared into the memory of state and local officials because of its severity, its large revenue shortfalls and its "fend for yourself" intergovernmental scenario. This third feature is especially noteworthy because it represents a sharp departure from earlier intergovernmental practices.

Over the years, state and local authorities have become accustomed to having the federal cavalry, albeit somewhat belatedly, come charging over the hill to break the recessionary siege with aid from Washington. Many officials keenly remember the Economic Stimulus Program of 1977-78 when the federal government authorized $16 billion in anti-recession grants to states and local governments.

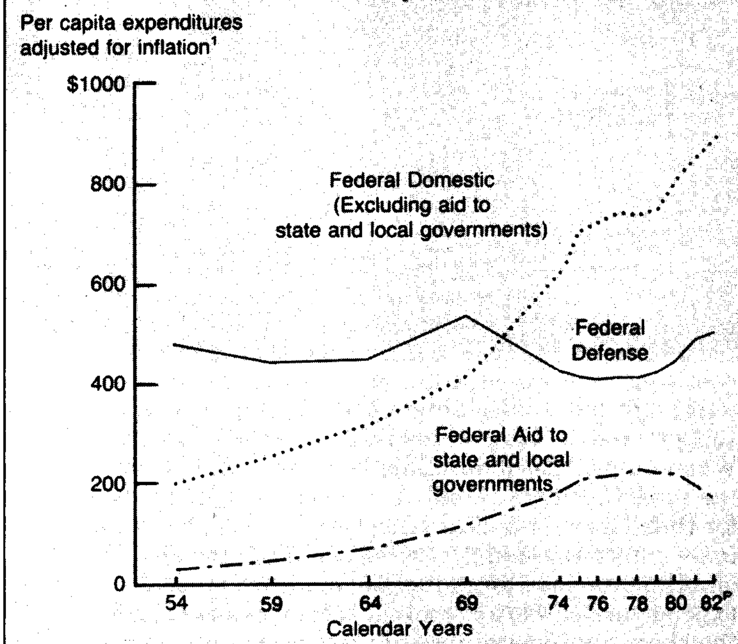
Now states and localities see their alternatives limited to painful belt tightening and tax increases. The latest box score *(Table 2)* lists 74 state tax increases during the last two years, a remarkable feat in this post-Proposition 13 era.

### Great State-Local Slowdown—The Bedrock Causes

In retrospect, the three fiscal shocks that made it easier for officials of state and local governments to say "no" to program expansions were, in turn, largely the product of more fundamental economic, demographic, and fiscal changes. When the economic pie is growing, the public demonstrates a far greater willingness to support tax increases for program expansions than it does when times are bad. Demographics and the

*Chart 3*

**The Growing Federal Aid Squeeze As Domestic And Defense Outlays Increase**




[1]Inflation adjustment by GNP Implicit Price Deflator, 1972 = 100.
Source: ACIR staff computations based on U.S. Department of Commerce National Income and Product Accounts.

Table 1

**The Tax Revolt's Effect On State-Local Expenditures And Employment**

Average Annual Percent Increase or Decrease (–)

| State and Region | Per Capita Expenditures (Adjusted for Inflation) 1957-78 | Per Capita Expenditures (Adjusted for Inflation) 1978-81 | Public Employment (Per 1,000 Population) 1957-78 | Public Employment (Per 1,000 Population) 1978-81 |
|---|---|---|---|---|
| **United States Total** | 4.40% | 0.54% | 2.7% | –1.1% |
| **New England** | | | | |
| Connecticut | 2.85 | 0.52 | 2.2 | 1.2 |
| Maine | 4.66 | –1.12 | 2.6 | –0.1 |
| Massachusetts | 4.03 | –0.10 | 2.0 | –0.5 |
| New Hampshire | 3.43 | 1.12 | 2.4 | –0.9 |
| Rhode Island | 5.17 | 2.08 | 2.9 | –0.6 |
| Vermont | 4.49 | –1.39 | 2.9 | –0.7 |
| **Mideast** | | | | |
| Delaware | 4.63 | 2.30 | 3.4 | –0.7 |
| Dis. of Columbia | 7.12 | –1.31 | 5.0 | –0.8 |
| Maryland | 4.86 | –1.39 | 3.6 | –2.2 |
| New Jersey | 4.68 | 1.15 | 3.0 | 0.0 |
| New York | 4.89 | 0.24 | 1.9 | 1.6 |
| Pennsylvania | 4.93 | –0.82 | 2.8 | –0.6 |
| **Great Lakes** | | | | |
| Illinois | 4.49 | 0.97 | 2.7 | –0.6 |
| Indiana | 3.56 | 2.88 | 2.6 | –0.2 |
| Michigan | 4.30 | 0.40 | 2.7 | –3.2 |
| Ohio | 4.16 | 0.71 | 2.5 | –0.2 |
| Wisconsin | 4.44 | 1.90 | 3.0 | –0.1 |
| **Plains** | | | | |
| Iowa | 4.22 | 0.65 | 2.6 | –0.7 |
| Kansas | 3.55 | 1.97 | 2.5 | 0.3 |
| Minnesota | 4.51 | 1.53 | 2.6 | –0.2 |
| Missouri | 3.85 | 3.05 | 2.9 | –0.4 |
| Nebraska | 4.68 | 0.60 | 3.1 | –0.7 |
| North Dakota | 3.85 | 2.44 | 2.7 | 0.4 |
| South Dakota | 3.75 | 1.18 | 2.7 | –0.8 |
| **United States Total** | 4.40% | 0.54% | 2.7% | –1.1% |
| **Southeast** | | | | |
| Alabama | 4.69 | 0.48 | 3.2 | –0.1 |
| Arkansas | 4.89 | 1.48 | 2.9 | 0.2 |
| Florida | 3.90 | –1.10 | 2.4 | –3.9 |
| Georgia | 4.68 | 1.46 | 3.4 | –1.4 |
| Kentucky | 5.34 | 1.56 | 3.1 | –1.9 |
| Louisiana | 3.37 | 3.22 | 2.4 | –1.0 |
| Mississippi | 5.40 | 1.41 | 3.2 | –0.4 |
| North Carolina | 5.03 | 0.50 | 3.5 | –0.3 |
| South Carolina | 5.11 | 1.72 | 3.8 | –3.6 |
| Tennessee | 5.23 | –0.41 | 3.0 | –1.1 |
| Virginia | 5.07 | 1.67 | 3.6 | –2.7 |
| West Virginia | 5.72 | 0.55 | 3.8 | –0.6 |
| **Southwest** | | | | |
| Arizona | 3.88 | –0.01 | 3.3 | –4.1 |
| New Mexico | 3.64 | 3.59 | 3.0 | 1.1 |
| Oklahoma | 3.12 | 3.99 | 2.5 | 1.4 |
| Texas | 4.09 | 1.22 | 3.1 | –1.5 |
| **Rocky Mountain** | | | | |
| Colorado | 3.71 | –0.42 | 2.9 | –3.5 |
| Idaho | 3.96 | –1.93 | 2.5 | –2.3 |
| Montana | 4.05 | –1.34 | 3.0 | –2.1 |
| Utah | 4.18 | 0.36 | 2.7 | –3.9 |
| Wyoming | 4.08 | 6.41 | 2.4 | 2.2 |
| **Far West** | | | | |
| California | 4.11 | –0.73 | 1.8 | –2.2 |
| Nevada | 3.16 | –0.99 | 2.7 | –6.2 |
| Oregon | 4.48 | 0.23 | 2.5 | –2.2 |
| Washington | 3.91 | 1.84 | 2.2 | –3.1 |
| Alaska | 10.14 | 14.54 | 6.2 | 3.5 |
| Hawaii | 4.99 | –3.76 | 2.3 | –1.6 |

Sources: ACIR computations. Fiscal year expenditure data from: **Historical Statistics on Governmental Finances and Employment**, 1977 Census of Governments; **Governmental Finances 1977-78; Governmental Finances 1980-81.** (U.S. Bureau of the Census Publications.) Implicit GNP price deflator from October 1982 **Survey of Current Business**, U.S. Department of Commerce.

resulting need for government services also play an important role in deciding whether the public will support higher taxes to help the cause of education. When public school enrollment was growing steadily, the school lobby could muster powerful political support for those state and local officials who voted for higher taxes. Since the middle 1970s, declining school enrollments have prompted far more demands for expenditure cutbacks than for tax increases. Finally, the change in federal expenditure priorities constitutes the third fundamental explanation for growing austerity at the state-local level. As federal policymakers turned their attention to enhancing our national defense capabilities, there was both a decline in federal aid flows and a sharp drop in Washington's stimulative influence on state-local expenditures.

## THE GREAT SPEEDUP IN FEDERAL EXPENDITURES

While state-local expenditures began their downward path after the passage of Proposition 13, federal expenditures turned sharply upward—rising in constant dollars from $1,150 per capita in 1978 to an estimated $1,396 in 1982, an increase of 21% *(Chart 1)*. The increase in federal spending is attributable to the three "Ds"—deficit financing, defense, and demographics (that is, population changes increasing spending for social security and Medicare).

*Table 2*

**An Index Of State Fiscal Pressure In the Post Proposition 13 Era— State Tax Increases On Households During 1981 and 1982**

| tate and Region | Gas & Motor Fuel[1] | Alcoholic Beverages | Cigarettes | General Sales | Individual Income[2] |
|---|---|---|---|---|---|
| umber of States | 27 | 16 | 11 | 13 | 8 |
| **ew England** | | | | | |
| Connecticut | | | | | |
| Maine | | X | | | |
| Massachusetts | X | | | | |
| New Hampshire | X | X | | | |
| Rhode Island | X | | X | | |
| Vermont | X | X | | X | |
| **ideast** | | | | | |
| Delaware | X | | | | |
| Maryland | X | | | | |
| New Jersey | | | X | X | X |
| New York | | | | | |
| Pennsylvania | | | | | |
| **reat Lakes** | | | | | |
| Illinois | | | | | |
| Indiana | X | X | | X | X |
| Michigan | | | X | | X |
| Ohio | X | X | | X | X |
| Wisconsin | X | XX | XX | X | |
| **lains** | | | | | |
| Iowa | X | | X | | |
| Kansas | | | | | |
| Minnesota | X | | | XX | XX |
| Missouri | | | X | X | |
| Nebraska | X | X | XX | X | |
| North Dakota | | | | | |
| South Dakota | X | X | X | | |

| State and Region | Gas & Motor Fuel[1] | Alcoholic Beverages | Cigarettes | General Sales | Individual Income[2] |
|---|---|---|---|---|---|
| Number of States | 27 | 16 | 11 | 13 | 8 |
| **Southeast** | | | | | |
| Alabama | | | | | X |
| Arkansas | | | | | |
| Florida | | | | X | |
| Georgia | | | | | |
| Kentucky | X | | | | |
| Louisiana | | | | | |
| Mississippi | | X | | X | X |
| North Carolina | X | | | | |
| South Carolina | X | | | | |
| Tennessee | X | X | | | |
| Virginia | | X | | | |
| West Virginia | | X | | X | |
| **Southwest** | | | | | |
| Arizona | XX | | | | |
| New Mexico | X | X | | | |
| Oklahoma | | | | | |
| Texas | | | | | |
| **Rocky Mountain** | | | | | |
| Colorado | X | | | | |
| Idaho | XX | | | | |
| Montana | | | | | |
| Utah | X | XX | X | | |
| Wyoming | | | | | |
| **Far West** | | | | | |
| California | X | | | | |
| Nevada | X | X | | X | |
| Oregon | X | | XX | | X |
| Washington | X | X | XX | X | |
| Alaska | | | | | |
| Hawaii | | | | | |

[1] Twenty-two states increased the gasoline tax by statute while five states increased the gasoline tax by administrative rule. California increased its gasoline tax on January 1, 1983 while Michigan adopted a variable rate tax (i.e., the gasoline tax is changed by administrative rule) for 1983 and future years.

[2] The recent increases in individual income taxes in Rhode Island, Vermont, and Nebraska are not included because the tax hikes were necessitated by the fact that these states calculated their state income taxes as a percentage of the federal income tax. Thus, when the federal income tax was recently reduced, it was necessary to increase the state tax rate just to stay even.

SOURCE: ACIR staff compilations based on Commerce Clearing House State Tax Reporter (various state volumes), January 15, 1983.

## Deficit Financing

Just as the tax revolt sharply influenced the behavior of state and local officials, deficit financing goes a long way in explaining why federal spending continued to rise in the post-Proposition 13 era. Unlike state and local officials, disciplined by balanced budget requirements, federal policymakers could finesse revenue shortfalls through the simple expedient of borrowing money. Thus, deficit financing enables federal officials to avoid making the painful choice between cutting expenditures or raising taxes (or both).

If political realities make it hard to balance the budget in good times, acceptance of the Keynesian counter-cyclical doctrine has now made it downright un-American to balance the budget in bad times. Conservative political leaders strongly object to major tax increases during a recession on the grounds that it is bad economic policy. By the same token, liberal political leaders oppose major cuts in domestic programs as being both inhumane and poor economic policy.

The combination of electoral politics and Keynesian economics has created a magnificent federal spending machine equipped with a hair-trigger accelerator and a powerful recession turbo-charger, but no brakes. This

**"This sporty federal car stands in sharp contrast to the old-fashioned state and local models equipped with balanced budget brakes and a "speed governor"—a feature added during the recent tax revolt."**

sporty federal car stands in sharp contrast to the old-fashioned state and local models equipped with balanced budget brakes and a "speed governor"—a feature added during the recent tax revolt.

Although deficit financing has rendered yeoman service on the revenue side of the budget by papering over tax shortfalls, it is becoming a very expensive item on the expenditure side of the federal budget. After adjusting for inflation, the per capita outlay for interest payments on the public debt has shot up from $103 in 1970 to an estimated $241 for the 1982 fiscal year. This significant increase in interest costs is due both to high interest rates and to the rapid growth in the size of the federal debt which recently crossed the $1 trillion mark.

As federal deficits increased sharply, the general public came to share the alarm felt by the financial community. This fear was expressed in the 1982 Congressional attempt to pass a Constitutional balanced-budget amendment. That attempt to tilt the Constitution toward a balanced budget passed the Senate but was narrowly voted down in the House of Representatives.

Federal legislators and budget officials cannot ignore the possibility that the next attempt to enforce some form of restraint on continued deficit financing may well be successful. The fact that 31 state legislatures have called for a Constitutional Convention to enact a balanced budget requirement adds extra force.

Pressures to reduce deficit financing also prompted the White House in 1982 to go along with a partial "take back" of the 1981 tax cuts. The need to strengthen revenue collections may again prove persuasive when Congress and the White House contemplate further actions to contain deficits. In fact, indexation of the federal income tax which was scheduled to take effect in 1985 now appears threatened as the growing public fear of deficits overcomes the earlier desire to protect taxpayers from unlegislated tax hikes due to inflation.

### Defense and Demographics

The next two "Ds"—defense and demographics—stand out as driving forces accelerating federal spending at an unprecedented peacetime rate. Without strong braking action, the federal expenditure curve will continue to rise, probably at an even faster rate than between 1978 and 1982 *(Charts 1* and *3)*

Demographics are now working against the national government because it has assumed primary responsibility for income support and medical care of an aging population. An ever-increasing number of federal beneficiaries (social security, civil service and military retirement, and Medicare), expanded benefits, and over-indexed cost-of-living adjustments have combined to create a fiscal triple-whammy that drives expenditures up sharply. These "entitlement programs" account for the bulk of the increase in all domestic federal spending shown in *Chart 3*.

Although substantial, the actual outlays to date for the federal defense program do not reflect the full cost of our national defense build-up because we are still in the R&D phase for some of the major weapon systems. Developing and procuring major weapon systems takes many years and it will be some time before current increases in obligations are translated completely into increased outlays. Thus, as the build-up continues, a more rapid increase in defense spending can be expected.

The current effort to both close the nation's "window of vulnerability" and finance an expanding social security system confronts policymakers with a harsh guns or butter dilemma during the severest economic downturn since the Great Depression. As noted earlier, aid to states and localities became the first major segment of the federal budget to feel the squeeze.

## SUMMARY AND CONCLUSIONS

Future historians of fiscal federalism may well point to 1982 as the year that provided the decisive evidence that federal and state-local spenders were going their separate ways—expenditure acceleration at the federal level and expenditure deceleration at the state-local levels.

In retrospect, this significant new trend had its roots in the 1978 tax revolt but it took until 1982 to nail down the fact that this far-reaching fiscal change represented more than just a temporary blip on the trend screen. 1982 marked the fourth year in a row that state-local per capita expenditures declined slightly when adjusted for inflation and contrasted sharply to the pre-Proposition 13 era when state-local expenditures grew steadily.

This remarkable manifestation of state-local fiscal discipline can be traced to a modern set of the three Rs—the revolt of the taxpayers, reduced federal aid, and recessionary pressures with no federal bailout. These three jolts came in rapid succession and powerfully strengthened the hands of the fiscal conservatives at the state-local level.

The acceleration in federal expenditures since the tax revolt stands out as the second reason for the growing divergence in federal and state-local expenditure behavior. The explosive growth in federal spending is due primarily to the three Ds—deficit financing, defense spending, and demographics (social security and Medicare).

Two policy implications can be drawn from this new trend. First, unless federal policymakers can build a high degree of discipline into their spending policies, the post-Proposition 13 era will be marked as one of Pyrrhic victories for political conservatives. Long fearful that the growth of government would squeeze out the private sector, political conservatives could point to a rather impressive victory. After having grown steadily since the Korean War, states and localities were stopped dead in their tracks and even forced to retrench. This austerity victory on the state-local front, however, was wiped out by the rapid growth in federal spending as total federal, state, and local outlays crossed the $1 trillion mark in 1982. In fact, total government spending for 1982 approximated 35.5% of Gross National Product—the largest public sector since World War II.

Second, there may also be a pyrrhic victory on the New Federalism front. Concerned that a rapidly expanding and highly intrusive federal aid system would soon turn state and local governments into administrative units of Washington, those persons favoring less Washington intrusion into state-local affairs could also point to a second impressive victory. The once irresistible federal aid system was also stopped dead in its tracks and pushed back.

**Washington: "Intrusive" or "Extrusive"?**

This victory for decentralization, however, may also prove more apparent than real if an "intrusive" Washington gives way to an "extrusive" Washington that pulls an increasing amount of resources away from state and local governments to underwrite rapidly expanding national needs. Up to now, a major intergovernmental battle for additional tax sources has been avoided by heavy federal reliance on deficit financing and by state-local exercise of expenditure restraint, thereby minimizing the need for additional tax revenue.

The intergovernmental tax picture is now changing rapidly. Because of the growing public concern about runaway deficits, the federal government is under growing pressure to strengthen its own tax system. At the same time, state and local governments are being forced to move back into the tax arena to offset the revenue losses caused by the recession and the slowdown in federal aid flows.

The decision of the federal government in 1982 to raise its tax rate on motor fuels by 5¢ a gallon may well be a sneak preview of a new federal tax policy—greater emphasis on consumer taxation. If that proves to be the case, state-local concern about possible federal tax preemption of the sales tax field could well become a lively intergovernmental issue during the 1980s.

The basic problem, however, goes far beyond an intergovernmental squabble over which level of government should be allowed additional access to the consumer tax field. In a more fundamental sense, it is the harsh task of reconciling changing expenditure priorities with limited tax sources. In this post-Proposition 13 era, the public will not tolerate the steady increase in taxes necessary to underwrite sumultaneously sustained growth in defense, social security, *and* state and local spending.

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# Coping With Cutbacks: States, Localities "Made Do" In 1982

by
Jerry Fensterman,
Susan Szaniszlo
and Carl Stenberg

**For the states, 1982 began and ended on an uncertain note. Faced with severe federal domestic budget cuts, shifts from categorical aids to block grants, and sluggish economic conditions, the states' initial response when the Reagan Administration's New Federalism initiative was unveiled in January was supportive but cautious. Although favoring a rebalancing of functional and fiscal responsibilities, there were strong doubts about the short-run and long-term effects of the President's far-reaching proposal, and subsequent amendments and alternatives that were offered. After all, many state governments were feeling a painful fiscal pinch as their revenue collections and federal aid payments fell below expectations. Confronted by budget balancing imperatives, service reduction necessities, and tax hiking probabilities, state officials found it difficult to generate much enthusiasm or support for pushing ahead on the federalism reform front until their own and the federal government's fiscal houses could be put in better order.**

The fiscal and political realities of 1982 generated other uncertainties—but these were directed at, rather than reflected by, the states. Some members of Congress, interest groups, and local government representatives greeted the New Federalism with concern and even alarm. To these officials, the state-oriented nature of the President's proposals charted a return to the past rather than a path for the future. The states' commitment and competence were called into question by those who felt that the national government was seeking to abrogate its domestic responsibilities, especially to disadvantaged people and communities. The federal government's role grew steadily in the postwar period, they argued, largely because of state neglect. Even where there was a willingness on the part of the states to act, managerial and fiscal capacities were too often inadequate. Therefore, returning responsibilities to jurisdictions that had once been unwilling or unable to meet them would be philosophically, politically, and pragmatically unacceptable.

For the advocates and opponents of the states, then, the intergovernmental mood was mixed at the outset of 1982. The New Federalism initiative and the debates over intergovernmental roles and responsibilities it kindled offered policymakers an unparalleled opportunity to launch a long overdue functional and fiscal "sorting out" process. But worsening national and state fiscal conditions, coupled with lingering doubts about state capabilities, made federalism reform an uphill battle.

As the year drew to a close, some of the doubts, concerns, and fears that had been expressed earlier had been confirmed, while others had been allayed. The New Federalism proposals had been put on the back-burner by the Administration, and some felt that the opportunity for meaningful reform had come and gone. The nation's economy did not rebound, and the national, state and local levels of government hiked taxes, raised fees, and continued to cut back programs. As the burden of recession increasingly fell on individual citizens, public resources were strained to meet higher demand for services. At the same time, even in this retrenchment environment, there was a growing recognition that the dire predictions regarding the fate of domestic programs at the hands of the states had been exaggerated. By year's end, the negative view of the states had been largely turned around. Although 50 separate analyses would be required to determine the states' actual performance, the perception of them as malapportioned, unresponsive governments was for the most part relegated to where it belongs, the annals of history, and not the 1980s.

For the second consecutive year, therefore, the intergovernmental pendulum continued to swing from a centrally dominated, growth-oriented federal system to one that was becoming more administratively decentralized, functionally devolved, and fiscally constrained. These changes have and will put the adaptive capacities of each level of government to a severe test.

This article focuses on the uncertainties facing states and localities arising from a year of economic, programmatic, and political ferment. Under the cloud of recession, states moved to implement the new block grants; local governments were confronted with a major challenge on the home rule front; and voters responded to an array of choices of candidates and issues. Three major "stories" of 1982—block grants, home rule, and the elections—serve to illustrate the uncertainties that characterized the year and the challenges that lie ahead.

## BLOCK GRANTS: ON THE FRONT LINE OF THE NEW FEDERALISM

The **Omnibus Reconciliation Act of 1981** authorized nine block grants by consolidating between 50 and 77 programs, depending on how one counts. Beginning in late 1981 and throughout 1982, the states assumed major roles as implementors of the new block grants. As this process evolved, however, it became apparent that the intergovernmental fiscal and political environment heavily conditioned the effectiveness of the block grant approach and the reactions of state and local officials to it. As the most tangible manifestation of the new federalism to date, how these programs work and what changes they may bring are being watched carefully to see if, in fact, the federal aid system can be streamlined and decentralized.

### The Early Transition Record

Whether they felt prepared or not, and with or without complete agreement on procedures, the majority of states assumed responsibility for six of the seven block grants available for immediate implementation—Alcohol, Drug Abuse and Mental Health; Preventive Health Services; Maternal and Child Health; Social Services; Community Services; and Low-Income Home Energy Assistance. (See box for a discussion of state implementation of the new Small Cities Community Development block grant program).

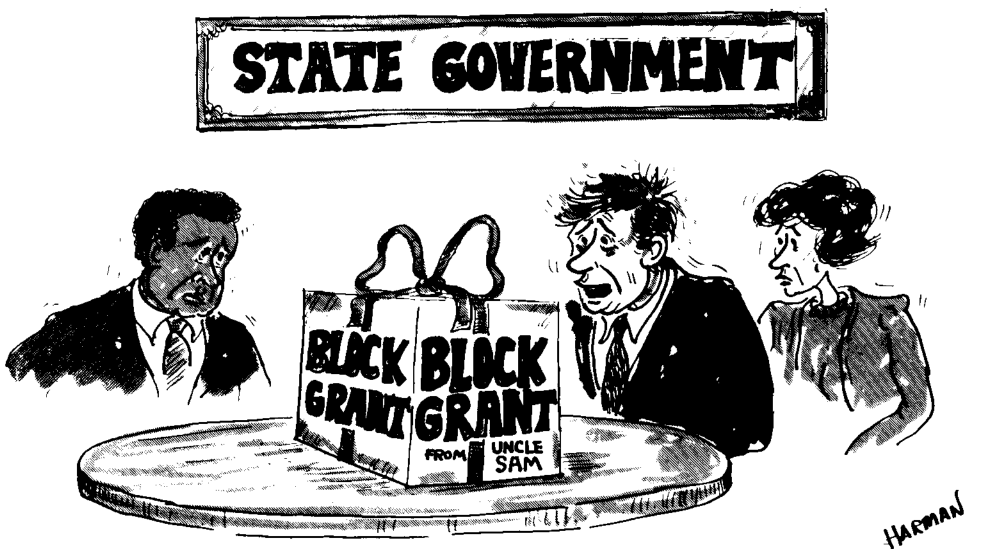
Implementation of the Education Block Grant is expected to be completed sometime during Fiscal Year 1983. All 50 states have submitted the necessary information to the Department of Education, but problems with private school participation, and how much money to withhold because of it, are delaying funding for two states. It is expected that these questions will be resolved, and funding will be approved retroactive to July 1, 1982.

Only two states—Georgia and West Virginia—and the Virgin Islands accepted the Primary Care Block Grant. By year's end, however, even those jurisdictions were prevented from operating the program when a U.S. district court enjoined the Department of Health and Human Sevices (HHS) from implementing the block grants. At issue were deficiencies in the states' grant applications and in the HHS review process. The injunction not only prevents HHS from allocating additional funds to the three jurisdictions, but also precludes the states from drawing down funds which already have been allocated. Pending resolution, the program will continue as a categorical grant administered by HHS.

State progress in taking over the new block grants available at the beginning of the 1982 fiscal year was considered adequate by a team of investigators from the General Accounting Office (GAO) studying block grant implementation in 13 states.[1] According to the GAO study, the transition from categorical aids "was eased considerably by states' experience with the predecessor programs. Generally, federal funds already flowed exclusively or, in large part, through the states." During the first year of adoption, few changes were made in the ways most states administered services funded by programs consolidated into the six HHS block grants. "Typically, block grant administration was assumed by the agencies which administered the prior progams or those which had compatible responsibilities," the GAO report said.

Another factor that minimized abrupt changes was

[1]U.S. General Accounting Office, Report to the Congress: **Early Observations on Block Grant Implementation,** August 24, 1982, p. ii.




"ALTHOUGH IT DOESN'T TICK, I AM STILL NERVOUS!"

the availability of "carryover" funds. Much of the money allocated within the block grants was for programs that were already funded for periods extending well into 1982. By carrying these amounts forward, states acquired additional time for making decisions about how to use their block grant funds. In the three health block grants and the community services program, in particular, ongoing federal monies carried over from previous years gave states time to adjust to lower funding levels.

In five of the block grants (social services; community services; low-income energy assistance; preventive health and health services; and alcohol, drug abuse and mental health), states are permitted to transfer from seven to ten percent of the funds to other programs, subject to certain prohibitions. The GAO survey revealed that some types of transfers occurred more frequently than others. No shifts of monies out of the health block grants were reported, but community services and energy assistance funds were used for several other purposes. For example, Washington transferred 3.5% of its energy assistance funds into community services, while Pennsylvania moved community service funds into its Head Start program.

According to the study, programmatic changes in the health and community services block programs were impeded by various statutory "strings" (e.g. earmarking, matching, maintenance of effort requirements) and the short time available before the grants went into effect. Funding patterns fluctuated considerably in the social services and low-income energy assistance areas. For example, Kentucky eliminated day care services for the elderly and reduced homemaker services to give higher priority to other programs. In Texas, the human resources department cut services to the handicapped upon determining that these services could be more properly administered by another agency.

One of the major selling points of the block grants was that they would reduce red tape and regulations. Although it is still too early to make a definitive judgment in this area—as with most issues relating to block grants—there are examples where reductions have occurred. For example, California estimated administrative savings of about $200,000, while Florida expected annual savings in the range of $1.2 million resulting from streamlined monitoring and application requirements. Massachusetts officials indicated real time savings in the applications for energy assistance, reducing the process time from 22 days to only three. Many of the opportunities that block grant supporters envisioned for states are evident in Pennsylvania Governor Richard Thornburgh's description of his state's implementation activities:

> "Through 36 public hearings, a statewide Block Grant Advisory Committee, departmental task forces and workshops for local governments, we developed a productive dialogue with local officials and private sector providers. By taking full advantage of decreased federal regulations we reduced administrative costs, saving, for example, more than $5 million at the state and county level by eliminating Title XX reporting requirements. We targeted block grant funds to meet state priorities, reduce gaps in service and increased administrative flexibility for local governments through an innovative state Adult Services Block Grant, and a "mini" block grant in the Department of Aging. We have found ourselves able to preserve basic services while still holding the line on state taxes and spending."[2]

Whether or not Pennsylvania and its 49 sister states will be able to continue on the block grant high-road remains to be seen in light of continuing economic pressures. By year's end, the "Keystone State" faced an unemployment rate in excess of 11%, had cut the general fund by 1% across-the-board, had postponed capital construction, and faced a potential $164 million shortfall for fiscal year 1983.

### Double Whammy Hits States, Overrides Block Grant Issues

The deepening economic recession, combined with federal budget cuts, preoccupied government leaders in 1982, overshadowing and overriding most other concerns. For states, it was impossible to ignore a nearly $8 billion collective shortfall in anticipated revenues. During the past year, a survey conducted by the National Governors' Association (NGA) and the National Association of State Budget Officers (NASBO) revealed that over half the states imposed hiring ceilings and made selective program cuts. Another 15 states enacted across-the-board cuts and virtually half the states raised taxes.[3]

A follow-up survey by the National Conference of State Legislatures (NCSL) corroborated the bleak findings of the earlier NGA-NASBO work. The NCSL study observed: " . . . state fiscal conditions have seriously deteriorated since mid-1982 (but) . . . while most states are still teetering on the brink of deficits, 1983 will not be a re-run of 1982 because the policies adopted are likely to differ. Indications are that in 1983 raising taxes will play a much larger part in solving budget problems than was true in 1982."[4]

In the current recessionary climate, federal aid cuts could not have come at a worse time for states. With revenues down, and demands for services up, most states were not able to compensate fully for cuts in federal funds. Early in 1981, both the National Governors' Association and the National Conference of State Legislatures had argued for a 10% reduction in certain federal funds in exchange for more flexibility in the use of that money. What they received in the newly-consolidated block grants passed later that year were

[2]This statement was prepared by Governor Thornburgh for ACIR.
[3]National Governors' Association Office of Research and Development and National Association of State Budget Officers, **Fiscal Survey of the States: December 1982 Update,** Washington, DC, December 1982.
[4]National Conference of State Legislatures, "State Fiscal Conditions Entering 1983," **Legislative Finance Paper #34,** Denver, January 1983.

# The Small Cities Block Grant: A 'Mini-Test' For The New Federalism

The Small Cities Community Development Block Grant is "a successful statement that states are prepared, willing and able to assist their local governments," according to Peter Harkins, staff director for the Senate Subcommittee charged with drafting the legislation that created the program.

State administration of the Community Development Block Grant Small Cities Program is unique among the block grants because the states have had no previous experience with it. The small cities program had been encompassed in a direct federal-local relationship until the Reagan Administration proposed in 1981 allowing the states to opt into it. Accepting the option is known as "buying in," by a state making a 10% cash or "in kind" match and taking administrative responsibility for the program.

### Demonstration Program Tests Concept

The small cities program was "tested" by two states in 1980 and 1981. These states, Kentucky and Wisconsin, were the first to implement the new block grant on October 1, 1981. Their success in the HUD demonstration project undoubtedly played an important role in assisting Congressional deliberations over the similar, national program and also in encouraging other states to follow their lead. According to HUD's Office of Program Analysis and Evaluation, both Kentucky and Wisconsin were able to assume control over the application process with a number of substantial achievements and no real failures. Further, both states made significant program changes, but could not in one year put in place all the changes they wanted. In effect, they were able to achieve one major innovation each.

The demonstration experience allowed both states to work out implementation problems and to begin FY 1983 with more assurance of success for their respective programs. Preliminary indications are that they have made adjustments where necessary, and are moving ahead with additional changes.

### Full-Scale State Implementation, An Option For FY 1982

By the end of 1982, all but 14 states had "bought into" the program, and at least an additional seven are expected to begin implementation sometime during 1983. If the small cities program is seen as a "mini-test" for the New Federalism, then most states would get high marks, according to Senate-aide Peter Harkins. In the vast majority of the 36 states that are currently participating, officials have shown initiative in program design and implementation. In a few cases, they are supplementing federal funds beyond statutory requirements to assist local development. In others, they have established a network to help smaller communities, frequently inexperienced with federal grants, apply for other programs such as Urban Development Action Grants for particular undertakings.

Even in the first year of operation, states instituted changes in the small cities block grant allocation process. Pennsylvania, for example, awarded a series of bonus points to communities having local codes and zoning laws and subdivision ordinances, a capital improvements program, a floodplain management program, a conservation program, or intergovernmental cooperation plans. Utah included health and safety factors, and the promotion of energy conservation or production. Wisconsin considered whether the applicant had a fair housing ordinance in effect. Wyoming included the ability to leverage other sources of funding and minimize administration costs. In Arizona, the state's five councils of governments played the central role in allocating the bulk of the state's award; the COGs' selection criteria were subject to state approval and emphasized leveraging non-block grant funds.[1]

An area to watch is whether states will tend to focus on statewide needs rather than continue HUD's practice of targeting resources. Ohio, for instance, changed the allocation process from a competitive one to a redistributive one. Under the state's plan, approximately 220 communities will receive funding as opposed to 39 the previous year.[2]

With fully 43 states expected to participate in the small cities program in 1983, evidence on how states are adapting this program to local needs should be more fully documented. Although several studies are underway to determine the effects of state implementation, it is too early to obtain data or to make a detailed assessment of progress. Already, though, a few signs can be read, and general observations made.

One overall trend that seems to be occurring is for states to fund more economic development activities than had been the case under the HUD-administered program that was heavily tilted toward housing rehabilitation.

The story of state implementation of the small cities program will be an interesting one. It will be perhaps the truest test of state administrative innovation and changing intergovernmental relations under the block grant component of the New Federalism.

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[1] **Housing and Development Reporter,** "State Plans for Fiscal 1982 Small Cities CD Block Grant Program," Bureau of National Affairs, Inc., publ., April 12, 1982, pp. 924-930.

[2] Nathan, Richard P. et al, **Reductions in U.S. Domestic Spending: How They Affect State and Local Governments,** John W. Ellwood, ed., Transaction Books: New Brunswick, N.J., Fall 1982, p. 3244.

**"Increased flexibility had not resulted in state savings commensurate with the cuts, in part because the cuts were deeper than anticipated, but also because flexibility was less than anticipated."**

more like 20% reductions in federal funding for health and human service programs. Reactions were strong. As one state legislator put it: "... states were given a 22.7% real reduction which meant cutting into the substance of the programs. Most states are currently dealing with budget reductions and revenue shortfalls and are in no position to subsidize programs that were originally initiated on the federal level and are now being shifted to the states."[5]

Increased flexibility had not resulted in state savings commensurate with the cuts, in part because the cuts were deeper than anticipated, but also because flexibility was less than anticipated. The NGA Center for Policy Research found that,

> "The most vexing problem being experienced in block grant administration is the shortfall between federal promises and delivery. The President's original concept of much greater state control over programs has not materialized. ... Yet, the reduction in federal funding support of the programs that were blocked greatly exceeded the amounts that the Governors agreed could be saved under the original consolidation plan. The net result, from our state's perspective, has been a reduction in the state's ability to deliver vital services."[6]

According to GAO, the first-year cuts in block grants ranged from a high of 25% in the community services program to 11% in the preventive health and health services areas. Low-income home energy assistance was the major exception—its funding remained relatively stable.

Although carryover funds and state adjustments softened the effect of budget cuts, fears of additional cuts for future years continued to heavily condition responses to the new blocks. Alan Karcher, Democratic leader of the New Jersey Assembly, reflected on the block grant experience: "The only thing that trickles down from the 'New Federalism' is the agony and bitterness of cutting people off. ... You're given this block grant. Who do you pull the plug on?"[7]

Clearly, the block grants would have been an ill wind indeed if they brought no change for the better. "Many states have been forced to invent new ways to save money, some painful, some long overdue," wrote **Washington Post** journalist Howard Kurtz on December 27, 1982. Donald Linky, then an aide to then New Jersey Governor Brendan Byrne, was quoted by Kurtz as saying: "Some of these programs seemed to be going on without any visible results. We were hiring people from year to year with federal money, and we were divorced from the responsibility of paying for them."[8]

First-year implementation, therefore, proceeded in a highly-charged atmosphere. Some officials agreed that the new block grants, and the budget cuts, were beginning to bring about reform; others claimed the block grants forced reductions in the states' ability to deliver vital services. All in all, the cuts in block grant funding levels did not result in the drastic changes many feared and did not "constitute a deep penetration into the 1982 base of federal spending for domestic purposes," according to Richard Nathan who directed the Princeton University study on the effects of these cuts.[9]

As 1982 wore on, however, it became harder to differentiate between cuts in block grant funding and cuts in other federally-assisted programs, particularly as the recession reached depression-type stages in many states and demands for public services stretched beyond state capabilities. In December, the NGA called for a halt in domestic spending cuts, and Congress was sympathetic to the governors' pleas. A continuing funding resolution passed in the lameduck session of the 97th Congress accommodated many state concerns. Total funding for the seven HHS block grants will be $5.978 billion for FY 1983, compared to $5.809 billion available in fiscal 1982 and $1.4 billion above the Administration's request for the current fiscal year. Included in these figures is a $50 million increase for social services for FY 1983 and some $100 million more for low-income energy assistance. The continuing resolution will run through the end of the federal fiscal year, thereby providing a measure of certainty for state planning and budgeting. Other important federal-state programs also received modest increases for FY 1983 over their fiscal 1982 levels in the waning days of the 97th Congress. In all, state officials appeared satisfied with the lameduck session, as critical programs were apparently spared what many feared would be crippling cuts. Block grant planning and implementation in the current fiscal year may therefore be freed from some of the problems that were present in 1982.

[5]Paul Hess, Kansas State Senator, in testimony before the Senate Committee on Governmental Affairs, Subcommittee on Intergovernmental Relations, on behalf of the National Conference of State Legislatures, May 11, 1982, p. 9.

[6]National Governors' Association Center for Policy Research and National Governors' Association Office of Research and Development, **1982 Governors' Guide to Block Grant Implementation,** NGACPR, Washington, DC, February 1982, p. 47.

[7]"After an Era of Growth, the States Face Anguish of Cutting Back," by Howard Kurtz, **Washington Post**, December 27, 1982.

[8]*Ibid.*

[9]*Nathan, Richard P., et al, "Initial Effects of the Fiscal Year 1982 Reductions in Federal Domestic Spending," from* **Reductions in U.S. Domestic Spending: How They Affect State and Local Governments,** John W. Ellwood, ed., Transaction Books, New Brunswick, NJ, 1982, p. 320.

## BLOCK GRANTS RAISE SUBSTANTIVE ISSUES, FOR 1982 AND BEYOND

### The Legislative Role

In the 1970s, legislative oversight of federal funds enjoyed popularity among the state houses, sparked by the realization that federal dollars were expanding and were making up larger and larger portions of state budgets. In the early 1980s, the issue continues to be both popular and significant, but for opposite reasons. If a growing federal presence skewed state priorities in the past, how will programmatic and budgetary retrenchments change state spending patterns in the future? This question is the challenge before many state officials today.

Most states are responding to the challenge, many to a remarkable degree. Nevertheless, procedural and political hurdles to legislative oversight of federal funds—and more specifically, the block grants—remain. Still lingering are the immense and sometimes overwhelming amount of paperwork involved in dealing with federal aid, the time and expertise necessary to oversee adequately the amounts and uses of federal dollars flowing into the states, and the potential conflicts over legislative "oversight" versus executive "administration."

In Florida, the appropriation bill passed in the spring included a section requiring that no new programs be implemented when additional block grants are made available until the programs are included in the Governor's budget and approved by the legislature. And the California legislature created a block grant task force to assess needs, delivery systems, and program performance, and to make recommendations for changing state practices.

In other actions, the Colorado legislature went ahead and appropriated the block grants despite the lack of clear statutory or constitutional language giving it the authority to do so. The West Virginia legislature has not appropriated federal funds in the past, but as a result of a 1982 law, will begin doing so in fiscal years 1983 and 1984. In addition, during the legislative interim, the Governor must submit a statement to the legislative auditor explaining why "unanticipated" funds could not reasonably have been anticipated in the budget process and describing how the monies will be spent. The unanticipated funds may not be used to create a new program or significantly alter an existing one. And in Illinois, the legislature created an 11-member block grant advisory committee that will be responsible for conducting public hearings, reviewing reports, and making recommendations to the legislature and governor on block grant implementation issues. Eight legislators and four public members, all appointed by the leadership in both houses, will serve on the panel.

The trend toward greater legislative involvement in decisions about federal grants was slowed considerably in a few cases. For example, in North Carolina and South Carolina, legal rulings upheld executive branch challenges to legislative membership on various committees involved in block grant funding decisions based on the separation of powers doctrine. And in Kentucky, a circuit court ruled unconstitutional 1982 enactments which gave the legislature broader interim authority to review block grants, changes in the budget, administrative regulations, governmental reorganization, and executive appointments. The dispute likely will reach the state supreme court in 1983.

With federal aid almost certainly a candidate for budget cuts in 1983 and beyond, and with even more block grants and other program packaging proposals on the horizon, the progress achieved thus far in executive-legislative relations will be further tested. How and how well governors and legislators respond may be one of the most important intergovernmental questions of the 1980s.

### The Local Role

The nine block grants enacted in 1981 and the job training bill approved in 1982 are important components of decentralization. In addition to deciding what the appropriate roles will be for governors, legislatures, and administrative agencies, the states also will have to deal with a number of critical issues affecting local governments. In the block grant context, fiscal and flexibility factors are at the top of the state-local agenda. The results of a 1982 survey by the U.S. Conference of City Human Services Officials and the U.S. Conference of Mayors, in which 55 cities reported on the status of human services in their jurisdictions, revealed strong reservations about the adequacy and equity of states' responses:

> Two-thirds of the cities reported that the conversion to state block grants in FY 82 had adversely affected their local human services programs. Seventy percent of the cities did not feel they had been fairly represented in either the state planning or the state resource allocation processes under the block grants. And three out of four cities did not feel that human services funds had been passed through the state to their local programs in an adequate manner.[10]

As block grant implementation proceeds, and debate surrounding the President's reform initiatives continues, the states' treatment of local governments will receive close scrutiny. Communications and consultations between and among state and local officials will be especially important, not just with respect to block grants, but in other key tension points such as the limits on local revenue raising capacity, the impact of state mandates, and the extent of local discretionary authority.

In this connection, several states have moved to create their own mechanisms to deal with intergovernmental problems. During 1982, at least three more states—Washington, Iowa and Georgia—created intergovernmental advisory panels, and proposals to establish similar groups were under review in nearly a

[10] The United States Conference of City Human Services Officials and the United States Conference of Mayors, **Human Services in FY 82: Shrinking Resources in Troubled Times,** October 1982.

## States Investing in Distresse

States are increasingly directing their economic development activities to distressed communities with the goal of creating jobs and expanding tax bases. Although federal funds for these activities have declined, state commitments to meeting the needs of economically-disadvantaged areas are generally being sustained and, in some states, intensified. Furthermore, a number of states are experimenting with new approaches to assist depressed areas, approaches that largely rely upon existing state resources and do not require major new appropriations.

As part of its on-going research project, **State Aid to Distressed Communities**, ACIR has identified three states that reflect a growing commitment to economic revitalization in hard-hit areas. California has created an interagency task force to help localities deal with plant closings. In Massachusetts, the legislature recently passed a public-private partnership program to match industry investment with public capital improvements. Missouri has pioneered in coordinating aid by using its enterprise zone bill as a vehicle for linking neighborhood assistance programs, employment tax credits, and other tax incentive programs to attract business to low income areas.

The common denominator in all three states is using existing agency resources, relying on tax expenditures or tax exempt bonds for financing, and greater public-private cooperation. These three programs illustrate how states can help communities and residents in need.

### California's Economic Adjustment Team

California is generally considered to have a diversified and stable economy, more capable than most of withstanding the types of economic pressures brought on by the current recession. But California is now facing decline in certain economic sectors due to the economic downturn, international competiton, changing consumption patterns, and a changing national economic base. Many of the state's industrial facilities have become obsolete and are shutting down. Since January 1980, approximately 1,000 plants have closed, displacing over 105,000 workers, and unemployment has reached 30% in some California counties.

Due to the severe impact a plant closing has on a community, Governor Jerry Brown in 1981 created the California Economic Adjustment Team (CEAT) to assist communities in either anticipating and averting plant closings, or in easing the transition where closures had already occurred. The CEAT idea was enacted into law in 1982 to minimize the effects of plant closings on workers and a community's economic stability, and to create the conditions necessary for long-term, continuing economic vitality and industrial growth.

While CEAT activities are not specifically targeted to distressed communities, plant closings usually occur in areas that are already economically marginal, or the closing itself turns an area into one of severe economic distress. However, in selecting communities for state aid, the Team directs it efforts to those with large numbers of displaced workers, where economic conditons are such that the recently unemployed cannot be easily absorbed and the community's ability to respond effectively is limited.

When a plant closes or a closing is anticipated, a community may obtain assistance by having community leaders, employers and unions draft an economic action program and submit it to the Team. In addition, the Team itself may find out about a closing and seek out community leaders to develop an economic action plan.

The Team's job is to marshal whatever resources are available to meet the community's needs. These resources include such things as workshops on economic adjustment, targeting re-employment training programs to displaced workers and, in some cases, helping employees assume ownership of the business that is closing. The state recognizes that local initiative is essential and that the technical assistance package must be tailored to local circumstances if it is to work.

Concrete examples of California's approaches are available. For example, in Weed, the International Paper mill is closing. The Team has provided counseling and training assistance to management, union and community representatives on the feasibility of a worker buy-out. In Salinas, the Team assisted the Spreckel's Ethanol Conversion project to see how the sugar mill could produce ethanol fuel for use by city vehicles. Community response committees were created in Fremont, San Jose, Modesto, and Milpitas to respond to possible automotive plant closings. The Masonite Corporation was aided in developing an energy-saving program, including a cogeneration project, to reduce operating costs and therefore avert a possible 1983 closing.

### Massachusetts' Community Development Action Grant Program

Three years ago, the Department of Community Affairs realized that the number of qualified applications for national Urban Development Action Grant funds (UDAG) was far greater than could be funded. Fearing that the UDAG program itself might be terminated or its funds reduced, and that state monies for economic development might be limited, state officials moved to offer alternative approaches.

The Department proposed creating a state-funded Community Development Action Grant program to pro

## Areas to Create Jobs

vide public funds for physical infrastructure improvements that would help attract private investment and business development. The program, passed by the legislature in 1982, provides $17.5 million from general obligation bonds. A total of $10 million is available in the first round of applications, with $2.5 million being the maximum grant for any single project.

The CDAG program is patterned after the national UDAG program in that it requires a public-private partnership to revitalize distressed areas. As in the national UDAG program, Massachusetts insists that public funds leverage private investment. Unlike the UDAG program, CDAG funds may only be used for publicly-owned improvements such as access roads, water and sewer construction, or parking facilities.

All 351 cities and towns in the state are eligible to apply for CDAG, although the projects must be sited in economically-distressed areas. During the first round of applications, twenty-seven communities submitted proposals. Fifteen are being funded with an average of $667,000 per project.

### Missouri's Targeted Tax Credit Programs: Neighborhood Assistance and Enterprise Zones

Over the past five years, Missouri has been a leader in offering incentives to businesses that locate in distressed areas. In 1979, the legislature passed the Neighborhood Assistance Program, and in 1982, it created a state enterprise zone program.

Tax credits for business are not a new policy tool for states, but their use as an incentive for corporate investment in neighborhood development projects or organizations is a recent innovation. Missouri's program to aid distressed communities stands out because tax credit programs are coordinated and linked together for the express purpose of targeting assistance to areas most in need.

Begun in 1978, Missouri's Neighborhood Assistance Program provides state tax credits to businesses that contribute to neighborhood programs or invest in neighborhood projects approved by the local government. This program tries to help resolve local development problems by promoting community control over the development process and by increasing private sector ties to neighborhoods.

Either a private firm or a neighborhood organization can apply to the State Division of Community and Economic Development for project funding. After approval by both State and local governments, the firm or organization receives a tax credit authorization for a year. Essentially this authorization is a "hunting license," permitting the organization or firm to offer and obtain a 50% credit on its state corporate taxes for contributions to neighborhood projects.

Missouri's high priority projects for funding include: those projects which substantially contribute to self-help efforts by residents in meeting locally-defined needs; projects that result in providing essential services to low- and moderate-income citizens who would not otherwise receive them; and, projects that tangibly contribute to a lasting partnership between business and neighborhood organizations. The legislature has limited funding for the program to no more than $8.75 million in tax credits, and no single firm can get more than $250,000 in tax offsets.

The NAP program did not catch on during its first three years, but it took off in 1981 when the Division launched an aggressive marketing program. In FY 1981 alone, a total of $1.6 million in tax credits were approved. Over the life of the projects, 1978 to 1981, a total of 730 investments were made in 282 projects by 486 businesses. More than 80% of these projects were in community services and neighborhood development.

Enterprise zone legislation was passed by the legislature in 1982 to revitalize depressed neighborhoods by inducing private investment there through a range of tax incentives. Although ten states have passed similar legislation, Missouri's program is noteworthy because it links together a variety of tax credit programs. Businesses expanding or locating in designated enterprise zones are eligible for special property tax relief and job investment tax credits (for hiring zone residents), in addition to Neighborhood Assistance Program incentives that are highly favorable to zone investors.

Two other programs should also contribute to the success of enterprise zones in Missouri. They will be available in 1983. The first is $1.5 million in direct loan authority. Although not specifically targeted to distressed areas, loans will be available to development institutions likely to invest in such neighborhoods. A second measure provides up to $1 million in loan and bond guarantees for financing fixed assets and infrastructure improvements and to leverage additional private funds.

To apply for enterprise zone designation, a local government must first hold a public hearing and then submit a plan to the state describing the range of supportive local actions that will be taken. Such local actions must include providing adequate police protection, efforts to ameliorate any negative effects of zone designation on residents, and providing business and resident with relocation assistance. Edward Humberger

## Connecticut Negotiates the Social Services Block Grant

Connecticut is winding up a year-long experiment in re-designing its major social service program, the new Social Services Block Grant, through negotiations. Rather than making arbitrary reallocations of federal funds among high-priority activities, Connecticut officials decided to use the Negotiated Investment Strategy, a negotiating process first used by three cities in 1980-81.

Three teams were appointed to negotiate: a team representing the state agencies eligible for block grant funds; a team representing Connecticut municipalities; and a team representing non-profit service providers. A fourth group comprising private funders of social service agencies was designated as observers.In addition to the negotiating team, an independent mediator and assistant were selected. Connecticut chose Joseph Stulberg of New York City as mediator based on his experience in labor management as well as community dispute resolution. The mediating function and staff support for the local government and non-profit teams were financed by community foundations.

The NIS process was first devised to "use negotiations to organize and direct public and private investments . . . to solve problems and maintain a healthy economy." It was used in Columbus (OH), Gary (IN), and St. Paul (MN) to bring together federal, state, and city officials to coordinate programs and plans for the overall development of the cities. Its use in Connecticut marks a first on a statewide basis.

To succeed, those involved must be ready to sit down at the bargaining table and to reach a final agreement to which they will be committed. In the case of Connecticut, Governor O'Neill's commitment to the process was considered essential. He was persuaded that the NIS process would enable the State to devise a workable Social Service Block Grant plan, including allocating the $33 million the state would receive in federal funds. The non-profit sector was committed to the process because it wanted a say in setting priorities for diminished federal funds. Municipal officials, not ordinarily involved in the delivery of social services in Connecticut, were given a new opportunity to participate in such decisionmaking.

During the course of the NIS process, participants compiled a good data base, adequate for making future NIS and other policy decisions. Secondly, the negotiations acquainted each of the teams with the problems others were experiencing. Furthermore, the negotiating teams have decided to continue to meet and to monitor the block grant implementation process. They will support continued data base development, training programs, and intergovernmental cooperation. The State of Connecticut has received a grant from the U.S. Department of Health and Human Services to disseminate the results of its experiment and to help other states implement this process if they are interested.

In January, Governor O'Neill submitted the NIS recommendation to the legislature as part of his budget for the 1984 fiscal year. The success of the NIS process depends upon legislative acceptance and, of course, on the degree to which it meets the State's most important social service needs. To obtain the support of legislative leaders, the three teams invited legislators to attend their negotiating sessions and frequently consulted with legislative staffs. Any evaluations now of the NIS process in Connecticut would be premature. However, any system that might replace the currently fragmented one in social services planning, funding and service delivery, is worth trying and watching. The NIS clearly has potential.

dozen other jurisdictions. Today, almost half the states have a functioning ACIR or similar kind of state-local advisory panel.

Many of these organizations played key roles during 1982 in implementing block grants and in assessing the likely effects of other components of the President's federalism reform initiatives. For example, the Florida, Texas and Tennessee ACIRs continued their efforts to analyze both the fiscal and programmatic effects of the block grants, and the Nebraska commission addressed a range of administrative options for block grant implementation. The Washington ACIR, created in May, had as its first task the review of new federalism initiatives and their impact upon the state.

### Early Readings From Year-One Of Block Grant Implementation

It is still too early to judge the effectiveness of block grants in achieving the ideological and managerial goals behind their adoption. Initial implementation was accompanied by reduced funding, and a smooth transition was hindered by regulatory confusion and the short time frames set forth in the enabling legislation. A truer test of block grant effectiveness in promoting the New Federalism most likely will come in 1983, when state and local governments have had an opportunity to devise more permanent fiscal and programmatic strategies.

As the year drew to a close, many of the questions about how the states would treat their local governments in administering block grants remained unanswered. From financial as well as flexibility standpoints, local officials were concerned about whether they would receive their "fair share" from the states. They wondered if the benefits of New Federalism—more discretion and fewer "strings" in allocating federal funds—would be passed through or stop at the state level.

## THE LOCAL DIMENSION: FROM "URBAN CRISIS" TO URBAN SURVIVAL

Like their brethren at the national and state levels, local officials spent 1982 preoccupied with budgetary problems. Unlike earlier recessions when federal aid increased to ease the "urban crisis," federal aid cuts made this recession a time of urban survival.

By any measure, the picture in many cities was bleak. "Trends in the Fiscal Condition of Cities: 1980-1982," a survey conducted by the Municipal Finance Officers Association for the Joint Economic Committee and released in September of last year, revealed:

- Almost 60% of the cities surveyed expected deficits in 1982;
- Federal aid as a proportion of total municipal revenues was falling, especially in larger cities; and
- For fiscal year 1982, cities projected little or no increase in revenues; at the same time, they anticipated an average 7.8% increase in expenditures.

Cities survived 1982 by laying off workers, increasing worker productivity, cutting back services, raising fees for services whenever possible, and hiking taxes when they could. Toledo (OH) Mayor Doug DeGood reported in a **Washington Post** article on January 28, 1983, that his city may well have defaulted were it not for considerable belt-tightening and an increase in the city's payroll income tax. In the same article, Phoenix (AZ), three times an All-American City, was portrayed as a city coping with a better than 10% unemployment rate and sagging revenues. Mayor Margaret Hance said that Phoenix made ends meet by laying off workers for the first time in a quarter century and by curtailing some city services. Phoenix also has had some help from its citizenry. One anonymous donor gave the city $20,000 to keep open three city swimming pools last summer, and a local builder offered to repair 550 miles of streets for free.

Ingenuity has become common in many localities. From Lincoln (NE) to Baltimore (MD), cities are publishing "wish lists" of items they would like their citizens to donate. San Antonio (TX) Mayor Henry Cisneros wrote a lengthy report on how to attract more high-technology companies to his city.

Not all municipal or other local problems can be addressed by a "can do" spirit, however laudable. Detroit's gleaming Renaissance Center ended 1982 in default, and the property tax revenues it was to generate have been erased, at least until buyers for the skyscraper can be found. Structural unemployment, plaguing Detroit and other cities, likely will persist even after the economy rebounds—and local officials are worried.

Some jolts to local government are not the product of recession; they come from within the federal system itself and raise fundamental questions about how the system was designed to operate and how it is now constituted. Such a jolt came early in the year when the Supreme Court, in **Community Communications Company, In. v. the City of Boulder,** declared that cities, and other units of local government, may be subject to the same antitrust laws that apply to private corporations. The decision is significant, not only because it creates uncertainty, and possible financial costs, for cities at a time when they can least afford them, but also because it raises the question: where stand our cities in the federal system?

## BEYOND BOULDER: HOME RULE AND MUNICIPAL ANTITRUST LIABILITY

The **Boulder** decision raises at least two significant intergovernmental problems. First, it appears to have reduced municipal "home rule" authority and, as a result, altered state-local relations. Second, it has opened local governments, already reeling under the weight of recession, to potentially very expensive litigation, causing them to seek redress at higher levels. From January 1982 when the decision was handed down, until the present, **Boulder** has been like an albatross around the necks of local officials, and a source of considerable uncertainty and anxiety.

The uncertainty permeates many of a city's routine operations. In their regulatory, land use, housing, trash collection, utilities, health care, and even recreation activities, municipal actions tend to have an anti-competitive effect. For example, a zoning ordinance may allow construction of a mall in a redeveloped downtown area but not allow a hotel to be built just outside the redevelopment zone if the city perceives the hotel to be a threat to the healthy growth of the mall. Such an outcome, were it an outgrowth of agreements between private parties, would come under the reach of the 1890 **Sherman Antitrust Act.** But implicitly since 1890, and explicitly for some 30 years following the Court's ruling in the 1948 **Parker v. Brown** case, states and their local governments have enjoyed broad immunity from antitrust litigation. In the **Parker** case, states were found to be immune from the **Sherman Act** because they "are sovereign save only as Congress may constitutionally subtract from their authority." The so-called "state action" doctrine was thought, until recently, to extend immunity from antitrust prosecution to local governments as well.

Two key Court decisions: **City of Lafayette v. Louisiana Power & Light Co.** (1978) and **Boulder** changed interpretations of this doctrine. Taken together, these decisions seem to indicate that local governments have no Constitutional standing in our federal system. Instead, they must rely on specific authorizations or mandates from and supervision by the states for many of the regulatory powers they had come to take for granted—powers that have taken nearly one hundred years to establish. Because these two decisions potentially diminish greatly local governments' discretion, President Reagan's New Federalism, were it to pass Congress, might become a hollow prize.

### Challenges to Municipal Antitrust Immunity

The Supreme Court explicitly addressed the question of whether municipalities were exempt from antitrust under the state action doctrine for the first time in **Lafayette.** The Court, by a 5-4 majority, concluded that a city owned electric utility was not protected by **Parker** immunity when it engaged in "predatory market activities." Four justices signed the plurality opinion holding that the **Parker** exemption as applied to cities was limited to actions taken "pursuant to state policy to displace competition with regulation or monopoly public service." In a concurring opinion, Chief Justice Burger wrote that the state action exemption did not apply in **Lafayette** because the city was engaged in "business activity," rather than governmental activities, making the case "an ordinary dispute among competitors in the same market." The four dissenting justices argued simply that the state action doctrine established in **Parker** applied equally to states and their political subdivisions.[11]

This decision, while a narrow one, caused concern among local government officials. But the troublesome expectations were mitigated by several unanswered questions. For one, no one opinion gained a majority, and the Chief Justice's position suggested that local governments retained immunity when undertaking ordinary governmental regulatory activities. The Court also left reason to believe that when cities' actions were within their geographic boundaries, the **Parker** exemption would protect them. Finally, none of the opinions suggested that anything more specific than inference from a city's broader powers and duties was needed to justify action.

The **Boulder** decision addressed these questions, while raising several more that today remain unanswered, and in doing so virtually eliminated **Parker** immunity. Specifically, the Court held that:

> . . . Boulder's moratorium ordinance [on further cable tv construction by the plaintiff] cannot be exempt from antitrust scrutiny unless it constitutes the action of the State of Colorado itself in its sovereign capacity, see **Parker,** or unless it constitutes municipal action in furtherance or implementation of clearly articulated and affirmatively expressed state policy, see **City of Lafayette . . . .** [12]

In short, the **Boulder** decision placed local governments in the same position as private individuals and businesses with respect to antitrust laws. The argument that broad home rule powers could be substituted for precise state policy was rejected. Further, whereas the Court had suggested earlier that justification for action could be inferred from the city's broader powers and duties, it now stated that authorization from the state must be in the form of "specific anticompetitive actions."

## The World According to Boulder

Not surprisingly, the **Boulder** decision has caused great and widespread controversy. Some observers share the sentiments expressed in Justice Rehnquist's dissenting opinion: "The Court's decision in this case . . . will . . . impede, if not paralyze, local governments' efforts to enact ordinances and regulations aimed at protecting public health, safety, and welfare, for fear of subjecting the local government to liability under the Sherman Act . . . ."[13]

Others believe this decision was a long time in coming, that in fact it does not sound the local death knell, but rather returns substate governments to their proper place in the intergovernmental scheme of things: not as sovereigns but as subjects of the several states, with the requirement that they abide by federal and state antitrust policy. Of course, a range of opinions also lie between these two extremes.

## Areas of Uncertainty Under Boulder

Although it mandated a vast change in municipal antitrust immunity, the Court failed to clarify the nature and character of the new circumstances facing state and local governments. This lack of clarity is not atypical for the Court, which prefers to let the law mature through a series of cases rather than through the issuance of a single definitive edict. Thus, important problems remain in determining where local governments stand in our federal system.

What emerges consistently in the literature that quickly followed on the heels of the decision is a vast general uncertainty about the world after **Boulder.** Perceiving no dire consequences, some people urge a wait-and-see approach, while others call for immediate corrective action, expecting sure and severe attacks on the ability of localities to govern. What all observers share is a sense of not knowing quite what to expect. There are three major reasons for this uncertainty:

1) The Supreme Court's decision in **Boulder** called into question standard municipal operating procedures, resulting in a reduction of local actions in such areas as land use and zoning, waste, and sewage systems, airport services and concessions, utility services, towing services, mass transit, licenses and concessions, land leasing, and taxicab services that might be subject to antitrust suits;
2) The decision left unanswered several important questions about how to comply with **Boulder,** including: (a) must the "clearly articulated and affirmatively expressed" state policy to displace competition with regulations or monopoly be a directive, or will it be acceptable if it is permissive? (b) must supervision of the policy be placed squarely, and actively, on the state, or can it reside in the hands of local government officials? and (c) will municipalities be held to answer to the standard antitrust test of whether action is pro-or anticompetitive or will local governments' police, welfare, or aesthetic

[11] **City of Lafayette v. Louisiana Power & Light Company,** 435 US 389 (1978).

[12] **Community Communications Company, Inc. v. City of Boulder,** 102 S Ct 835 (1982).

[13] **Boulder.**

judgements be weighed as well?[14]

3) Few cases have yet been decided; lower courts, to date, appear to be circumventing the decision.

### Intergovernmental Responses to Boulder

Although people read its effects differently, there is a basic agreement that, short of any major corrective action, **Boulder** has had and will continue to have a profound effect on intergovernmental relations. According to James V. Siena, a counsel to the National League of Cities:

> **Boulder** represents an effort to reconcile two fundamental interests of the law—the interest in maximizing economic efficiency, which is (contemporarily, at least) the goal embodied in the antitrust laws, and the interest in ensuring that each level of government preserves the authority necessary to discharge its role, a goal embodied in the principles of federalism. Whether it is a successful reconciliation depends on one's perspective.[15]

Numerous antitrust suits covering a broad range of activities have been filed against municipalities since the **Boulder** decision. In only one, **Affiliated Capital v. City of Houston,** has an antitrust verdict, of $6 million, been entered against a municipality. That judgment was overturned at the district court level and is presently on appeal to the 5th Circuit Court of Appeals.

In light of these developments, fear and uncertainty accurately symbolize the prevailing mood among municipal officials. Janet Gray Hayes, Mayor of San Jose, California, paraphrasing Sir Winston Churchill, observed that " . . . the meaning of the **Boulder** decision is a mystery within a riddle wrapped in an enigma."[16]

The real cost to the cities has been the delays in public policy implementation. It is not only the losing lawsuits that hurts—indeed, no losses in terms of damages awarded have yet been incurred—but merely being sued can bring great costs. Even short of litigation, the mere threat of legal action, with all the costs that entails—treble damages, injunctions and relatively long delays in a case going to trial, service interruptions, criminal prosecutions—has impaired local operations.

Experts have identified a number of ways to minimize municipal vulnerability to antitrust litigation, such as doing a municipal audit to see where the city might have an exposed flank and having city attorneys become more expert in antitrust law. Yet no one knows what is or is not protected anymore; there are only educated guesses. Thus, while cities can reduce their risk, their real interest lies in corrective action.

Local governments have three sources for help. The first are the states. The Court aimed them in that direction, indicating in general terms that the cities could find immunity through specified types of state action. In fact, such protection has been secured in Maryland and Virginia, where specific legislation protects counties in regulating cable television. Yet, it is unclear whether such acts are sufficient to insulate these governments from antitrust prosecution.

But state action is mixed blessing for local governments because it will probably entail the partial or total loss of some local discretion. In addition, delays caused by having local problems dealt with in often overburdened state legislatures may be significant, especially if cities are supposed to receive a separate directive for each area of regulation in which they want to engage.

The position of state attorneys general on this issue is clear. In fact, 23 state attorneys general filed *amicus* briefs in favor of the Community Communications Company, Inc. in the **Boulder** case. State legal officers are generally satisfied with the Court's decision, reflecting their past concern with what they perceive to be blanket immunities for municipalities when operating in anticompetitive ways.

A second place localities can look for help is Congress. According to Steven Chapple, general counsel of the U.S. Conference of Mayors, "It's not a state problem. It's a federal problem: the **Sherman Antitrust Act.** Fifty state solutions won't work."[17] What is sought at the national level is an amendment to the **Act** providing the kinds of protections everyone acted as if they had, prior to **Boulder.** But no one knows if this action will occur. In its favor, it appears to be a nonpartisan issue. Further, last summer, hearings were held by the Senate Judiciary Committee, indicating some Congressional concern. But concern and remedial action are two different matters, especially in a Congress beset by other matters of much higher priority.

A third source of hope for cities are the U.S. Department of Justice and the lower courts. Abbott Lipsky, Jr., Deputy Assistant Attorney General in the Antitrust Division, stated at a conference on this subject that: "While there may be the exceptional case, perhaps a situation in which some city official has covertly abetted a clearly criminal conspiracy in order to line his own pocket, the Justice Department is not about to indict mayors and members of city councils for doing their jobs."[18] Indeed, the Justice Department has not yet brought a case against a municipal official for antitrust violations under the terms of **Boulder.**

The lower courts, too, are further helping to relieve the burden of the cities, though they may be bending the law to do it. According to Jeffrey Howard, a member of the law firm that represented the City of Boulder in the antitrust case:

> The courts seem to be struggling to make the **Boulder** ruling workable and to relieve cities from the

[14]**Antitrust & Local Government: Perspectives on the Boulder Decision,** edited by James V. Siena, Seven Locks Press, Washington, DC, 1982, p. 199.

[15]*Ibid.*, p. 179.

[16]For example, see Testimony of The Honorable Janet Gray Hayes, Mayor of San Jose, California, on behalf of the U.S. Conference of Mayors before the Senate Judiciary Committee Hearing on Antitrust Liabilities of Cities, June 30, 1982.

[17]Frank Gresock, "Boulder Decision Raises Fears Among City, County Officials of Avalanche of Antitrust Suits," in **The Weekly Bond Buyer,** September 7, 1982.

[18]Abbott Lipsky, Jr., "The Justice Department Looks at **Boulder,**" in Siena, p. 197.

# View From The States

ACIR asked representatives of state-level intergovernmental advisory groups to respond to this question: "What major challenges and opportunities did the New Federalism initiatives present to state-local relationships in your state during 1982?" Here are some of their responses.

**Assemblyman James W. McCabe, Sr., Chairman of the New York Commission on State-Local Relations:**

"The challenge presented by cutbacks, consolidations, and shifts in program and funding responsibilities inherent in the New Federalism initiative amounts to a virtual restructuring of the basic framework of government. Existing interdependencies of program and funding responsibilities require equally significant changes within the Nation's 50 state-local systems. The magnitude of this challenge is unprecedented, and clearly we must respond. Failure to do so would certainly increase the probability of even further program reductions. We must also remember that challenge begets opportunity. For example, lawmakers in New York, as in many other states, are starting to use this opportunity to achieve an appropriate state-local policymaking framework—one that fosters a true working partnership among the brotherhood of governments. That task accomplished, further opportunities are truly endless."

**Dr. Walter Plosila, Chairman of the Pennsylvania Intergovernmental Council:**

"The past year required Pennsylvania and its communities to constantly adjust to changing budgetary actions in Washington. Block grants have provided both a challenge—to minimize administrative costs and to maximize reduced federal funds for services—and an opportunity to incorporate state policies and priorities, in the context of intergovernmental consultation, within these efforts."

**Travis County Commissioner Bob Honts, Chairman of the Texas ACIR:**

"Here in Texas there is strong opposition to the proposed distribution of a trust fund based on tax or fiscal capacity. Although there was considerable interest in Texas regarding increased flexibility and an expanded role for state and local governments when President Reagan initially announced his New Federalism proposal, I am hearing concerns voiced now by state and local government leaders about several aspects of the proposal and the many alternatives being developed by the various coalitions and interest groups. . . . The advent of block grants has probably increased interaction between the state and its cities, counties, and special districts on budget priorities. But there is no single or well-defined process for sorting out priorities and functions between the two levels."

**Ed Schulenberg, Administrative Staff Coordinator of the Nebraska ACIR:**

"The major challenge to the Nebraska ACIR was to further understanding and awareness regarding the intents of federalism initiatives among all levels of government and to work toward a format for a Nebraska sorting out process."

**Eugene J. Schneider, Executive Director of the New Jersey County and Municipal Government Study Commission:**

"To date, state-local relations in New Jersey have been impacted only minimally by the New Federalism initiatives. But because, thus far, the concept has been associated with reduced aid (accompanying the first round of block grants) the New Federalism enforces the concern of local governments that they will be the ultimate losers in the process. . . . Although the continuing fiscal crisis has put the New Federalism on the 'back burner', the search for funding alternatives is developing into an evaluation of the functional responsibilities and service capabilities of the state and local governments. This process is likely to continue and may become more structured with persistent scarcities."

**Dan B. Mackey, Executive Director of the South Carolina ACIR:**

"The significant decrease in financial assistance from the national government coupled with dreadful economic conditions nationwide hit South Carolina at a moment of particular vulnerability. . . . (However) frustration and fiscal hard times brought about a greater appreciation for the need for intergovernmental cooperation. The state and its local governments must assume greater responsibilities for governmental services. An introspective examination of governmental services and procedures has identified numerous opportunities for cost-savings and more efficient operations. Just considering governmental improvements necessitated better communications among all the levels of government. Good discussions led to the identification of specific problems of mutual concern and courses of action to take care of them."

burden of having their legitimate governmental activities subjected to routine antitrust attack. The trouble is that the courts are unable to accomplish this result through a strict application of the . . . **Boulder** test.

Accordingly, the cases reported thus far seem to bend and twist that test in order to make it fit into a sensible pattern which will achieve a just result . . . .

. . . recent cases indicate an unwillingness by the lower courts to apply the Supreme Court's **Boulder** edict in a literal way . . . .[19]

Such action on the part of the lower courts may not go unnoticed by the Supreme Court. Many analysts expect the Court will have to revisit **Boulder.** Whether or not the Court acts on the issue of municipal antitrust immunity, the major intergovernmental issue underlying the decision—the powers, responsibilities, and independence of local governments—will need to be clarified; local officials will not allow it to rest.

## THE ELECTION: NEW PEOPLE, NEW DIRECTION?

Although federalism did not surface as a major issue in the November elections, the voters' choices will undoubtedly exert considerable influence on the future course of federalism reform. The mid-term election was billed as a test of the nation's course—should it be stayed or changed? However, neither landslides nor mandates emerged, thereby adding a political dimension to the fiscal, programmatic and judicial uncertainties already facing policymakers at all levels. In addition, the results of the various initiatives and referenda sent mixed messages to public officials on the tax limit and local restructuring fronts. These state electoral highlights, and their implications, are discussed below.

### Governors And Legislators

The major electoral change this year was in governors' offices; of the 36 that were contested, Democrats captured 27 for a net gain of seven. The Democrats now occupy 34 state executive mansions. The largest switch in gubernatorial posts occurred in the Midwest, where Democrats added Michigan, Ohio, Wisconsin, and Nebraska to their gubernatorial ranks.

The Democrats unofficially had a nationwide net gain of about 200 seats in state legislatures. Going into the 1982 election, Republicans trailed Democrats in both the number of seats held overall and in the number of state houses held. As a result of the November voting, Democrats now hold 4655 seats to the Republicans' 2718. The net gain of nine state houses by the Democrats gives them control over 73 chambers, while 25 are held by Republicans. Democratic majorities in both houses are found in 34 states; in 11 the Republicans hold both; in four the two parties split control; and, in one—Nebraska—the legislature remains unicameral and nonpartisan.

Although no one knows for sure what these changes may bring, a consensus is emerging about the implications in three key areas. First, Democratic gains notwithstanding, fiscal stringency remains the watchword for the public sector; neither analysts nor politicians interpret the Democratic gains as a move in the direction of increased state spending. Second, the message to hold the line on spending increases also fairly clearly indicates opposition to further cuts in federal domestic spending. Democratic victories on the state as well as national levels might go a long way toward assuring such restraint, but Republicans have also expressed concern about the federal government's responsibilities in these matters. In particular, states that have bitten the bullet and raised taxes to make ends meet can be expected to be unsympathetic to further hikes in defense spending sustained by cuts in domestic programs. Finally, as in 1982, the fate of the President's revamped New Federalism proposals will be closely tied to developments in the national economy, the federal budget, and the states' fiscal condition.

### Initiatives And Referenda

Besides voting for representatives, people in 42 states and the District of Columbia voted directly on initiatives and referenda. The latter are statutes or state constitutional amendments that have been passed by the state legislature but which must have voter approval before they can take effect. Initiatives, permitted in approximately half of the states and the District of Columbia, are statutes or constitutional amendments that are placed directly on the ballot by voter petition.

The 1982 election included initiatives in a record number of places—18 states and the District of Columbia. In total, citizens throughout the country voted on 51 initiatives, the greatest number since 1932, and over 180 referenda.

No single headline can capture the voters' responses. One analysis, for example, argued that "there were few signs that the celebrated 'Tax Revolt' which generated so many tax cut initiatives in 1978 and 1980 has continued,"[20] while another, looking at the same results, claimed that "most Americans indicated they are still in a tax-cutting mood."[21] These seemingly contradictory views reveal much about what did happen in 1982. The voters sent mixed signals, approving some new taxes and limiting others, passing a city-township consolidation in one place and rejecting merger in another.

### Taxes

A survey of election results shows that voters in 15 states opted to limit or cut state taxes or to restrict state spending, and in four states they rejected new taxes or tax increases. Further, new taxes were approved in two states, while voters in three others re-

[19] Jeffrey Howard, **The Boulder and Hydrolevel Cases: Changing Antitrust Risks for Local Governments and Their Membership Organizations,** November 3, 1982, p. 11.

[20] **The Initiative New Report,** November 12, 1982, p. 5.

[21] Joseph Summers, "Voters Still Favor Lower Taxes, But Some States Buck the Trend," **The Weekly Bond Buyer,** November 8, 1982, p. 5.

jected tax limitations or tax exemptions. In two states, voters simultaneously approved some new taxes and limited others. A closer look shows the range of choices presented to voters:

- For the third time since 1978 Oregon voters rejected a Proposition 13-type constitutional amendment to cut statewide property taxes, preferring higher taxes to likely cuts in state services. The narrow defeat, though, is considered an endorsement of property tax relief, but for a type less dramatic than this particular proposal.

- In Maine, voters approved a moderate tax indexing measure that would prevent inflation from pushing state income taxpayers into higher brackets, a measure similar to one that California voters backed in June of 1982. Maine's plan was drafted to ensure that its benefits would accrue mainly to middle- and lower-income taxpayers. In addition, Alaska voters passed a constitutional amendment capping state expenditures at $2.5 billion, adjusted annually for changes in population and inflation. The Alaska limitation, may, however, be modified under certain specified exceptions.

- Voters in Missouri passed an initiative to raise the state's sales tax by 1%, with half the new revenues going to property tax relief and the rest to education. Interestingly, this hike came just two years after Missouri voters approved an amendment to limit future tax increases and require voter approval for any new or increased tax or fee. At the same time, they defeated a series of user taxes for roads and bridges. Ohioans rejected a 1% sales tax earmarked for a high speed rail transit system between its seven major cities.

- After abolishing the state inheritance tax a year ago, Washington voters rejected a tax cut initiative this year. They sent down to defeat a new 10% tax on corporate taxable income that would have abolished the state's sales tax on food after learning that the former would bring in about $100 million less than the latter. This defeat appears to be a reaction against what would have been necessary budget cuts had the switch been approved.

- Idaho voters passed an initiative to shift property taxes from homes to businesses, the burden of which, it was claimed, had been shifting onto homeowners since the passage of a Proposition 13 type initiative in 1978. And Tennesseeans passed property tax relief for certain elderly low-income homeowners.

A few observations seem pertinent here. For one, property tax relief remains consistently popular, but is occurring in perhaps a more sophisticated form than during the "tax revolt" of the past few years. Except for indexation in Maine and an expenditure limit in Alaska, voters seem less inclined than in recent years to bind the hands of state legislators, as was done with Proposition-13-style initiatives that went far beyond simple property tax relief. Voters also seem to appreciate the difficult fiscal straits in which many states find themselves; approvals of tax and revenue increases indicate a willingness to give transfusions to those states hemorraging from the recession.

Bond propositions received strong support throughout the country. As the **Weekly Bond Buyer** noted in its November 8, 1982 edition: "Overall, 186 bond programs appeared . . . on 124 state and local ballots. Voters in 79 elections approved 129 of the issues. The 57 proposals that were defeated in 45 elections totaled $619.2 million." The nearly $3.85 billion of long-term tax-exempt bonds passed on election day was the third largest amount since the **Weekly Bond Buyer** began charting these totals in 1946. Further, the passage of 87% of the $4.46 billion submitted for approval was among the highest bond success ratios experienced during that same period.

Analysts tended not to see these results as a repudiation of recent anti-tax sentiment, an appraisal that basically conforms with the returns on other issue-oriented ballot questions. According to some, the voters realize that capital facilities have been underfunded. The high level of approved funding reflected an awareness that project costs have increased and that too little has been alloted to maintaining and replacing capital assets. In some cases, voters appeared willing to bear higher taxes to fund capital needs.

The largest local bond issues passed in the 1982 election were for local governments with major revenue sources other than property taxes. Moreover, a large percentage of mortgage and veteran bonds were approved. Such issues have minimal effects on taxes, but are popular in the face of high mortgage rates and high unemployment.

### Consolidations

Two important governmental structure issues were on the November ballots as well. Voters in the areas of Battle Creek, Michigan, and Louisville, Kentucky, chose whether to consolidate two governmental units.

Prompted by an ultimatum from the Kellogg Company, a majority of voters in both Battle Creek city and township chose to form one government. Kellogg, located in that area for some 70 years, threatened to move its facilities because of difficulties in dealing with two—rather than one—local governments. However, Kellogg promised that in return for consolidation, it would build a new worldwide headquarters there and, further, would pledge $1.6 million—the amount it would save through reduced taxes on its city properties over five years—to initiate a fund for small business creation in Battle Creek. Other firms pledged an additional $4 million. The $5.6 million was used to leverage private and federal monies to establish an $8 million fund for creation of about 1500 new jobs.

The new Battle Creek government, supported by a 9-to-1 margin in the city and a 2-to-1 margin in the township, gains an important additional benefit from consolidation. The combined population, now more than 56,000, raises the jurisdiction into the ranks of entitlement cities for the distribution of Community Development Block Grants.

In Kentucky, an attempt to reorganize and consolidate the governments of Jefferson County and the City of Louisville lost by fewer than 1500 votes out of nearly 183,000 cast. Such consolidation has been debated since the 1920s, but for several decades every effort to do something about it was squelched in the legislature. In 1972 the legislature granted to every county, save Jefferson, the authority to consolidate. The Jefferson exclusion reflected opposition to consolidation among the county's legislative delegation. Finally, with the support of the chamber of commerce, city and county officials, much of local organized labor, and many local residents, the Kentucky General Assembly in 1982 granted consolidation authority to Jefferson County. Given this backing, a proposal was quickly drafted. The plan initially called for eliminating all 90 governments within the territorial boundaries of Jefferson County. It quickly became apparent that this approach had little hope for adoption, and so it was altered to consolidate only the City of Louisville with Jefferson County.

Proponents based their campaign—by far more expensive of the two—on four main issues: that consolidation would bring about a better, streamlined, and more efficient government; that it would bring a more representative government because there would be more elected representatives than before; that it would cap new taxes and require voter approval to increase property and occupational taxes; and that it would help the area's economic development efforts.

Opponents argued that there would be tax increases because the costs of government would rise; that the quality of police services would be compromised because police accustomed to either the city or the county might be sent to the other area with which they would be far less familiar; and that the "better government" claims were merely a smokescreen to wrest influence and power from minorities. Another issue that appeared to play a lesser role in the outcome was the potential loss of $4.5 million annually from the approximately $17 million the two governments receive in Community Development Block Grants.

The struggle left the area badly divided. Despite a losing margin of less than one percent, many local leaders are reticent to raise the issue again soon, preferring to let wounds heal before another battle.

### 1982 LEAVES MANY QUESTIONS UNRESOLVED

Looking back on the year, intergovernmental issues were often in the headlines and in the forefront of the nation's policy agenda. But there was much more talk than action. Given the magnitude of the fiscal and programmatic realignments, and of the economic problems confronting the country, it should not be surprising that 1982 was a year of debate and transition.

The three major intergovernmental "stories" of the year discussed in this article illustrate this phenomenon. The shift to block grants was fairly smooth, with few marked changes in funding and programming patterns and few flare-ups in national-state-local relationships. The **Boulder** case raised but left unresolved important issues regarding local home rule. Finally, although federalism per se was not an election issue, related matters ran throughout the voting for state offices and on various initiative and referenda proposals.

Looking ahead, it appears that many of the uncertainties will carry over, and perhaps be exacerbated. Whether and when the national economy will rebound, of course, are the key concerns. Yet other significant unresolved intergovernmental questions also carry over into the new year, including:

- to what extent will further cuts be made in the federal domestic budget?
- how receptive will the Congress be to the President's federalism reform and block grant proposals?
- in what ways will changes in federal tax policy affect state and local revenues?
- in what form will the revamped New Federalism appear, and what will be the shortrun and long term consequences for states and localities?
- to what extent will state and local governments have to raise taxes and reduce services?
- will states pass through to local governments an equitable share of funds and sufficient amounts of discretionary authority under block grants?
- will the obstacles to the exercise of local home rule powers be removed?

These issues set the scene for a year that will test the strength, endurance, and resiliency of the intergovernmental partnership. It is possible that 1983 could be a watershed period for federalism as the rebalancing effort picks up momentum. It is also possible that preoccupation with the economy, unemployment, and defense spending will crowd federalism off the policy agenda, or that negotiations over the President's proposals will stalemate. If the latter occur, intergovernmental issues may continue to be dealt with incrementally in the context of pending legislation on General Revenue Sharing, housing and community development, transportation, and environmental programs.

It is too soon to write off the New Federalism and to conclude that 1982 was a year of lost opportunity as far as a major realignment of governmental powers, roles, and resources are concerned. But, it is increasingly clear that more action and less rhetoric are needed if the nation's policymakers are serious about federalism reform.

*Jerry Fensterman and Susan Szaniszlo are ACIR Fellows in the Policy Implementation Section. Carl Stenberg is Assistant Director for Policy Implementation. Jane Roberts, ACIR's State-Local Relations Associate, also contributed to this article.*

Former Secretary of State Edmund Muskie, Representative L. H. Fountain and Senator Dave Durenberger (R-MN) at ACIR Reception and Testimonial Dinner for Representative Fountain, December 2, 1982.

## ACIR Honors Representative L. H. Fountain

On December 2, the ACIR held a commemorative dinner honoring Representative L. H. Fountain's crucial role in founding and sustaining the Commission. Rep. Fountain retired from Congress this year, having continuously represented North Carolina since 1952. In 1958, the House Intergovernmental Relations Subcommittee, chaired by Rep. Fountain, held hearings on the report of the Kestnbaum Commission (a temporary commission formally known as the Commission on Intergovernmental Relations) that called for strengthening executive branch resources to deal with emerging intergovernmental problems. Shortly thereafter, the subcommittee issued a report based on these hearings and called for the establishment of the ACIR. Rep. Fountain, together with Florence Dwyer of New Jersey, introduced ACIR's enabling legislation in the House while then-freshman Senator Edmund Muskie (ME) sponsored a companion bill in the Senate. The measure passed and was signed into law by President Eisenhower on September 24, 1959. Rep. Fountain became an original ACIR member and served until his retirement from the House on January 3, 1983.

At the ACIR testimonial dinner, former Secretary of State Muskie spoke for Rep. Fountain's colleagues in Congress and on the Commission when he cited the Congressman's many contributions to improving government. Other past and present ACIR members joined the former Secretary in noting the Congressman's unique and lasting mark on the Commission's philosophy and deliberations.

## Commission Takes Stand on State Taxation of Multinationals, Completes Regulatory Reform Agenda

Congress should not pass legislation limiting state tax practices with respect to multinational corporations or "foreign source" income, the ACIR recommended at its December meeting. ACIR took this position because:

- our federal system allows states the widest latitude in determining their own tax structures,
- the judicial system provides processes for determining whether state tax practices conflict with Constitutional standards,
- business enterprises in our federal system are free to locate in states that provide the most congenial tax climate, and
- there is no evidence that state tax practices cause harm to the nation.

State taxation of multinational corporations has been accorded increasing prominence in recent years due to court decisions, state legislative actions, deliberations on international tax treaties and proposed national legislation. The controversy focuses on the extent to which states should be allowed individually to decide how they will tax the income of multinational corporations. Some states currently calculate taxes due by apportioning part of a corporation's worldwide earnings (called the worldwide combined reporting method), claiming that such procedures are necessary to prevent corporations from avoiding state taxes by shifting income between subsidiaries.

## Regulatory Reform Agenda Completed

Also in December, ACIR members completed consideration of findings from a study on regulatory federalism and finalized its agenda for reforming the way the national government influences state and local activities. The recommendation adopted in December calls upon the national legislative, executive and judicial branches to reconsider the current legal and policy interpretations that sustain the newer and more intrusive forms of federal regulation into state and local activities. These newer regulatory techniques—such as partial preemption devices, cross cutting grant requirements and crossover sanctions—represent, in the Commission's view, major departures from past intergovernmental practices. The Commission further urged that the federal judiciary revive and expand upon the principles expressed in the landmark case, **National League of Cities v. Usery** (426 U.S. 833), especially those addressing the "basic attributes of state sovereignty" and "integral functions" of state government.

The Commission's call for a re-assessment of current interpretations of the commerce and spending powers completes a set of 12 recommendations stemming from its study of regulatory federalism. These recommendations were adopted to encourage a more restrained use of the national government's intergovernmental regulatory powers.

## Frank Bane, ACIR's First Chairman, Dies at 89

Frank Bane, ACIR's first Chairman, died of cancer on January 23 at the age of 89. He was widely considered one of the most influential men in the national government from the 1930s through the 1950s. In 1930, he founded the American Public Welfare Association and was influential in developing the concept of public welfare into a major governmental function. From 1935, when it was organized, until 1938, he administered the vast Social Security System.

In a **Washington Post** interview shortly before his death, Frank Bane looked back on the early years in the Social Security System's history and said "I made a mistake." The mistake, he explained, was in failing to foresee that Americans would live as long as they do now. In 1930, American life expectancy was 59.7 years; in 1980, it lengthened to 73.8 years.

Frank Bane himself had a long and productive career. He organized national rationing of scarce items in World War II and was, for 20 years, the executive director of the Council of State Governments. He served as Chairman of ACIR from 1959 to 1966 and was a friend and supporter of the Commission until his death. He will be remembered for his many contributions to the commonweal, including his dedication as ACIR Chairman to strengthening the role of the states in the federal system.

Commission members and staff who worked closely with him over the years will miss his keen intellect, his cheerful manner, and his everpresent sense of humor. He will be remembered by longstanding ACIR watchers as a gracious but firm Chair, as a genial but effective mediator, and as the only presiding officer ever to have the opportunity to break a tie with his vote.

## Three New Commission Members Named

Over the past several months, three new members were named to serve on the ACIR. Last fall, Speaker of the U.S. House of Representatives Tip O'Neill, Jr., appointed Representative Barney Frank (MA) to replace Representative Charles Rangel (NY). In November, President Ronald Reagan named William Murphy, County Executive of Rensselaer County, NY, and Gilbert Barrett, Chairman of the Dougherty County Board, GA, to serve as two of the three ACIR members representing counties. They replace Lynn Cutler of Black Hawk County, IA, and Roy Orr of Dallas County, TX.

Each of ACIR's recently appointed members brings considerable intergovernmental experience to the Commission. Rep. Frank is a member of the House Subcommittee on Intergovernmental Relations and Human Resources which has jurisdiction over General Revenue Sharing and oversight responsibilities for human resource programs and ACIR. Prior to his election to Congress, he served in the Massachusetts legislature for seven years.

County Executive Murphy is Rensselaer County's first and only county executive, having served continuously since the county changed to the county executive form in 1974. He is currently president of the National Association of Counties.

Chairman Barrett has served 24 years as a county official and was recently reelected unopposed to his second term as Chairman of the Dougherty County Board. He was president of NACo in 1973 and has continued to participate actively on the organization's executive committee and on its board of directors.

## Charleston to Host Next ACIR Meeting

The Commission will meet on March 10, 11, and 12, 1983, in Charleston, SC. Charleston's Mayor Joseph P. Riley, Jr., an ACIR member, will host the forthcoming meeting. The national ACIR is holding a hearing on March 11 at which it will gather information on state-local relations issues, especially from its state-level counterparts. State ACIRs and similarly organized state-local advisory bodies have been increasingly visible in recent years in studying intergovernmental trends, assisting in the transition to block grants, and ironing out problems that arise within state boundaries.

The meeting will also feature the first nationwide gathering of state ACIR-type organizations to discuss common problems and to share insights about activities and useful approaches. The decentralizing thrust of the Reagan Administration's New Federalism initiatives and the strengthened status of states generally, have given added significance to long festering state-local issues. The Charleston meeting will be another indication of the Commission's traditional interest in and study of state-local relations.

## Current Members of the Advisory Commission On Intergovernmental Relations
**February 15, 1983**




The Chairman of the Advisory Commission on Intergovernmental Relations has determined that the publication of this periodical is necessary in the transaction of the public business required by law of this Commission. Use of funds for printing this periodical has been approved by the Director of the Office of Management and Budget through March 20, 1985.



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