Readings in Federalism

Perspectives on a Decade of Change

acir ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS

SR-11
May 1989

Members of the Advisory Commission on Intergovernmental Relations

(May 1989)

Private Citizens

Daniel J. Elazar, Philadelphia, Pennsylvania
Robert B. Hawkins, Jr., *Chairman*, San Francisco, California
Vacancy

Members of the U.S. Senate

Dave Durenberger, Minnesota
Carl Levin, Michigan
Charles S. Robb, Virginia

Members of the U.S. House of Representatives

Sander Levin, Michigan
Larkin Smith, Mississippi
Ted Weiss, New York

Officers of the Executive Branch, U.S. Government

Richard L. Thornburgh, Attorney General
Vacancy
Vacancy

Governors

John Ashcroft, Missouri
George A. Sinner, North Dakota
Vacancy
Vacancy

Mayors

Donald M. Fraser, Minneapolis, Minnesota
William H. Hudnut, III, Indianapolis, Indiana
Robert M. Isaac, Colorado Springs, Colorado
Vacancy

Members of State Legislatures

John T. Bragg, Deputy Speaker, Tennessee House of Representatives
David E. Nething, North Dakota Senate
Ted Strickland, Colorado Senate

Elected County Officials

Harvey Ruvin, Dade County, Florida, County Commission
Sandra Smoley, Sacramento County, California, Board of Supervisors
James J. Snyder, Cattaraugus County, New York, County Legislature

Readings in Federalism

Perspectives on a Decade of Change

ADVISORY COMMISSION ON
INTERGOVERNMENTAL RELATIONS

SR-11
May 1989

Preface

In 1989—the 200th anniversary of our federal republic—American federalism is a system out of balance, both in terms of the federal budget and the constitutional balance of power. The 1988 U.S. Supreme Court opinion in *South Carolina* v. *Baker* brought to a head concerns about the erosion of state authority in the federal system that had been raised following the Court's 1985 opinion in *Garcia* v. *San Antonio Metropolitan Transit Authority.* Observers of the federal system note that, with these decisions, the federal government is free to regulate almost every aspect of state administration and management.

In a statement to the National Economic Commission in 1988, we noted that the Advisory Commission on Intergovernmental Relations has endorsed federal deficit reduction, in part because the federal debt affects policymaking in ways that harm our federal system. The ACIR believes, moreover, that the federal government should draw on state experiences in fashioning tools to discipline its fiscal behavior. The states have long had a good record of fiscal discipline—buttressed by constitutional and/or statutory requirements for a balanced budget, debt limits, and tax and expenditure limits. Furthermore, while federal debt is incurred for current operating expenses, state and local debt is incurred mainly for capital projects, which benefit present and future taxpayers who will share the costs of these benefits.

While recognizing differences in the fiscal circumstances of the national and state governments, in *Fiscal Discipline in the Federal System: National Reform and the Experience of the States*, the ACIR has recommended that: (1) the Congress consider proposing a balanced budget amendment to the U.S. Constitution; (2) the Congress and the President consider adopting a biennial budget, a capital budget, rules of germaneness for all bills, and taxing and spending limits; and (3) the President be given a line-item veto of appropriations voted by the Congress, subject to an appropriate override by the Congress.

The Commission is very concerned that a rebalancing of the federal budget be accompanied by a rebalancing of power in the federal system. There is a budget deficit and a power surplus on the national side of the federal equation. The federal budget is out of balance in part because the federal system is out of balance. The federal government has used its spending powers, among others, not only to strengthen national defense and public welfare, but also to invade traditional domains of state and local authority, and to impose requirements on states and localities. Unless the imbalance of power is redressed, federal deficit reduction may simply shift costs to state and local taxpayers, and compel state and local officials to make the hard political and fiscal choices that should be made by the elected federal officials who created the budget crisis.

Deficit spending and surplus power allow federal officials to create rules and programs without having to ask the voters for a tax increase. Deficit spending shifts costs to future generations, and surplus power shifts costs to state and local governments. If deficit spending is curtailed or eliminated, then federal officials may use their power simply to require state and local implementation of, and payment for, federal policies. Elected federal officials would be able to claim credit for policies that work, while hiding behind state and local officials who would bear the onus of asking voters to pay for federal policies, good and bad.

Based on its research on restoring the constitutional balance in the federal system, the ACIR has concluded that present trends already "indicate a basic and growing imbalance between the fiscal side and the regulatory side of federalism. Federal regulation of state and local governments is outpacing federal financial support."

For several decades, federal aid to states and localities was increased in partial compensation for the growing imbalance of power. In effect, the federal government purchased power from state and local governments. Federal grants to state and local governments grew from 4.7 percent of all federal spending in 1955 to 17 percent by 1978. Similarly, federal grants represented 10.2 percent of state and local spending in 1955, but climbed to 26.5 percent by 1978. Since then, however, federal aid has been dropping—to an estimated 10.9 percent of federal outlays and 17.1 percent of state-local outlays in 1989, according to the 1988 edition of *Significant Features of Fiscal Federalism*. The federal government now has the lion's share of power, but not the money to pay for the use of all that power. Increasingly, state and local governments are getting stuck with the bill.

A further decline in federal aid will be a problem for fiscally distressed state and local governments, but not the key problem for states and localities as a whole. The key issue is whether state and local governments will have enough authority to cope with federal deficit reductions in ways that best suit their needs and citizens. Increased federal regulation, restrictions on state and local authority, unfunded mandates, preemption, and invasions of state and local revenue sources to balance the federal budget will only place state and local governments in the same predicament as the federal government now finds itself. The federal government cannot expect states and localities to pick up costs while also hampering or invading their revenue-raising abilities and policymaking authority.

Federal deficit spending has been like a pressure valve, allowing steam to escape from the fiscal system. If deficit reduction closes that valve, then pressure will build up in the federal fiscal system. If costs continue to shift to state and local governments, then those governments will be pushed ever more tightly against the legal tax, debt, and expenditure limits desired by their citizens, causing political conflict and possibly damage to long-standing tools of fiscal discipline. States and localities must, therefore, have greater policymaking authority in order to accommodate and reduce fiscal pressures within limits of their own choosing.

Along these lines, in 1984 in *Regulatory Federalism: Policy, Process, Impact and Reform*, ACIR recommended "full federal reimbursement to state and local governments for all additional direct expenses legitimately incurred in implementing new federal statutory mandates, including costs imposed by federal direct order mandates, crosscutting requirements, partial preemptions and provisions enforced by crossover sanctions." The ACIR also recommended "that the legislation establishing such a system specify that no state or local government be obligated to carry out a federal statutory mandate that does not fulfill this requirement." These recommendations must be an integral part of any serious deficit reduction plan if we are to maintain our federal system.

In *The Federal Role in the Federal System: The Dynamics of Growth*, the Commission also recommended that a number of grant-in-aid programs be reduced through termination, phase-out, and consolidation. Specifically, the

> most likely candidates for consolidation should be those which are, or could be made, (a) closely related in terms of the functional area covered; (b) similar or identical with regard to their program objectives; and (c) linked to the same type(s) of recipient governmental jurisdictions. The primary candidates for termination and phase-out should include: (a) the approximately 420 small federal categorical grant programs, which account for only 10 percent of all grant funds; (b) programs in functional fields in which federal aid amounts to approximately 10 percent or less of the combined state and local outlays, including federal aid; (c) programs which do not embody essential and statutorily clearly stated national objectives, or which are too small to address significantly the need to which they relate; (d) programs, especially small ones, which have high administrative costs relative to the federal financial contribution; (e) programs which obtain, or could obtain, most of their funding from state and/or local governments, or fees for service, or which could be shifted to the private sector.

In its report on *Devolving Selected Federal-Aid Highway Programs and Bases*, the Commission has also concluded that turnbacks (simultaneous repeal of federal aid programs and relinquishment of federal tax bases) are a promising way to achieve greater political decentralization. The Commission has recommended devolution of non-Interstate federal-aid highway programs, for example, and believes that turnback legislation should be based on the following principles:

- An adequate transition period to allow state and local governments to adjust to the new environment of increased political decentralization.
- An adequate pass-through of state funds to local governments during the transition period to minimize fiscal dislocation and uncertainty as local governments adjust to the new environment of political decentralization.
- A mechanism during the transition period to facilitate any state legislative or constitutional changes necessary to adjust the political and fiscal relationship between states and their local governments, such as adjustments in local financial aid and changes in laws affecting local taxing authority. (*Devolving Federal Program Responsibilities and Revenue Sources to State and Local Governments.*)

Growing concern about the expansion of federal power relative to the states, and consternation over such recent U.S. Supreme Court decisions as *Garcia* v. *San Antonio Metropolitan Transit Authority* (1985) and *South Carolina* v. *Baker* (1988) prompted the ACIR in 1988 to recommend that the states form a commission on constitutional revision, and that the Congress and the states amend the U.S. Constitution to remove the prospect of a "runaway" convention as an obstacle to state-initiated amendment proposals. These recommendations reflect the Commission's view of the gravity of the situation for federalism today.

Restoring balance in the federal budget and balance in the federal system must proceed in concert and with all deliberate speed. State and local governments must bear a fair share of the burden of deficit reduction, but must not become convenient receptacles for the costs of responsibilities shed by the federal government. If the federal government expects state and local governments to share the costs of deficit reduction, then the federal government must also share power with the nation's 50 states and 83,166 local governments.

This book of readings, compiled mostly from ACIR's *Intergovernmental Perspective,* provides a convenient overview of the many developments, especially in fiscal federalism, that have brought about the current condition of federalism. The essays cover a 30-year period, although the main focus is on the period 1978 to 1989. We hope that these essays will be useful to policymakers and students of federalism who wish to look back on 30 years of change in our federal system so as to develop a better understanding of the past in order to shape the future.

Robert B. Hawkins, Jr.
Chairman

Acknowledgments

This book of readings was initiated under the auspices of John Shannon, former Executive Director of ACIR. The materials were compiled by Robert Gleason, former ACIR Director of Communications.

John Kincaid
Executive Director

Contents

Introduction

As the large theater of politics and government engenders a nomenclature that marks eras—"Manifest Destiny," "New Deal," "Great Society"—so does the more specialized discipline of federalism. In this volume can be found phrases that track the course of intergovernmental relations over the past three decades: creative federalism, Revenue Sharing, new federalism, block grants, taxpayers revolt, countercyclical aid, and many others. These terms appear again and again in public policy debates—seeming not too distant, but losing decibels in the din of new contentions. Yet the ideological and administrative considerations underpinning these concepts remain current because the experiments and experiences in domestic policy over the past three decades have redefined the parameters of any debate about the future of intergovernmental relations.

These readings are a contemporary history. The articles consist largely of edited reprints from ACIR's quarterly magazine, *Intergovernmental Perspective*. After an overview of the 1959 to 1979 period, they begin with the election year of 1976 and end with the next to last year of the Reagan administration (1987). That they offer a succinct overview of the recent past can be seen from a review of the cover titles of the issues in which they appeared, and from selected quotes. For example:

> **Restraint and Reappraisal: Federalism in 1976.** "Highlighted by the presidential election and a continuation of 1975's fiscal squeeze, the nation's bicentennial year saw more reevaluating of existing programs and a reluctance to pass new legislation."

> **A Tilt Toward Washington: Mixed Signals on Centralization vs. Decentralization (1977).** "Is authority being decentralized or recentralized? Unlike the previous three national administrations, the first year of the Carter administration did not reveal a clear preference or shift toward decentralization or centralization of decision-making authority. Instead, mixed signals were given."

1978: The Year of the New Populism. "There can be no doubt that the headliner in the 1978 intergovernmental drama was California's Proposition 13 [the taxpayers revolt]. Not only was it momentous in its impact on fiscal and functional intergovernmental relationships in California, but it had major spillover effects for other states and the federal government as well."

The Big Squeeze: Government by Tradeoff. "One intergovernmental event occurred in 1979 which sets the year apart from those of the recent past and raises important questions for the future of American federalism. In 1979, federal aid to state and local governments, which had undergone a long period of rapid growth, peaked and actually declined in real dollar terms."

1980 Spotlights Rebalancing Federalism. "In Washington, the key intergovernmental question through most of 1980 was the long-standing one of how dollars and power should be distributed in our intergovernmental system. The stakes were dearer and the bidding more shrill than ever before, however, as economic concerns forced reductions in federal expenditures. Attention to the game of power and money shifted, however, with the year's most important intergovernmental event—the decisive election of former Governor Ronald Reagan to the Presidency."

1981: A Threshold Year for Federalism. "1981 was clearly a year when intergovernmental finance moved from bit player to star billing in the theater of national public policy. . . . In retrospect, students of American fiscal federalism may well point to 1981 as the beginning of the 'do it yourself' era of intergovernmental relations—a period to be marked by major and sustained constraints on federal fiscal resources with consequent reductions in federal ability to aid and direct state and local governments."

Perspectives on a "New Day" for Federalism. "On January 26, 1982, President Reagan made federalism, once dubbed the 'dismal swamp' of intergovernmental relations, the centerpiece of his State of the Union address.... The attitude of the Congress, the mood of the people, and the overall state of the American economy will all play major roles in determining how equity, accountability and efficiency concerns get balanced out in New Federalism."

Federalism in 1982: Renewing the Debate. "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. . . . For federalism, the year 1982 ends on a note of uncertainty. In the final analysis, the 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."

De Facto New Federalism in 1983. "President Reagan's proposals for his version of new federalism barely saw the legislative light of day during 1983. This inaction, and a diminution in the standing of federalism as an issue on the national political agenda, misled some observers into concluding that a new federalism is dead. To be sure, certain proposals are probably lifeless, but the basic underlying trends that are altering American federalism are still very much alive."

1984: Not a Good Year for Big Brother. "1984 marked Year Six for De Facto New Federalism: a fiscal decentralization process slowly nudged along by growing fiscal stringency at the federal level and given added impetus by the strong public support for the Reagan administration's conservative and decentralist philosophy."

The Return to Fend-for-Yourself Federalism: The Reagan Mark [1987]. "When compared with the states of other major democratic federations—Australia, Canada and West Germany—American state governments operate in a fairly harsh and politically risky fend-for-yourself fiscal environment. . . . The American brand of federalism is marked by diversity, competitiveness, and resiliency, and the Reagan administration's contribution boils down to this—it has helped give our pre-Great Society brand of fend-for-yourself federalism a new lease on life."

Federalism Becomes Finance [1988]. "Whatever one thinks of President Reagan's federalism record heading into the final year of his administration, it must be noted that of all the post-war presidents he arguably got the most of what he wanted.... He did not accomplish all he wanted, and especially not the way he wanted. Nevertheless, from a financial standpoint, the division of responsibilities among the levels of government has been more clearly defined."

Like the old baseball adage that you're never as bad as you look when you lose, and you're never as good as you look when you win, it is possible to exaggerate the magnitude of intergovernmental change that this volume chronicles. After all, federal grants to states and localities were only retrenched; few were repealed. Growth in federal domestic spending slowed, but did not stop. While state and local governments became more self-reliant, they did not supplant Washington.

Yet that is the norm for intergovernmental relations—evolution, not revolution. The Great Society, for example, was perhaps the most fiscally centralizing force in the nation's history. Nevertheless, grant-in-aid funding did not peak until three presidential administrations later. Similarly, the fiscal retrenchment of the past decade has returned grant-in-aid funding to the levels of the early-to-mid 1970s, not pre-Great Society.

Beyond documenting the recent evolution in intergovernmental relations, the purpose of these readings is to serve as a primer for evaluating the future of federalism, and to illuminate how our federal system works.

And how is it working? As one of the following articles maintains:

> The English historian Thomas Carlyle described the highly centralized government in France on the eve of the Revolution as a regime suffering from apoplexy at the center and paralysis at the extremities. A future historian of American federalism might well conclude that during the 1980s our intergovernmental system was marked by growing fiscal distress at the center and remarkable resiliency at the extremities.
>
> This verdict serves as a most telling argument in favor of our decentralized federal system and vindicates the wisdom of the framers of the Constitution in Philadelphia 200 years ago—that of not placing all of our policy eggs in Washington's basket.

Federalism in Transition: 1959-79

SUMMARY AND HIGHLIGHTS

Commenting on the vast proliferation of federal programs during the 1960s and 1970s, historian Theodore White wrote: "Each program was pressed through Congress in the name of virtue. No single program could be denounced, vetoed, or buried in committee without the objectors being shamed for their indifference to the call of conscience. . . . Who had the courage to choose among all the calls of virtue and goodwill? And Congress, for almost 20 years, chose not to choose, but to enact them all."

This article chronicles the federal government's march toward programmatic ubiquity during that 20-year period. Although Washington may not have chosen among programs, it made many choices among administering agents and grant mechanisms.

State governments, which had long been the traditional recipients of federal grant-in-aid programs, were substantially augmented by local governments, particularly urban jurisdictions. In the late 1960s, local governments were themselves "leapfrogged" as some federal funds were channeled directly to community action agencies or other neighborhood groups. In program design, categorical grants remained the mechanism of choice (and became increasingly narrow and restrictive), but the era also gave birth to block grants, Revenue Sharing, procurement contracts, and cooperative agreements.

Yet the political fashions of this era changed as quickly as its clothing fashions, and were equally confusing. The Great Society was an intensely centralizing force; yet it established a network of community-based organizations. Distrust of state governments undergirded President Lyndon B. Johnson's domestic policy; yet this predisposition was quickly reversed under President Richard M. Nixon's New Federalism. Still, Washington's omnipresence accelerated, even as the Nixon administration was trying to rein in the bureaucracy. Concurrent with an explosion of intrusive categorical grants for intrinsically local concerns (e.g., rat control and fire protection). Congress also enacted General Revenue Sharing with virtually no restrictions on how the money was to be spent. All of these conflicting signals occurred within the context of unrest and disillusionment: the civil rights movement, Vietnam, urban riots, deteriorating cities, sunbelt v. frostbelt antagonism, the oil crises, and finally, unbridled inflation.

Of most lasting importance, however, was the dichotomy in financial circumstances between 1959 and 1979. At the beginning of the era, the national treasury was a horn of plenty; by era's end, it was trumpeting fiscal retreat. Not unrelated were the intervening events of New York City's financial crisis and the taxpayers revolt. These portents are presented as an overview in this article, and recur with increasing intensity later in the volume. The article first appeared as a chapter of ACIR's 1980 publication *The Future of Federalism in the 1980s*, and was written by Carl W. Stenberg, former ACIR Assistant Director for Policy Implementation.

* * * * *

The evolution of the American federal system has been accompanied by significant changes in the distribution of governmental powers and responsibilities. Sometimes these shifts have occurred gradually over several decades. Other times they have taken place over a relatively short period, particularly in response to developments on both the domestic and international fronts. The Civil War and Great Depression, for example, tested the strength, endurance, and adaptability of the federal system. Worldwide inflation, energy shortages and costs, and monetary instability present similar challenges to contemporary intergovernmental relationships.

The past two decades have witnessed many key events that initiated or affected the nature and direction of major intergovernmental trends. These events and trends have altered the fiscal, functional, and political balance within the federal system and have rekindled debate over the proper division of powers and responsibilities among the constituent governmental units. Together they mean that as the nation enters the 1980s, the patterns of intergovernmental relations are fundamentally different from those that had been present 20 years earlier.

This paper reviews developments between 1959 and 1979 that challenged and changed the course of the American federal system. It is based on a survey conducted by ACIR professional staff members regarding the most significant intergovernmental events and trends over that period. While the results may not be necessarily representative of the wide range of participants and diversity of viewpoints in the field, the purpose is to provide a point of departure for, and perhaps a stimulant to, students and practitioners who seek to understand and assess federalism in transition during the 1960s and 1970s, and to provide a historical perspective for those who wish to prepare for the federalism of the 1980s.

GOVERNMENTAL GROWTH

The most striking change in intergovernmental relations between the 1950s and the late 1970s was the growth of government, especially in the federal and state sectors. This expansion was reflected in many ways:

—A sharp rise in federal domestic expenditures and state-local outlays from 15.9 percent of the Gross National Product (GNP) in 1959 to 25.9 percent in 1979;

—A near doubling (from 19 to 37) between 1960 and 1979 in the number of states using both income and sales taxes;

—A 90.6 percent hike between 1953 and 1977 in the real tax burden for the middle-class family;

—A 72.5 percent increase between 1957 and 1977 in the number of state and local employees per 10,000 population; and

—An explosion in the number and types of regulatory activities, illustrated by expansion in the size of the Code of Federal Regulations from 23,000 pages in 1950 to nearly 84,000 pages in 1978 and of the Federal Register from 9,500 pages to over 61,000 pages during the same period.

These figures represent significant changes in the role of government in the private sector of the economy and in the day-to-day lives of American citizens. From the standpoint of intergovernmental impacts, however, the federal government's assumption of progressively greater responsibility for dealing with domestic problems through use of grants-in-aid stands out as a dominant feature of this 20-year period. Federal funds supported state and local efforts to tackle tough social and physical problems; they stimulated new undertakings; they helped develop more systematic ways of identifying interfunctional linkages and coordinating activities; and they encouraged improvement of recipient organizational arrangements, of personnel systems, as well as of planning and management capabilities. At the same time, they occasionally generated administrative, fiscal, and political problems for both grantors and grantees.

At least seven aspects of this federal assistance phenomenon are especially noteworthy:

1. **The Dollar Amount.** Aid to state and local governments has mushroomed from approximately $7 billion in fiscal year 1960 to $83 billion in fiscal year 1980, with the annual rate of growth during the past decade standing at about 15 percent, or $6 billion a year. As a percent of total state-local expenditures, federal aid has risen from 14.7 percent to 23.6 percent over this period. The number of programs also has climbed steadily—from 150 in 1960 to 498 in 1979.

2. **Instruments.** The types of instruments for dispensing aid have increased and given rise to a variety of federal-state, local, and federal-private transactions under formula and project categorical grants, block grants, General Revenue Sharing, procurement contracts, and cooperative agreements. Determining which instrument to use to accomplish a particular purpose has only recently become a real concern to assistance program designers.

3. **Participants.** The extent of state and especially local government involvement in federal programs has expanded to the point where virtually all general purpose local units and many special purpose ones now receive federal funds. This was not the case as recently as the early 1970s. Until the advent of General Revenue Sharing many smaller jurisdictions and rural communities did not participate in federal grants or received only relatively small amounts of funds through a limited number of programs. Some jurisdictions, especially the larger ones, have come to depend heavily on this source of revenues to sustain their service delivery system. Federal aid as a percent of own-source revenue of the nation's 47 largest cities, for example, jumped from 2.6 percent in 1957 to 49.7 percent in 1978. Adding to the complexity of the intergovernmental partnership are organizations like Federal Regional Councils, multistate and substate regional planning and development agencies, and neighborhood bodies that have been established to plan

for, administer, coordinate, or spend federal monies. The number of people affected by the actions—or inactions—of these units has similarly multiplied.

4. **Strings.** The conditions attached to federal programs are often extensive, expensive, and intrusive. While traditional "watchdog" requirements (such as financial reporting and audits) continue to be applied, in recent years the federal government has increasingly used assistance programs as vehicles for achieving national social policy goals, such as affirmative action, environmental quality, historic site preservation and citizen participation. Some 59 of these crosscutting requirements apply to most or all federal aid programs, regardless of purpose.

5. **Certainty.** Although more federal funds are now available to more jurisdictions for more purposes than ever before, recipients' capacity to plan for the effective use of these monies continues to be impaired by uncertainty over whether the amounts required to launch a program or to undertake a project will be available when they are needed, and whether they may be used for recipient priority purposes. Advance planning is made difficult by the annual nature of most grant awards, as well as by the frequent wide gaps between congressionally authorized spending levels and actual appropriations.

6. **Bypassing.** The bypassing tendencies of federal agencies and congressional committees has become more pronounced over the past 20 years. States in particular have been the long-standing targets, although during the 1960s local governments experienced some of this federal leapfrogging with money going directly to community action agencies or to other neighborhood groups. While the majority of the 39 federal-local programs were enacted between 1960 and 1967 (with the exception of public housing, urban renewal, airport development, and community action), most of these involved relatively small project grants. With the establishment of General Revenue Sharing and sizable block grants in the community development and employment and training areas in the early 1970s, however, the dollar amounts of direct federal-local aid increased substantially by the end of the decade to some 30 percent of total federal assistance to state and local governments, and double the 1968 percentage.

7. **Lobbying.** Accompanying the growth in the number of programs and the amounts of federal assistance was an increase in the intensity and the number of participants in congressional lobbying. Functional interest groups have long been an integral part of the Washington scene. During the 1960s and 1970s, various special issue interest groups (such as civil rights advocates, the handicapped, environmentalists, and consumers) as well as public interest groups like Common Cause and "Nader's Raiders" were influential in the design of federal policies, programs, and procedures. Their actions often produced new requirements and conditions that were imposed on grant recipients. Not widely recognized, however, were the activities of what Professor Samuel Beer of Harvard University has called "topocrats," or representatives of a particular place rather than function or special issue.

   From the standpoint of program politics, this intergovernmental lobbying phenomenon has at least two key dimensions. First, the efforts by national associations of state and local chief executive and legislative officials have increased to articulate the need for federal action, to urge the use of certain instruments to accomplish national purposes, and to support the renewal and perhaps redesign of existing programs. Second, spokesmen for regions of the country that are seeking their "fair share" of federal resources have emerged. Representatives of the sunbelt states, for instance, have sought to end what they consider to be long-standing patterns of geographic discrimination in aid formulas and to achieve a more balanced distribution. The presence of these intergovernmental lobbyists has added a new and sometimes controversial dimension to the so-called "iron triangle" of federal agency-congressional committee-special interest group participation in national policymaking.

THE URBAN CONNECTION

The factors responsible for the substantial growth in the federal government's fiscal role have their roots in the Great Society. Beginning in 1964, President Lyndon B. Johnson called for the development of new and expanded federal partnerships with state and local governments and with private enterprise to tackle many of the pressing problems of urban society—poverty, crime, unemployment, illiteracy, substandard housing, disease, and physical decay of the infrastructure. His "creative federalism" agenda launched a number of what were to become long-standing changes in the nature and extent of the federal government's relationships with the state, local, and private sectors. In addition to the seven general features of federal assistance noted earlier, these included:

—A shift in the functional distribution of federal assistance outlays from commerce and transportation programs (36 percent of the total in 1963 to 23 percent by 1968) to health and human resources programs (13 percent of the total in 1963 to 40 percent in 1968);

—Changes in the objectives and operation of the traditional grant-in-aid system featuring: (a) the use of federal aid to stimulate state and local action in behalf of an expressly stated national purpose instead of to support the ongoing operations of these governments, (b) the active intervention on the part of federal administrators to influence the program priorities and implementation processes of recipients, and not to remain largely in the background, (c) the distribution of an increasing share of federal funds on a project grant and competitive basis instead of in accordance with a statutory formula and as an entitlement, and (d) the assumption of a substantial federal matching share (for example 80 percent or more) instead of the requirement for a significant state or local cash contribution (such as 50 percent) to program costs;

—A recognition that the resources of private enterprise should be mobilized to work with government agencies in tackling urban problems, and that financial assistance or tax benefits should be offered as an incentive to such involvement;

—A willingness on the part of Great Society architects to use federal funds to facilitate the organization of community groups or private nonprofit organizations to plan for and carry out federal programs, sometimes without the consent or cooperation of local government officials; and

—An increase in the number of devices to help coordinate the rapidly proliferating federal aid system, including assignment of convener authority to certain agency heads, designation of the Vice President and the Director of the Office of Emergency Preparedness as the President's liaison with the nation's mayors and governors respectively, installation of new budgeting and management techniques such as the Planning-Programming-Budgeting System (PPBS), and creation of community-level and substate regional coordinating mechanisms like community action agencies, model cities boards, and councils of governments.

The Great Society years generated great expectations on the part of many people—especially the poor and racial minorities—who historically had experienced difficulty exercising effective political clout at the local level and penetrating the Washington "iron triangle," which had crafted the federal aid system, and often steadfastly resisted any alteration in the program status quo. A fundamental shift in the purposes of federal assistance was triggered by at least three forces: the emergence of black political power in many of the nation's cities; the coalescing of divergent urban, consumer, civil rights, environmental, and other groups in the wake of the Vietnam war and the assassinations of Rev. Martin Luther King and Sen. Robert Kennedy; and the social unrest and violence in many of the nation's cities and on college campuses. As a result, more and more money was targeted to needy jurisdictions and, directly or indirectly, to the needy people living in them.

In the middle to late-1960s, discussion of the urban condition were permeated with the notion of "crisis." Attention was riveted on the problems of the "unheavenly city," the migration of people and businesses to the suburbs, and the social, economic, and physical consequences of local budgetary overburdens, infrastructure deterioration, metropolitan disparities, jurisdictional fragmentation, citizen alienation, and city hall isolation. At that time, the best course of action appeared to be the declaration of a national objective, the designing of an aid program, and the establishment of a new office or agency in Washington to administer it. There was close relationship, in the minds of many, between the amount of outside financial assistance available and the prospects for successfully remedying urban problems.

Yet the Great Society also left in its wake much disillusionment, if not despair. The great promises and sometimes lofty social goals of Johnson-era federalists—to eradicate poverty, to control crime, to restore a sense of community, to rebuild the urban physical plant, and so forth—were inspiring to many, but by the late 1960 the amounts of dollars that a national budget stretched by the Vietnam war could make available severely curtailed the level of national effort that could be mounted. Local revenue systems, hobbled by dependence on the property tax, could do little to compensate for these cutbacks. There was a growing realization that the exercise of governmental spending powers provided no assurance that various societal problems could be ameliorated. Some even contended that certain governmental programs, like those that encouraged suburbanization, only compounded the problems of urban America.

Ten years later, significant shifts were evident with respect to the future of central cities. It had become commonplace for politicians to talk about a "lowering of expectations" with regard to what could be accomplished as a result of governmental intervention. The Carter administration developed a national policy and a series of program initiatives aimed at targeting federal resources to distressed urban and rural areas, better coordinating agency actions that impact on these places, and leveraging private sector investments in community development. A number of states took similar actions. At the same time, many cities were experiencing the "gentrification" phenomenon in response to rising energy costs and soaring real estate values. While concerns mounted about the effects of the displacement of the poor and elderly from neighborhoods undergoing renewal, and the dependence of larger jurisdictions on outside funds, by the end of the decade a somewhat strengthened intergovernmental commitment to community conservation was apparent.

THE STATES: UNRECOGNIZED PARTNERS?

One of the real ironies of the 1959-79 period involves the states' position in the intergovernmental system. The bypassing of the states in the antipoverty, model cities, and other urban development and social programs of the Great Society raised serious questions in some quarters about the viability of state government. These included basic concerns about the proper role of the states in relation to their political subdivisions, the range of responsibilities that the federal government should assume in meeting urban needs and problems, the prospects for increasing centralization of power in Washington, the possibility that the states had forfeited their role as major urban policymakers to become administrative adjuncts of federal agencies, and the most desirable and feasible ways to provide federal financial assistance to local governments.

In other quarters, the post-1960 resurgence of direct federal-local relationships merely confirmed the validity of certain indictments of the states that had been made again and again since the Depression. The most common charges were that state elected and appointed officials were corrupt, incompetent, and racist; that state constitutions were long, complex, and antiquated; that governors were weak, underpaid, and overworked; and that legislatures were unrepresentative, backward, and cumbersome. As a result of these conditions, so the argument ran, states maintained outmoded and unnecessary shackles on the structural, functional, and fiscal powers of local government. While recognizing that these indictments did not apply across the board, during the 1960s and 1970s, some national and local observers nevertheless would probably have agreed that Charles E. Merriam's 1934 assessment of the states' activities was of contemporary relevance: "In many instances the state is a fifth wheel as far as city government is concerned."

By the early 1970s, however, many of the indictments of the states were no longer valid, largely because of constitutional modernization and reapportionment. Nearly all governors served a four-year term and were eligible for reelection, and most had gained greater control over management of their executive branch as a result of a reduction in the number of separately elected officials, an authorization to reorganize agencies subject to a legislative veto, and the establishment of an executive budget process. The states' legislatures also had become more effective as well as representative. Meeting on an annual basis, increasing the number of professional staff, raising salaries, streamlining committees, and other institutional improvements made state legislative offices more attractive to potential candidates and enhanced the exercise of the legislatures' lawmaking and oversight functions.

State revenue systems have also been overhauled in recent years. The increased revenues collected by the states have been used to expand state educational, social welfare, health and hospitals, transportation services, and local aid programs, as well as to provide tax relief to certain residents, such as the poor and elderly, and to businesses. These state accomplishments generally were ignored by national policymakers throughout the 1970s. The bypassing tendencies increased, the failure to differentiate among the states on the basis of their interest and capacity to handle urban problems persisted, and the paternalistic or contemptuous attitudes in some Washington quarters concerning states continued. More often than not, these attitudes were conditioned by outdated political attitudes (e.g., deep-seated antagonism and distrust between state and big city political leadership), political philosophy (e.g., "states' rights"), and political pragmatism (e.g., easy access to national decisionmakers). They failed to recognize that in at least a legal sense local governments remained "creatures" of the state, to take into account the growing evidence of the states' willingness and ability to assume new urban responsibilities and to appreciate fully their record in discharging existing duties.

New Federalism

An exception to these generalizations was Richard Nixon's "New Federalism" domestic agenda. Coming in the wake of a national administration that had justified the expansion of the federal role in domestic affairs partly on the basis of the states' default on their urban responsibilities, the Nixon administration adopted a much more supportive position concerning the states.

In August 1969, President Nixon introduced a series of proposals that formed the core of his agenda for New Federalism. In special messages on welfare, manpower, and Revenue Sharing, the President called for a fundamental departure from the trends in federal-state relations that in his view had developed over the previous 30 years. The New Federalism of the 1970s would be an administratively decentralized and functionally devolved system. The deliberate intents of the administration's proposals were: (a) to reverse the flow of power, funds, and responsibilities away from the federal government and toward the states, localities, and general public; (b) to reduce the size and power of the federal bureaucracy; (c) to simplify intergovernmental administrative machinery; and (d) to bolster the authority of elected officials of general purpose governmental units and to curb that of private nonprofit organizations, special districts, and other so-called "paragovernments." The principal themes of New Federalism included:

—A belief that big government and large centralized bureaucracies remote from the people and the sources of problems were undesirable, and that the best government is that "closest to the people";

—A feeling that Washington alone cannot accurately diagnose or solve all or even most domestic problems, and that a loss of public faith in the federal government had occurred because of a gap between promise and performance;

—An assumption that the appropriate roles and functional assignments of different levels of government could be identified, and that subnational units would be willing to assume their proper responsibilities;

—A view that the structure of the federal executive branch needed to be overhauled, its bureaucracy cut down and made more accountable, and its personnel put "on tap, but not on top"; and

—An awareness that the degree to which functions could be returned to states and localities would be conditioned by their willingness and capacity to perform, and that federal tax revenues should be used for the purpose of strengthening the capabilities of state and general purpose local governments.

These themes could be traced as far back as to the 1950s, when agreement was fairly widespread that the states were responsible and responsive partners in the federal system, and that federal centralization was a dangerous condition. They also paralleled one of the main purposes behind the creation of the Joint Federal-State Action Committee (1957-60) and, to some extent, the Commission on Intergovernmental Relations (1953-55)—the pinpointing of functions that are performed by the federal government that could be turned back to the states. Twenty years after these bodies issued their reports and disbanded, and six years after President Nixon left office, the interest in functional reassignments is now reemerging. One example is President Jimmy Carter's establishment of a commission to develop a national agenda for the 1980s, which will consider this issue among others. The renewed interest in functional reassignment during the 1970s has largely been a reflection of mounting concern about accountability stemming from what has become a "super-marbleized" and overloaded federal system.

The Accountability Quest

The New Federalism years witnessed the launching of the tripartite federal assistance system, featuring the addition of block grants and General Revenue Sharing to existing categorical aids. By the mid-1970s, the structure of federal assistance was more diverse and discretionary. Although the number of categorical programs continued to increase, block grants, General Revenue Sharing, and some large formula categoricals gave state and local recipients considerable leeway in allocating federal funds to their priority needs. To some observers, including President Nixon, these discretionary instruments were a "leap of faith" in federalism. To others, like the national associations that represent state and local chief executive and legislative officials, they were symbols of important victories in the battle against the "iron triangle." To still others, especially members of Congress, they were necessary compromises that could be kept in check by employing a number of tactics, such as selectively earmarking priorities or establishing additional program categories, allowing the buying power of federal dollars to be eroded gradually by inflation, and requiring recipients to adopt a number of procedural devices such as public hearings and periodic audits to help ensure openness and enforce compliance.

The rapid expansion in the dollar amounts of federal assistance, the diversification of funding instruments, the lobbying by state and local governments for more federal involvement (at least fiscally) in domestic affairs, the emergence of and competition between sunbelt and frostbelt states and other regional coalitions in formula battles, and the desire of Congress and of the federal bureaucracy to show sensitivity and concern for national as well as less than national problems all combined to effectively blur responsibility between the various governmental levels. Responsibility for handling matters that as recently as the early 1960s had been exclusively within the domain of state or especially local governments was increasingly shared by a variety of governmental, paragovernmental, and nongovernmental actors. A review of federal aid bills introduced in Congress since that time, for example, reveals a long list of activities considered by some members to be national, not subnational problems. These include:

—school security,
—pothole repair,
—training for use of the metric system,
—home insulation,
—urban park facilities,
—meals-on-wheels,
—jellyfish control,
—snow removal,
—police disability payments,
—aquaculture,
—displaced homemakers,
—bridge replacement and rehabilitation,
—urban gardening,
—noise control,
—arson,
—rat control,
—alcohol abuse,
—solid waste disposal,
—aid to museums,
—runaway youth,
—art education,
—rural fire protection,
—education of gifted children, and
—development of bikeways.

Unquestionably, many of the federal assistance programs spawned during the 1960s and 1970s were desirable and even necessary. But intervention on such a massive scale also created confusion and uncertainty over which level of government or group of public officials were ultimately responsible for service delivery. There were simply too many fingers in the intergovernmental service delivery pie.

Somewhat ironically, although New Federalists sought to keep the size and influence of the federal government and especially its bureaucracy in check, as well as to decentralize decisionmaking, the opposite occurred. The amounts of federal aid and the number of programs mushroomed, while decentralization efforts were for the most part sporadic and short-lived. Moreover, the structure of the intergovernmental system became more complex, confusing, and costly. Thousands of institutional bodies were created largely as a result of federal initiatives or resources to perform various roles in connection with assistance programs. These included ten Federal Regional Councils, several multistate economic development commissions, over 500 clearinghouses to handle areawide review and comment procedures under the Office of Management and Budget (OMB), and more than 2,000 single and multipurpose substate regional planning bodies. Most of these bodies were established to plan, coordinate, and facilitate communications-functions that were especially vital to intergovernmental relations in the 1960s. Their implementation capacity, however, has been severely curtailed by their voluntary nature and lack of operational authority.

In addition to the emergence of new organizations and intergovernmental procedures, the 1959-79 period witnessed a tremendous expansion in the volume of paperwork that flowed between grantor and grantee agencies through these and other organizations. This increase was attributable to many sources including: (a) crosscutting requirements attached to grant programs that require aid recipients to document their compliance with various national priorities and social policy objectives; (b) plan development, application submission, and financial reporting conditions that provide federal funding agencies and congressional committees with information necessary to make decisions on grant awards as well as to monitor and evaluate program implementation; (c) regulations governing procurement procedures, subcontracting, employment conditions, and the like; (d) laws such as the Freedom of Information and Privacy Acts that are intended to make governmental records available to the public and to provide guidance for disclosing or not collecting certain types of information about citizens or public employees; and (e) procedural requirements imposed on recipients that seek to ensure that decisionmaking in connection with the use of federal funds will not occur behind closed doors and that genuine opportunities will be provided for citizen access to and participation in these manners.

Mounting paperwork requirements have greatly increased the compliance costs that both public and private agencies must pay. For example:

—A 1979 report by OMB on progress in implementing the Federal Paperwork Commission's recommendations indicated that federal agencies were using 4,916 forms, reports, and record keeping requirements which imposed an estimated reporting burden of over a million hours.

—In a November 1, 1979, statement before the Senate Governmental Affairs Committee, OMB Associate Director Wayne G. Granquist estimated that over half of the total federal nontax reporting stems from the need to ensure compliance with laws or regulations.

—A study for the Joint Economic Committee by Murray L. Weidenbaum predicted that the public and private sectors would spend at least $100 billion complying with federal regulations during 1979; the Department of Commerce put the figure at between $150 billion and $200 billion, and others claimed that both estimates were incorrect.

—On June 16, 1979, the federal government announced that over a three-year period, 13 federal agencies had spent $36 million to comply with the Freedom of Information and Privacy Acts.

Despite the volume of paperwork and administrative costs that are associated with various efforts to enhance public sector accountability, several intergovernmental realities reduce their effectiveness. Federal funds under many programs are highly fungible, in the sense that once they are deposited in the recipient's general fund they simply become money available to carry out services. The possibilities for supplantation, displacement, or diversion are real and will remain so until federal funds can somehow be traced.

Even if clear "audit trails" could be established, the sheer number of recipients, the range of their program commitments, and the staff and geographic limitations experienced by grantor agencies mean that much activity under federal programs actually escapes review or scrutiny. The General Accounting Office, for example, recently released a study of 73 grant recipients that revealed that 80 percent of their federal funds were not audited by grantor agencies.

A third factor is how the information supplied by recipients is handled in Washington. Plans, applications, financial reports, and technical materials travel from city hall or county courthouse through a chain of regional, state, and federal intermediaries before arriving in Washington, where they may be given a cursory review, filed away, and forgotten. The sheer amount of required information, and the usually large number of participants, make intensive scrutiny a luxury that understaffed grantor agencies cannot normally afford. As President Carter indicated in his September 9, 1977, memorandum to the heads of federal departments and agencies on improving grants management:

> Many existing federal requirements are confusing and unnecessarily difficult to comply with. They produce mounds of paper—some grant applications arrive in Washington in crates rather than envelopes—but the material they demand is too often duplicative, unhelpful, and sometimes even unread.

As a result of the foregoing factors, many of the approaches that have been employed over the past 20 years to instill accountability for the proper expenditure of public funds could be considered at best as ineffective and inefficient and at worst as misguided and counterproductive. As the decade of the 1970s ended, there seemed to be a growing realization that federal agencies were mainly check and condition writers, not service deliverers. Recipients who are hundreds, if not thousands, of miles away from Washington were resource mobilizers and program implementors. In an increasingly complex assistance structure and costly regulatory environment, the need to rethink the accountability dimension of intergovernmental relations has become more and more critical.

The Trust Factor

Even though the past 20 years have witnessed rapid governmental growth accompanied by significant changes in intergovernmental relations, one factor has been omnipresent—the skepticism, if not distrust, shown toward state and local elected officials by many of their counterparts at the national level. These attitudes have been reflected in a variety of ways:

—The bypassing of states and occasionally localities by the federal government;

—Conditions attached to federal funds under 155 programs calling on recipients to hold public hearings, to organize advisory committees, and to establish other processes for facilitating citizen participation in decisionmaking;

—The 59 crosscutting requirements that mandate recipients to prepare frequently massive and costly documentation of their adherence to various national social policy objectives; and

—The reluctance shown by Congress to expand significantly the discretionary portion of federal assistance, and ready willingness to recategorize existing block grants and to let General Revenue Sharing twist slowly in the inflationary winds.

In the view of some members of Congress, federal program administrators, and interest group spokesmen, these trends indicate that the state or local ballot box does little to ensure that elected officials will be sufficiently sensitive of, and responsive to, constituents' needs and interests. The perpetuation of so-called "picket fence federalism" tendencies—featuring close and frequently reinforced ties between functional specialists at the various governmental levels which elected and appointed generalist officials can do little to alter—illustrates a fundamental underlying question in intergovernmental relations: Whom do you trust? The "creative federalism" and "new federalism" periods indicate the extremities of this issue; the former relied heavily on the Washington bureaucracy, the latter on state and local elected officials. During the Ford and Carter years, more of a middle-ground approach between the

ACIR's Poll of Major Intergovernmental Events of the Past 20 Years

In order to more accurately identify and review the key intergovernmental events and trends between 1959 and 1979, a poll of ACIR professional staff members was conducted in the fall of 1979. Two rounds of surveys were undertaken. The first asked for a list of the ten most significant intergovernmental events during the past 20 years and the reasons why each item was chosen. The second round listed these responses in three clusters—intergovernmental events, trends, and societal events—and called for a ranking of the most important ones in each category. The survey results were then reviewed and discussed by ACIR's management staff.

Listed below are the intergovernmental events that were ranked highest by the staff. The intergovernmental trends are listed in the next box. While the poll was neither scientific in technique nor necessarily representative of the views of the wide range of participants in intergovernmental relations, we hope it will serve as a point of reference for—and perhaps stimulant to—others who attempt to assess federalism in transition.

1. Passage of General Revenue Sharing and Five Block Grants.

Most frequently cited item by the staff, primarily due to the fact that these enactments put into place a tripartite system of federal aid that gave states and localities added discretion over how federal dollars could be spent.

2. Enactment of Civil Rights/Voting Rights Legislation.

Facilitated the expression of minority political clout, especially in central cities.

3. *Baker* v. *Carr.*

A landmark Supreme Court decision calling for "one man, one vote" in state legislatures that brought to an end rural domination of many state legislatures and led to the modernization that occurred there throughout the 1970s.

4. Passage of California's Proposition 13.

Was the most dramatic expression of citizen dissatisfaction with government and led to considerable activity in cutting taxes and establishing spending and taxing limits in cities and states across the country and a rethinking of the roles of the various levels of government. Was also significant in that such a major tax policy was the result of citizen initiatives successfully bypassing representative government.

5. Economic Opportunity Act/War on Poverty.

Heralded the major acceleration of federal domestic assistance, providing substantial federal dollars to inner cities while largely bypassing state and local government.

6. *National Environmental Policy Act* (NEPA).

Led to federal preemption of the air/water quality field and served as a forerunner to other national level actions in the regulatory area that threatened the "balance" of federalism.

7. *Serrano* v. *Priest.*

A California Supreme Court decision that reaffirmed the principle of equity in funding/service delivery and brought about significant reorganization of school finance systems.

8. New York City Fiscal Crisis.

Capped the awareness of the intergovernmental effects of suburbanization and the intergovernmental responsibilities toward central cities and urban areas.

9. School Desegregation Court Cases: *Green* v. *New Kent County School Board*, *Swann* v. *Charlotte-Mecklenburg Board of Education*, *Milliken* v. *Bradley*.

While *Brown* v. *Board of Education* was the first such case in the early 1950s, the past two decades saw cases that in combination laid the basis for HEW school desegregation initiatives that have powerfully affected and sometimes damaged numerous central cities.

10. Peaking of Federal Aid.

After years of skyrocketing federal aid increases, the last year of the decade brought a turnaround and an apparent peaking of the massive aid increases. The impact on state and local governments which have grown accustomed to substantial federal aid "fixes" may well be enormous.

11. Passage of Medicare/Medicaid.

Represents another major expansion of governmental activity involving all three levels of government and significantly expanding social programs to the elderly and poor.

forces of centralization and decentralization and the position of generalists and specialists in intergovernmental decisionmaking had been sought in actual practice.

Throughout the 1970s, another element of this equation became more and more significant. Middle-class Americans, who had experienced a progressively bigger tax bite as government operations at all

ACIR's Key Intergovernmental Trends of the Past 20 Years

1. Growth in government and expansion of governmental roles into many areas formerly in the purview of the private sector.

2. Massive growth in the size, scope, and intrusiveness of federal aid.

3. Troubled cities and urban areas.

4. Increasingly significant role of the courts in intergovernmental areas accompanying a concern for equity in the system.

5. Growing local government (particularly cities) dependence on state and federal aid.

6. Strengthened states in general and more powerful state revenue systems in particular.

7. Disaffection with government and growing concern for government accountability, manifested in the late 1970s by Proposition 13 and other "tax revolt" activities and responses.

8. Increased intergovernmental lobbying—governments lobbying government.

9. Increasing numbers of regional bodies.

10. Emergence of the Frostbelt-Sunbelt regional competition, also the growing tensions between the "haves" (the oil rich states) and the "have nots" (the consumer states).

levels expanded and mounting frustrations at perceiving that their tax burdens far outweighed the benefits they received from the public sector, turned to the initiative and referendum to send a message to governmental officials concerning their dissatisfactions. Many of these actions took the form of proposals to establish state constitutional or statutory limits on taxes and/or expenditures. Pressure was also placed on Congress by many state legislatures to pass a Constitutional amendment requiring a balanced federal budget.

Some of these proposals were not well conceived, and the long-term impact of those that were successful cannot be discerned yet. But the tax and expenditure limitation movement reveals much about the breakdown of representative government processes that enable an airing of views on policy alternatives, provide vital checkpoints that mitigate against radical change, and offer opportunities for making compromises and forging consensus. The middle-of-the-road philosophy of the major national political parties since 1964 regarding federalism issues contributed to this breakdown.

As the decade of the 1980s gets under way, perhaps the most disturbing trend involves the future directions of representative government. Concerns about the proper relationship between the governors and the governed go back to the founding of the Republic. But considering the dramatic changes that have occurred over the past 20 years, and the current domestic and international challenges confronting the nation, the restoration of trust in representative government is crucial to the course of federalism in the years ahead.

Government Growth: An Intergovernmental Concern

SUMMARY AND HIGHLIGHTS

This article and the one that follows backtrack to the presidential election year of 1976. Because a public disenchantment with "big government" had become a campaign issue at all levels of government, there was speculation that for governmental growth 1976 might be the beginning of the end. It was not. To be sure, the taxpayers revolt, the election of a more conservative Congress in 1978, and the election of a conservative president in 1980 ensued; but spending by all levels of government grew from 33.5 percent to 35.1 percent of Gross National Product over the next decade.

However, by 1976 the rate of growth in government was beginning to subside. Adjusted for inflation, per capita spending by all levels of government grew by 24 percent between 1954 and 1964, and by 44 percent between 1964 and 1974; however, between 1974 and 1984, growth reverted to 24 percent. For the conduct of politics, policymaking, and intergovernmental relations, the repercussions of that growth slowdown were substantial. Combined with transfigured spending priorities and growing alarm over deficit spending in most political quarters, Congress was forced to become more exacting in choosing among new program proposals, and to reevaluate spending on existing programs. In the course of this process, the greatest slowdown (and eventual decline) in spending occurred in programs targeted at state and local governments.

Because this article was written at a time when rapid growth in government had gone on for so long that it seemed the natural order, it sets the stage for the tensions that would be wrought by a new era of federal fiscal stringency. Indeed, 1976 might be considered a way station in the changing fiscal fortunes of all three levels of government. The article also describes various methods for measuring the size of government, explores the effect of government growth on centralization, and looks at the diversity in public sector size among the several states. All these issues are returned to in more detail later in the volume. Former ACIR staff members Michael Bell and L. Richard Gabler wrote this article, which first appeared in the Fall 1976 issue of *Intergovernmental Perspective.*

*　　*　　*　　*　　*

As the United States celebrates its 200th birthday, the fundamental issue of the role of government—its size and function—is under intense scrutiny and is the object of considerable debate.

"Big government" has become a campaign issue to those seeking office at all levels. The issue is not only the apparent growth of the public sector but also the impact this growth has had—or may have—on individuals and on our federal system. Public sector growth has become a controversial area partly due to the seemingly contradictory statements and conclusions that have been made about it.

For example, U.S. Treasury Secretary William Simon in an August 1975 speech outlined what he called "the threat to free enterprise in the growing dominance of government spending within our economy. Back in the 1920s, 12 cents out of every dollar spent in the United States was spent by government. Today 33 cents out of every dollar is spent by the government.

"And if these trends continue," he said, "before the end of this century, the government could be spending as much as 60 cents out of every dollar."

An opposite view was expressed by Blechman, Gramlich, and Hartman of the Brookings Institution in *Setting National Priorities: The 1976 Budget.* They concluded that, "although there are many possible ways of measuring the growth of the federal sector, by most measures, there has been relatively little change in the share of total output consumed by the federal government in the past 16 years."

In this article we assess the impact of public sector growth on the intergovernmental system by focusing on four key areas:

—the various measures available to gauge the degree of public sector use of economic resources;

—the extent to which public sector growth results in a "centralization" of governmental activities; and

—the differential growth rates among functional components in federal and state-local budgets; and

—the differential growth rates in aggregate expenditures among state and local governments regionally.

MEASURING THE SIZE OF GOVERNMENT

Analysis of public sector growth is hindered by the absence of a single measure that encompasses all direct and indirect effects of governmental activities. Governmental decisions impact on the economy in many ways including: determining the level of overall expenditures and levels for particular programs, distributing benefits and program costs among specific economic groups, allocating tax burdens among competing economic interests, and issuing regulations affecting individuals and/or businesses. All of these governmental actions affect the allocation of resources that are only approximated by aggregate measures of governmental activity.

We will examine six commonly used measures of growth: total public expenditures; public expenditures as a percent of the gross national product (GNP); public expenditures adjusted for price changes; number of public employees; number of public employees per 1,000 population; and tax burden for the middle income family. These measures reflect the use—and transfer—of economic resources by the governmental sectors. They are not, however, measures of the full effects—direct and indirect—of governmental decisions on either the individual or the economy as a whole.

According to the public expenditure measure, the growth in the public sector is almost nine-fold since 1949—a percentage change of 871 percent. The growth in the public sector relative to the total economy (as a percent of GNP) has been nearly 50 percent over the same period. State and local governments have registered somewhat sharper advances than the federal sector, by both measures.

Public employment trends offer another measure of government growth. The number of public sector employees increased from under 6 million in 1949 to over 15 million in 1976—an increase of 152 percent. Allowing for growth in population, government employment (per 1,000 population) has still increased but at less than half the rate—75 percent. This growth in public sector employment per 1,000 population takes place at the state-local level; indeed, the federal rate shows a slight decline.

To determine more accurately what is happening to the "real" size of the government sector compared to the "real" size of the private sector, it is necessary to deflate the current dollar figures since inflationary pressures have a different impact on GNP, federal spending, and state-local expenditures. Thus, additional insight into the "true size of government" can be obtained by adjusting both government expenditures and GNP for the differential impact of inflation. After allowing for the differential impact and price changes, the public sector, relative to GNP, has increased by 25.3 percent since 1949—from 26.9 percent of GNP to 33.7 percent. Here, however, the rate of federal government growth outpaces that of the state-local sector.

Still another way of gauging public sector growth is by its impact on the taxpayer. In 1953, the "average" family, with an income of $5,000, paid 11.8 percent of its income in taxes. By 1975, the same average family had a $14,000 income, and paid nearly twice the 1953 level—22.7 percent of its income.

Thus, while the various measures show different rates of growth, they all show an upward trend in the size of public sector. The growth rates between the federal and state-local sectors are roughly comparable during the post-World War II period. The state-local sector advances a bit more rapidly in terms of current dollars and considerably more rapidly in terms of public employment; the federal sector sets the pace when constant dollars are used.

INTERNATIONAL GROWTH PATTERNS

Public sector growth is not unique to the United States; in fact, there has been a notable growth in government expenditures in virtually every country. Comparisons among 23 countries show the government growth in this country is not particularly rapid.

To compare rates of growth among the nations for the most recent years available, we used two separate indicators: total taxes as a percent of GNP and current expenditures as a percent of Gross Domestic Product (a measure which is roughly equivalent to GNP but differs in the main by excluding the international sector.) In both instances, the United States ranked far below the median.

Using total taxes as a percent of the GNP, the Unites States ranked 15th out of 20 with a 1973 figure of 28 percent (a 12.4 percent increase over 1965 figures.)

Using current governmental expenditures as a percentage of GDP, the U.S. ranks 15th out of 23 with 29.6 percent in 1974—representing a rate of change only 2.4 percent since 1969.

The short time span covered by the international data render long-range projections somewhat risky. However, it does appear that the international trend is toward increased governmental responsibility and that the United States is far from the vanguard of the movement in terms of size and growth.

THE CENTRALIZATION ISSUE

Once "growth" in the public sector has been acknowledged, a second question arises: Does that growth lead to "centralization" at particular governmental levels or is it spread uniformly among all? A centralization tendency has been chronicled in Great Britain; it was not found, however, in Canada. Has it happened here?

To answer this question, we look at revenues and then at expenditures both in the aggregate and by function.

On the revenue side, there are at least three possible measures to assess centralization: general revenues (which exclude utility, liquor store, and insurance trust revenues); tax revenues (which exclude fees and charges from the general revenue measure); and total revenues.

Federal revenues rose as a percentage of total spending from 1929 to 1954, and since that time have declined. The federal share of each revenue measure during the years selected here increased from an average of over 72 percent in 1954, with a gradual fallback to an average of less than 60 percent in 1975. Thus, while the federal share in 1975 is approximately double the 1929 figure, most of the growth occurred prior to 1954, and the trend of the last 20 years is toward decentralization of revenue raising responsibilities away from the federal level.

Understandably, the state-local sector demonstrates the reverse of the federal trend. That is, the state government share of each revenue measure fell from approximately 20 percent in 1929 to around 14 percent in 1954; the local government ratio declined from a 50 percent share to the same 14 percent range. Since 1954, however, both state and local governments have increased their share of the revenue pie—the state share rising almost to the one-quarter mark, the local share approaching the one-fifth figure.

On the expenditure side, there are two measures that can be used to assess the shift in spending among governmental levels: total expenditures and total domestic spending. Because of the importance of intergovernmental grants, each series is presented on a before transfers (where grants are included in the originating governmental level spending) and an after transfers basis (where grants are included in spending of recipient governments). Expenditures give a broader picture of the centralization of fiscal power than do revenues since the data incorporate expenditures from deficit financing as well as revenues.

Total expenditures (including national defense) were increasingly concentrated at the federal level, certainly in the 1929-54 period. That is, there is a near tripling of the federal share of total spending between 1929 and 1954. Yet, the federal share of total spending has subsequently declined—both when federal grants are included in federal spending (from 72 percent in 1954 to 68 percent in 1975); and when grants are excluded (from 69 percent to 57.6 percent).

State and local sectors have increased their share of total spending since 1954 and by nearly comparable margins (with grants included in their spending). When federal grants are excluded (that is, the "before transfers" series), the state sector increase is still evident. At the local level, however, there is a slow—but steady—erosion of the local share from its peak of 17 percent in 1971 to 14.5 percent in 1975.

Of the various aggregate revenue and expenditure series considered here, domestic expenditures before transfers exhibit the greatest tendency toward centralization in the past two decades.

This upward movement was modest from 1954 through 1969 but has accelerated during the 1970s. Aside from two jumps in 1972 and 1975 the tendency toward centralization reflected in this measure has been modest. Indeed, at least part of these large and discontinuous jumps can be attributed to the generally depressed state of the economy during those years and therefore is not necessarily indicative of a long-term trend.

While the states have maintained a relatively constant share of domestic expenditures since 1954, the local before transfers share of domestic expenditures has decreased steadily, from 29 percent in 1954 to 18.5 percent in 1975. Even after transfers, the local share decreased from 38.9 percent in 1954 to 33.5 percent in 1975.

The movement toward centralization of aggregate domestic expenditures before intergovernmental transfers at the federal level in the postwar period was centered in two areas: social welfare expenditures (including income maintenance, health and medical care, education and related welfare programs) and grants-in-aid.

Total public spending for social welfare rose from \$23.5 billion in 1950 to \$285.6 billion in 1975; the federal share of this total rose from 29.4 percent to 42.1 percent. Within this total:

—public sector expenditures for income maintenance rose from \$9.5 billion in 1950 to \$132.1 billion in 1975, with the federal share increasing from over half (52.3 percent) to more than two thirds (67 percent);

—total public spending for health and medical care advanced from $3.1 billion to $49.9 billion, with the federal share rising from 11.7 percent to 28.5 percent;

—spending by federal, state, and local governments for public education increased from $9.4 billion to $82.9 billion while the federal share fell from 26.6 percent to 13.3 percent; and

—public spending for other welfare related services grew from $1.3 billion in 1950 to $21.6 billion in 1975, with the federal share rising from 30 percent to 67.5 percent.

The centralization in intergovernmental fiscal relations has led to local governments becoming increasingly dependent on outside sources of revenue—state and federal aid—to finance total local expenditures. In 1954, state and federal aid amounted to 43.5 percent of local own source revenue; by 1975, that percentage had increased to over 75.

States, too, have become increasingly dependent on outside revenue sources—federal aid—as a means of financing state expenditures. In 1954, federal aid came to 21.5 percent of state own source revenue; in 1975 it was just over 40 percent.

Although there is little evidence of either revenue or expenditure centralization—in the aggregate—at the federal level, this tendency does show up where more specific bases are used. Local governments are becoming increasingly dependent on state and federal aid; states are becoming more dependent on federal funds; and the federal government has taken over increased responsibility for the social welfare functions.

COMPOSITIONAL SHIFTS IN GOVERNMENT SPENDING

A functional analysis of federal spending reveals some dramatic compositional shifts over the past 20 years. These shifts are less apparent at the state-local level.

The two most rapidly growing components in the federal budget are: payments to individuals[1] (a budgetary aggregate closely corresponding to the social welfare category) and federal grants-in-aid to state and local government.

These shifts in the federal budget emphasis—toward payments to individuals and the state-local sector—are highlighted in yet another way. That is, between 1960 and 1970, payments for individuals and federal grants taken together accounted for 46 percent of the total increase in federal outlays—30 percent for payments to individuals and 16 percent for grants. For the 1970-75 period, similar increases in these categories were evident: 59 percent for payments to individuals and 20 percent for federal grants. Thus, taken together, these two classifications account for just under 80 percent of the total increase in federal outlays.

Although the payments to individuals category is a heterogeneous classification, it consists mainly of Social Security, Medicare, unemployment compensation and public assistance programs that account for 75 percent of the total 1975 payments to individuals and over 80 percent of the growth in the category between 1967 and 1975. This growth can be attributed to increases in the number of eligible participants, higher benefit levels and an increase in the level of participation of those eligible. Yet, there is evidence that in spite of the significant growth in dollar expenditures, there has been a steady erosion of real per capita benefits at least since 1972.

Thus, despite the relative growth of the payments for individuals category, the fact remains that, at least for recent years, even among the fastest growing programs within this classification, there has been a deterioration in services, when adjusted for population and inflation.

In the early years of the grant system, federal grants to state and local governments were largely concentrated in two areas: in 1940, for example, 71 percent of all federal grants went for income security and community development. By 1960, 80 percent of all grants went to two functional areas: income security, and commerce and transportation. The decade of the 1960s saw the federal grant system become much more diverse with education, health, and community development more significant in the total aid picture.

The 1970s have been marked most dramatically by the emergence of a new form of federal grant—General Revenue Sharing—which in 1975 represented approximately 12 percent of the grant total. The introduction of this grant program has reduced the relative importance of grants in the more traditional functionally aided areas but, in general, shifts among these functional components have been milder during the 1970s than they were in the decade of the sixties.

These two shifts highlight a change in the type of activities performed by the federal government: from a purchaser of goods and services (in defense outlays) to redistributor (collecting revenues but transferring these sums to individuals and state-local governments who then make the final purchases). If interest

[1]Payments for individuals include, with minor adjustments, payments for Social Security, unemployment compensation, Medicare, Medicaid, Veterans benefits, and public assistance.

payments are included in the transfer role of the federal sector, this redistribution activity accounts for more than 60 percent of 1975 federal outlays—a figure that is projected to hold for 1980.

In contrast to the compositional shifts in the federal budgets, there were no dramatic shifts in total state-local spending from 1965 to 1974. The changes that have occurred were in reduced highway spending (about one-sixth of state-local spending in 1965; one-tenth in 1974) and increased welfare spending (from about one-twelfth of total expenditures in 1965 to about one-eighth in 1974).

States are assuming a slightly larger share of total state-local spending: from 34.9 percent to 37.2 percent. When federal aid is excluded, the shift is more dramatic: from 47.0 percent to 55.5 percent. Most of this increase can be traced to the welfare area where the state share has jumped from 47.9 percent to 61 percent of the total (including federal aid). In no other area, however, has there been a significant shift.

INTERSTATE DIFFERENCES IN PUBLIC SECTOR SIZE AND GROWTH

National totals of public sector size and growth mask certain key differences among the states. Therefore, we look briefly at public sector size, growth, and functional expenditure shifts in the 50 states.

Using per capita direct expenditures as a measure of the public sector, state-local per capita expenditures ranged from $2,501 in Alaska and $1,448 in New York to a low of $609 in Arkansas—a differential of 4 to 1 at the extremes and just under 2.5 to 1, excluding Alaska as a basis of comparison.

To gauge the relative rates of public sector growth in individual states, we calculated the percent change for each state in per capita expenditures between 1957 and 1974 and expressed them as a percent of the national average growth rate. With the exceptions of Alaska and Hawaii, all of the states growing at rates exceeding the national average (23) were located in the east—including all 10 of the southern states at the lower end of the spending spectrum in 1957. By way of contrast, only two of the high spending states—Hawaii and New York—had growth rates exceeding the national average.

Indeed, the rate of growth of per capita expenditures between 1957 and 1974 for the top 10 spending states of 1957 was 12.1 percent below the national average compared to a growth rate of 22.7 percent above the national average for the lower spending states of 1957.

Excluding the top and bottom states, the average per capita expenditures of the lowest spending nine states rose from 55.1 percent to 62.3 percent of the average spending for the top nine states between 1957 and 1974. Yet, this narrowing process was only marginal when comparing the ratio of spending between the second lowest and second highest spending states—from 45.6 percent in 1957 to 47.3 percent in 1974.

Most significant of the interstate narrowing of public sector differences, however, is the fact that 36 states were spending within a range (plus or minus) of 20 percent of the national average in 1974 while only 31 fell in this spectrum in 1957.

There is a clear regional dimension to these figures. For example, in 1957, seven of the 10 "big spenders" were in the west; all 10 of the lowest spending states were in the south. By 1974, the number of western "big spenders" had dropped to five; and three southern states had moved out of the lowest spending category.

A comparison of budget expenditures by function between the high and low spending states reveals that the latter spend a larger percentage of their budget on three "traditional" state expenditures (education, highways, and welfare). Education makes up 41 percent of the budget in the 10 lowest spending states and only 35.6 percent in higher spending states. Welfare expenditures make up 10.6 percent of outlays in high spending and 9.7 percent in low spending states. Highway expenditures make up 12.8 percent in the lowest spending states' budget; 10.8 percent of the budget in the top ten states.

The highest spending states also provide a broader range of public goods and services than their lower spending counterparts. Eight of the ten high spending states fall below the national average in terms of the share—not per capita levels—of state-local spending in the big three areas; while eight of the ten lowest spending states exceed it.

CONCLUSION

Thus, looking at four key areas of public sector growth as it affects our intergovernmental system, we found:

—While the various measures show differing rates of growth, they all show an upward trend in the size of the public sector.

—Although there is little evidence of overall centralization in the postwar period, this tendency does show up in the increasing federal role in financing aggregate domestic expenditures, mainly due to social welfare and federal grants-in aid. Indeed, it is evident in a growing local dependency on state aid and federal aid and on growing state dependency on federal aid.

—At the state-local level, there appears to be a slight trend toward "centralization" at the state level when the state's share of total spending includes federal aid. When federal aid is excluded, there appears to be a significant increase in the state share in state-local spending.

—There is some narrowing of the differences among states in their spending levels. While these differences remain large, the tendency is for states to become more alike, not more disparate.

Restraint and Reappraisal: Federalism in 1976

SUMMARY AND HIGHLIGHTS

By 1976, and for a number of years thereafter, American sectional antagonism reached an intensity rivaled only by the agrarian-led populist revolt of the late-1800s. It was the Bicentennial Year, and a freedom train traversed the continent, tall ships sailed into New York Harbor, and fireworks exploded across the land on the Fourth of July. But these symbols of national good will were not paralleled by the political discourse of the era. Two bulletins stand out:

> *Front page headline in the New York* Daily News: **"Ford to City: Drop Dead"**
>
> *Texas bumper sticker:* **"Let the Bastards [Yankees] Freeze in the Dark"**

In the northeast and industrial midwest, two recessions during the early 1970s had rocked the regions' economies, New York City was in a financial crisis, inner cities were deteriorating, manufacturing jobs were being lost, population growth was stagnant or declining, and in the aftermath of the first oil crisis (1973), denizens of the north were spending a lot more of their incomes on heating their homes, driving their cars, and lighting their lamps. To alleviate all these ills, appeals were being made to Washington.

In the south and west, the economic grass was decidedly greener, or, better still, there was oil and gas beneath the sagebrush. The economies of most these states were expanding, population in some of these states was exploding, and per capita incomes were catching up to the north and east. In general, these regions were evidencing animosity toward Washington, and in the west there was even a name for it: The Sagebrush Rebellion.

Against this backdrop the presidential campaign of 1976 produced two interesting results—one regional and one intergovernmental. Politically, the country was divided at the Missouri River. Jimmy Carter's electoral vote majority was garnered by carrying most of the states of his native south, plus several large northern industrial states. But with the exception of Hawaii, Gerald Ford carried every state in the west. From a federalism standpoint the election was significant because Jimmy Carter was the first former governor to be elevated to the presidency since Franklin Roosevelt.

This article details the conflicts during this presidential election year: sunbelt v. frostbelt, urban v. suburban and rural, and federal government activism v. laissez faire. It was written by former ACIR Information Officer Carol S. Weissert, and first appeared in the Winter 1977 issue of *Intergovernmental Perspective.*

* * * * *

1976 was a year of restraint and reappraisal rather than venturesome policymaking.

Highlighted by the presidential election and a continuation of 1975's fiscal squeeze, the nation's bicentennial year saw more reevaluating of existing programs and a reluctance to pass new legislation, and a heightened awareness of economic problems in the northeast and midwest regions of the country that led to some new initiatives through regional organizations.

The nation's economic conditions were the major determinants of decisions at all levels of government. The federal government used its economic leverage to provide some relief to recession-torn states and cities through countercyclical and public works programs; states raised taxes or implemented program and expenditure cutbacks in attempts to ward off upcoming revenue shortfalls; localities looked toward new and diversified taxes on income, sales, and gasoline to relieve the heavy burden on property owners.

Presidential candidates of both major parties emphasized economic issues in their campaigns—primarily unemployment, inflation, spending programs, tax reforms, and budget deficits. While such issues as welfare reform, Medicaid reform, federal aid distribution and administration, and help for the nation's cities were not highly contested presidential campaign issues, they came to the surface again at year-end as interest groups lobbied a new administration beginning to set its program priorities for 1977.

Another offshoot of the economic situation was its disproportionate effect on the northeastern and midwestern sections of the country. These areas, already burdened with high energy and welfare costs, found added unemployment and related cost and revenue impacts a fiscal load too heavy to bear alone. Armed with research on the differential impact of federal aid, procurement policies, and military installation location, these regions urged the Congress and the President to redress what they believe to be inequitable distribution of federal funds and policies that further the economic deterioration of their states.

The year's two most dominant features, the presidential campaign and continued concern about economic stability, helped to generate these emerging trends:

—Considerable restraint and caution were exercised concerning new spending. Very few new or innovative programs were passed at either the federal or state levels.

—There was a heightened awareness of multistate regional problems and more attempts to deal with them through regional organizations, several of which were formed in 1976 specifically to confront these problems.

—Although urban problems were somewhat obscured in broader domestic issues discussed during the presidential campaign, toward the end of the year attention was focused on means to aid the nation's cities. There appeared to be some shifting of emphasis away from sending more federal money and more towards reordering existing federal aid programs, improving local government capabilities to raise money and utilize current resources, and searching for workable solutions to aggravated metropolitan and political balkanization problems.

FISCAL RESTRAINT

At both the federal and state levels in 1976, the realities of a depressed economy, buttressed by an electorate which was clearly not supporting new and expensive programs, produced caution in looking at spending proposals and more careful reevaluation of existing programs.

President Ford keynoted this need for fiscal restraint in his 1976 State of the Union message: "In all that we do, we must be more honest with the American people, promising them no more than we can deliver and delivering all that we promise."

The Second Session of the 94th Congress did not promise or deliver innovation—or new spending programs. The only two major programs renewed were not altered in program design or allocation level. What innovation there was came in the form of legislation designed to deal with economic conditions. Most notable among the enactments was a new program of countercyclical aid to state and local governments.

Countercyclical Aid

The countercyclical aid legislation was actually one section of the *Public Works Employment Act of 1976*, a law that also provides $2 billion for emergency support for public works projects and $700 million for waste treatment programs. The countercyclical antirecession aid for state and local governments was authorized at $1.25 billion for five quarters beginning in July 1976, with allocations based on unemployment rates for the first three months of last year.

Title II of the law, entitled State and Local Government Grants, provides emergency support grants to state and local governments with unemployment rates exceeding 4.5 percent for a calendar quarter.

One-third of the funds go to states; two-thirds to local governments according to a formula which relates unemployment rates to each prospective recipient's Fiscal Year 1976 General Revenue Sharing allocation.

In the debate on this legislation, proponents argued that countercyclical aid is necessary to help stabilize state-local budgets and to prevent them from having to take steps, such as layoffs, hiring freezes, and capital project deferrals, which might in turn further aggravate the recession.

The program, they said, also has the advantage of giving the money to those who need it (those governments with high unemployment) and providing the funds quickly without undue red tape.

Arguments of opponents were primarily along the lines that state and local governments will waste the money or spend it in ways that create relatively few jobs, and that such grants tend to insulate state and local governments from the "fiscal discipline" imposed by falling revenues.

The law also directs the President to convene a White House Conference on Balanced Natural Growth and Economic Development in the fall of 1977 and to assist the states in organizing regional conferences on balanced growth and economic development.

General Revenue Sharing

Supporters of the *State and Local Fiscal Assistance Act of 1972* had hoped to see renewal of this legislation early in the 1976 session. This hope was not fulfilled. PL 94-488, the *State and Local Fiscal Assistance Amendments of 1976*, passed the Congress shortly before it adjourned in early fall and was signed by the President on October 13.

The renewal changes the funding mechanism from a trust fund to guaranteed entitlement financing and extends the program for 3-3/4 years at a base authorization level of $6.65 billion for each fiscal year. A $200 million increase could occur during fiscal years 1978-80 if revenues from the federal income tax increase by a like amount.

Given the most conservative of inflation estimates, Revenue Sharing's purchasing power will decrease steadily below the original (1972) authorization level of $6.5 million per year, and the program is likely to decline as a percent of total aid to state and local governments.

State-Local Fiscal Restraint

In his 1976 state of the state message, Michigan Governor William G. Milliken summarized the feelings of many state officials when he said: "We are entering another year of hard decisions and real sacrifices. This year, as last year, we will have to deal with a depressed economy by appropriating wisely and managing well. There is no room for waste, or even for an overly generous definition of what is essential."

So it was in most of the states in 1976. A survey conducted by the National Association of Budget Officers (NASBO) for the National Governors' Conference showed that the governors looked at the upturn in the economy in the spring of 1976 not as a signal to "loosen the purse strings," but as an opportunity to "consolidate a balanced budget without new taxes." During 1976, 17 states enacted new taxes or increased existing taxes. New Jersey became the first state to adopt an income tax since 1971 and left only nine states without a broad-based personal state income tax.

ACIR estimates of state balances in 37 states at the end of Fiscal Year 1977 show some deterioration in financial conditions of many states. The figures also show regional variation. Many of the northeastern and midwestern states have little if any "cushion." Outside of Michigan, most of the states in the midwest and the fuel and farm states are fiscally sound. Yet, even those states have seen their surpluses decline dramatically from their 1975 year-end balances.

There was also state action to control the taxing or spending powers of their local units of government. In a report issued in 1976, the ACIR studied 14 states and the District of Columbia which had enacted such controls since 1970. Each of these 14 states passed local levy controls and limits—in conjunction with other state actions providing local revenue diversification and/or increased state financial aid.

Still another expression of fiscal cautiousness was in the number of proposed constitutional amendments on the November ballot calling for state and/or local fiscal limitations. Although voters in all six states rejected these proposals, the fact that they were on the ballot is in itself significant.

New York City Loan Program

In December 1975, the Congress rather hurriedly enacted the New York City Seasonal Financing Act setting up a special $2.3 billion New York City Seasonal Financing Fund in the Department of the Treasury. Prior to passage of the federal legislation the city had agreed to raise taxes and borrow from pension funds, and the state passed a three-year moratorium on maturing short-term city notes and agreed to provide additional monies to the city. Although the federal action was warmly welcomed by the city and state, it inevitably opened the door for some additional federal involvement in city affairs. For example, U.S. Treasury Secretary William E. Simon and the Senate Committee on Banking, Housing, and Urban Affairs, publicly expressed concern over continuation of the city's rent control and "liberal" fringe benefits for city employees. The Senate Committee, which has held and will continue to hold oversight hearings on the New York City financial situation, made a series of recommendations suggesting increased Treasury involvement in and oversight of New York's financial situation "to assure progress in meeting its fiscal responsibility under the seasonal financing programs. "

The congressional and administrative interest was predictable, according to officials in New York who work closely with the loan program. Felix G. Rohatyn, chairman of the Municipal Assistance Corporation, said that "any time somebody lends money to somebody else, it implies a certain degree of involvement. It automatically means a new type of relationship and one that involves a certain amount of intrusion."

In late December, President-elect Carter, following a meeting with New York City Mayor Abraham Beame and Governor Hugh Carey, pledged to work to keep New York City out of bankruptcy, to assure that all its borrowing needs are met in the future, and to review systematically the actions he as President could take to help the city overcome its budget deficit in 1977. President-elect Carter told the New York officials that "bankruptcy is not an option for New York City." He also asked his designated Secretary of the Treasury, W. Michael Blumenthal, to review such options as the continuation of the existing federal loan program, the creation of new loan guarantees, or the establishment of an urban development bank, an idea advanced by the U.S. Conference of Mayors, several congressmen, and northeastern governors.

REGIONAL COOPERATION

In 1975, the terms "sunbelt" and "frostbelt" made their way into the vocabulary of journalists, political scientists, and politicians to describe the demographic and economic shifts from industrialized states in the northeast and midwest to those in the south and southwest.

In 1976, the talk led to action on the part of state leaders in those states perceived to be on the losing end of the regional competition.

The idea for a regional coalition of governors to deal with some of the economic issues facing the northeast was first voiced by New York's Governor Hugh Carey in his 1976 state of the state message. At that time he said, "I shall seek to form a common purpose with governors of the kindred states of our region to better coordinate our efforts in Washington, to restore economic vitality to the birthplace of industrial America. We can no longer afford to pump our revenues to other parts of our nation without a fair return."

In February, Governor Carey met with four other northeastern governors to discuss the possibility of a regional coalition. The Coalition of Northeast Governors (CONEG) was formally created by seven governors in July. At that time, the newly formed group issued a statement saying, "As the nation has in the past recognized the development needs of various sections of the country, such as the western frontiers and the rural south, so now the nation must acknowledge a similar commitment to the older, yet still vibrant, northeast."

Federal Aid

In June 1976, a *National Journal* survey showed "that there is a massive flow of wealth from the northeast and Great Lakes states to the faster growing west and south." Although noting some key exceptions, the survey indicated a heavy flow of federal dollars away from—rather than toward—the states and regions of the nation in the most severe economic straits.

Similar findings were revealed in an earlier Tax Foundation study which compared dollars going into the federal government to finance federal aid and dollars returned in federal aid for each state. It found that some states, including Connecticut, Delaware, Massachusetts, New Hampshire, New Jersey and Pennsylvania, paid more than a dollar for each dollar they received in federal aid. Other "losers" in the study were several midwestern states, including Ohio, Illinois, Indiana, and Kansas, which contributed approximately $1.40 for each $1 received. However, New York, one of the leaders in the effort to inform national leaders of the fiscal difficulties of the northeast, contributes only 85 cents for each dollar received, according to the study.

Population Shifts

Between 1970 and 1975, states in the south had an 8.4 percent increase in population and western states had a 8.7 percent increase. The midwestern states' population increased by only 1.9 percent; the northeast by less than one percent. In fact some states in the northeast have lost population. New York has lost more than 100,000 in population since 1970; Pennsylvania, more than 30,000.

Manufacturing Jobs

According to the *Empire State Report*, the northeast is the only region which has suffered a net loss of manufacturing jobs over the past 15 years. The job loss was not new to 1976, of course. Yet indications are the trend is not slowing or reversing. Between 1970 and 1975, total nonfarm employment rose 20 percent in the south, and 33 percent in the Mountain states. In contrast, nonfarm employment increased only 7 percent in New England, 2 percent in the mid-Atlantic, and 6 percent in the Great Lakes states.

New York Commissioner of the Bureau of Labor Statistics Herbert Bienstock said in mid-October that the northeast had added 7,000 new jobs between June 1975 and June 1976. In that same period, the south added 521,000; the north Central, 418,000; and the west 351,000.

Per Capita Income

According to ACIR statistics, regional disparities in per capita income have been greatly reduced during this century. In 1974, the per capita income of the northeast was 116 percent of the national average. The southeast, historically the poorest section of the country, was 83 percent of the national average. These figures are even more startling when compared to 1929 when the southeast was 53 and northeast 150 percent of the national average.

Acceptance of these descriptions of the plight of the northeast and midwest is not universal. Some of the emerging research concludes that some of the figures are misleading, if not inaccurate. For instance, a study by the Economic Development Administration, released in November, concluded that "the recent arguments regarding the relative economic positions of the northeast and the south are, at best, tenuous; at worst, they are severe distortions of reality."

The EDA rebuttal included these points:

—Although the Sunbelt did grow at a faster pace in population than did the Northern Tier states, the region's growth was somewhat skewed by the increase in one state, Florida, which had a growth rate of 22.9 percent, or over 30 percent of the increase in the entire region. When that state is excluded, the region's growth falls from nearly 9 to approximately 7 percent. Growth in the northern states was 1.0 percent.

—The relative per capita income in the Northern Industrial Tier is greater than that in the Sunbelt, even with an adjustment for cost of living differentials. In fact, the authors say, the size of the actual disparity in economic well-being indicated by comparisons of per capita income, adjusted or unadjusted, is understated because of the more unequal income distribution in the south and the far greater incidence of poverty there.

—Migration of firms from the north to the Sunbelt has not been the major problem many make out, says the report. Over the past few years, the primary cause of declining employment in the north has been the death or closing of existing firms. In the south, the primary cause of the increasing employment has been the expansion of existing firms.

One difference in the EDA comparisons with others such as those of the *National Journal* is in the definitions of the regions. The EDA designation of "Sunbelt-South" does not include Delaware and Maryland, and its "Northern Industrial Tier" omits Maine, New Hampshire, and Vermont, which are included in other comparisons.

Yet much of the data and accompanying press coverage were in line with what the *New York Times* called the northeast's "impressive case for consideration in Washington."

The future of the Coalition of Northeast Governors is still uncertain. Several of the active governors will no longer be in office in 1977, and the full commitment of some of the others has still not been tested. Yet some feel the effort thus far has proven worthwhile.

"I don't know what will evolve," said Felix G. Rohatyn, New York City's Municipal Assistance Corporation chairman who serves as Governor Carey's business representative to CONEG. "But surely we will have a much better, much more educated dialogue on the issue, and there will be less resistance to change."

Complementary to the governors' actions was formation of two other regional groups in the northeast. The Northeast-Midwest Economic Advancement Coalition, made up of congressmen from 16 states from Maine to Minnesota, was formed in the fall. This group, chaired by Rep. Michael Harrington of Massachusetts, has held hearings on federal aid and related economic issues and plans to look at possible further changes in federal aid formulas.

A Council of Northeast Economic Action was established in October with a grant from the federal Economic Development Administration. The council has representatives of government, industry, labor and financial institutions in the northeast. It hopes to provide research to back up the efforts of the CONEG, the congressional coalition, and others.

There have also been efforts in the Great Lakes region to establish a regional apparatus to stem the flow of federal resources toward the south and west. In October, members of the CONEG met with governors and their representatives from the Great Lakes region to discuss changes in federal aid formulas which would provide more money for industrial states.

The Western Governors' Conference is expected to accept a recommendation of its regional policy management task force to set up a Western Governors' Policy Council, combining such existing regional organizations as the Federation of Rocky Mountain States, the Western Interstate Nuclear Board, and the Western Governors' Regional Energy Policy Office. Such a consolidation would strengthen the voice of the western governors in five areas of top priority: energy resources, human resources, agriculture, natural resources, and water resources.

The Southern Growth Policies Board is spearheading an effort in that region to identify potential problems and work out reasonable solutions connected with growth and development in the southeast.

Thus, the move toward regional efforts at problem solving is widespread and appears to be growing stronger. Whether this trend toward competitive sectionalism develops further or shifts toward a more unified effort to encourage expenditure of a larger portion of the nation's gross national product for economic development purposes remains to be seen.

A NEW APPROACH TO SOLVING URBAN PROBLEMS

George Sternlieb, Professor at Rutgers University, reflected the view of many politicians and political scientists in 1976 when he told the Joint Economic Committee's Subcommittee on Urban Affairs in May, "For many people, the bulk of whom are voters, the American city is something they'd like to forget."

Some contended that this feeling was shared by the major candidates for the Presidency. David Broder expressed exactly this concern in a syndicated column published in August: "In three presidential and vice presidential debates, there has yet to be a single question directed specifically to the problems of the cities, and the candidates are equally reluctant to raise the subject on their own.

"The problems of the metropolitan areas—racial, social, economic, and governmental—will be there next January, awaiting whoever is President," he continued. "And they cannot be brushed aside in the four years as easily as they have been by the complicity of the opponents in this campaign."

By the end of the year, however, more attention was focusing on urban problems: the nation's mayors called for a set of new urban priorities, including a greater role in White House policymaking; congressional hearings were held on the "rebirth of the American city"; and several special committees studying the needs of urban areas offered their recommendations.

Perhaps more important than the renewed interest in problems of cities was the direction in which the solutions seemed to be heading. Mayors and congressmen alike appeared to recognize that the days when more and more federal money will be available to cities may be over. Likewise, the realization seemed to be widely expressed that many urban problems result from structural and functional weaknesses in state and local governments and can best be dealt with by a concentrated and coordinated reform effort by cities, counties, states, and the federal government working together in a complementary and supportive partnership.

President-elect Carter, in a meeting with the nation's mayors in June, expressed this view when he said that the federal government should be involved in helping cities solve their problems, but that the cities must also work "to reorganize your own governments, to root out inefficiency and waste, to deal with administrative problems in a courageous way."

Some mayoral responses indicated agreement. Richard Hatcher, mayor of Gary, IN, said "we must draw upon our basic spirit to survive and rely upon our innate abilities to grow." New Orleans Mayor Moon Landrieu proposed that the President-elect use the moral power of the presidency to encourage regionalization of tax bases and services in the nation's urban areas.

A list of urban priorities, drawn up at a meeting of the nation's big city mayors soon after the election, reflected the mayors' understanding of the need for cooperation at all levels—and the limited prospects for massive new federal financial infusions. Although the priorities included two rather expensive federal programs—a call for more jobs in central cities and creation of an urban development bank to provide loans to businesses and cities for economic projects—there were also items of major concern which did not involve more federal aid.

Improved access to the White House for mayors and their staffs was given a high priority, as was development of a coherent national urban policy that would consolidate and provide cohesion for federal aid going to cities. In addition, they urged that all existing federal agencies consider the effect of their programs on cities. The mayors pointed out that even those policies not perceived as affecting cities, such as federal tax policies, do in fact directly affect urban areas by influencing where capital investments are or are not made.

Congressional Hearings

"The Rebirth of the American City" was the theme of a week of hearings conducted this fall by the House Banking, Currency, and Housing Committee and organized around a book, *The Recovery of the American City*, by Paul R. Porter. Porter, the lead witness at the hearings, said that the recovery of the city "will be its regained ability to compete with its strongest suburbs as a place to live and to meet its needs from revenues of local origin, a freedom from financial dependency."

The House hearings were based on the thesis that "there are already major social and economic forces at work which can help the cities recover if they can be nudged in the right direction," said Committee Chairman Henry Reuss of Wisconsin in keynoting the session.

The 54 witnesses, who did not include elected officials or representatives of executive agencies or trade associations, discussed some of the longstanding problems of the city, namely, race, jobs, relocation, economic development, and division of governmental responsibility.

Important to any recovery, they said, were such issues as encouraging people to live near their jobs, rehabilitating older housing in cities, encouraging citizen participation, redefining the roles of federal, state, and local governments in sharing financial and operational responsibility for major programs, reforming local taxation as an aid to municipal finance, and setting priorities in allocating federal funds to cities.

ACIR Chairman Robert Merriam told the committee that meeting the needs of urban America is a job for all three levels of government. The state and local governments have the basic responsibility for meeting these needs, he said, but federal urban policies and financial assistance should facilitate the fuller exercise of these basic responsibilities and be sensitive to wide variations in state and local needs from one part of the nation to another.

ACIR Assistant Director John Shannon testified that local fiscal conditions could greatly be assisted by a combination of equalizing state aid and federal takeover of public welfare. Since those states with the heaviest public welfare burdens are, for the most part, the very same states which must contend with the most acute central city fiscal problems, federal aid to those states might allow them to extend financial aid to their hardest pressed local governments.

THE PRESIDENTIAL CAMPAIGN

The single most important event in 1976, of course, was the presidential election. As in past elections, personalities and events sparked most of the news coverage, and the issues—particularly intergovernmental issues—were sometimes obscured, though they did receive somewhat more attention in the primary campaigns. Presidential and vice presidential debates—the first since 1960—served to highlight some issues, although, understandably, economic matters and foreign policy got most of the attention.

Some of the key domestic issues discussed during the campaign, such as management of the economy and welfare reform, are highly intergovernmental and were so recognized during the campaign. For instance, welfare reform was couched in terms of relieving a burden on cities and states. National economic actions were seen as contributing to the plight of the cities. Federal job programs were discussed in terms of efforts to finance public works projects of the states and cities.

Thus, although these intergovernmental issues did not always rate newspaper headlines, the candidates' understanding of, and concern for, the intergovernmental impact of such programs was an important first step in strengthening the federal system.

Party Platforms

One barometer of political awareness of intergovernmental issues may be the two major party platforms and their recognition of the importance of the intergovernmental component in federal policymaking. This year, both in the treatment of intergovernmental issues and in their understanding of the intergovernmental impact of federal action on state and local governments, the party platforms registered improvement over previous years.

For instance, the Democratic platform on welfare reform highlighted the importance of relieving a fiscal burden on cities and states. It said, "As an interim step, and as a means of providing immediate federal fiscal relief to state and local governments, local governments should no longer be required to bear the burden of welfare costs. Further, there should be a phased reduction in the state's share of welfare costs."

Although supporting a different solution, the Republican platform was equally cognizant of state and local needs. It said that reform of the welfare system should "better coordinate federal efforts with local and state social welfare agencies and strengthen local and state administrative functions. We oppose federalizing the welfare system; local levels of government are most aware of the needs of their communities. Consideration should be given to a range of options in financing the programs to assure that state and local responsibilities are met."

Another example of intergovernmental recognition was in statements on federal aid, where the Democratic Party recognized that "an uncoordinated policy regarding eligibility requirements, audit guidelines, accounting procedures, and the like characterizes the over 800 categorical aid programs and threatens to bog down the more broadly conceived flexible block grant programs." Thus, the statement continued, "The Democratic Party is committed to cutting through this chaos and simplifying the grant process for both recipient governments and program administrators."

The Republican platform "promoted the new concept of federal block grants to localities for much greater flexibility. Under block grants, federal funds can be tailored by the states and localities to the wishes of each community."

The Unresolved Questions: Federalism in 1977

SUMMARY AND HIGHLIGHTS

From a federalism perspective, 1977 was like August: slow news period. The new Carter administration expended most of its efforts on streamlining organization and procedures, and neither the administration nor Congress was giving clear indications about where the intergovernmental system was heading.

Yet, the year was not without political significance, for 1977 would prove to be the calm before the storm. The following year witnessed the beginning of the taxpayers revolt and federal retrenchment. Undoubtedly, there was at least some measure of cause and effect. With Washington seemingly unable to make up its mind about what government should or should not be doing, and how, the electorate was sending a message that it wanted to rein in government.

Significant developments outlined in this article include the acceleration of bypassing state governments in favor of direct federal grants to local governments (irrespective of the fact that President Carter was a former governor and state governments had become much more sophisticated), a new emphasis on centralization in some areas, the quest for a balanced budget (with strong opposition in some quarters), and an institutionalization of regionalism and congressional special interest caucuses. The article first appeared in the Winter 1978 issue of *Intergovernmental Perspective.*

*   *   *   *   *

From the standpoint of intergovernmental relations, 1977 will be remembered as a year of bold beginnings, unfinished work, and lingering uncertainties. After weathering a series of foreign and domestic crises, the federal system was put to a different test—dealing with a period of relative political stability and economic recovery. To be sure, critical problems existed—energy, environmental quality, and urban fiscal conditions—but they did not overwhelm the political agenda. Instead of being preoccupied with responding to various crises, the nation's political leaders had the interest and time to consider reforms in basic governmental institutions and processes.

The initiatives taken during 1977 were largely in response to the high level of public expectations generated during the election campaigns the previous year. Particularly at the national level, the defeat of the incumbent President was considered by many observers to be a signal that citizens were no longer satisfied with "politics as usual," and that it was time for major change. The spotlight was turned on Washington, DC.

Many of the changes which were launched during the year—reorganization, zero-based budgeting, sunset legislation, and merit system reform—went to the essential "nuts and bolts" of public management. Others—such as the Carter administration's emerging urban policy and the fiscal 1981 balanced budget goal—sought to substitute systematic and coordinated policy development and implementation for "quick fix" solutions to the nation's problems. These were significant actions, having potentially significant consequences.

While the President scored some successes on the budgeting, grant management, reorganization, and intergovernmental consultation fronts, expeditious action did not occur on many major domestic policy issues. Even where there was general agreement within the executive and legislative branches on what basically needed to be done to respond to certain national problems, there was little consensus on how to do it—and, in the process, "whose ox should be gored."

These differences, coupled with an absence of a severe crisis as a catalyst for decisionmaking, took a toll. The President's popularity rating in the polls dropped. The Congress as an institution was thought by many to be ineffective, even though in the view of others it has been the chief molder of the intergovernmental system for at least two years. And, the media expressed concern that the sheer abundance of Presidential initiatives had clogged the policy pipeline, and reflected on its earlier apprehensions about domination of the decisionmaking processes by a Congress and President of the same party.

In the absence of significant actions on proposals to make major changes in the status quo, uncertainties developed. Citizens wondered if the Social Security System would survive; whether income taxes would be raised or lowered; and if they would have to wait in lines at the gas pump, or would have adequate supplies of energy for home heating.

Local government officials wondered what would happen if "temporary," federally funded employment, training, and public works programs were not extended, and if grants for other purposes would decline as federal deficits mount and the administration seeks to achieve its balanced budget goal during the next two years. State government officials also wondered about the future of federal aid, and especially whether the recent growth in direct federal-local grants would continue to undermine their position as the overseers of local government. The Congress wondered why the President was not more willing to communicate, cooperate and compromise, and the President wondered why the Congress was unable to move on his domestic legislative proposals in a timely manner.

These uncertainties are not inconsequential. Taken together, they indicate doubts in many quarters as to where the federal system is heading. Three basic questions which were raised in 1977, but not resolved, highlight these concerns.

Is authority being decentralized or recentralized? Unlike the previous three national administrations, the first year of the Carter administration did not reveal a clear preference or shift toward decentralization or centralization of decisionmaking authority. Instead, mixed signals were given. The President's memorandum urging departments and agencies to consult regularly with state and local governments in their policy, management, and financial decisionmaking suggested that the decentralization thrust of the Nixon and Ford administrations would continue. Statements by Jack Watson, the head of the White House Intergovernmental Affairs Office, underscored this apparent commitment on the part of the administration to genuine communication, consultation, and coordination with state and local representatives.

The fact that the President was a former governor lent additional credence to this position. On the other hand, actions taken by the administration during the year raised some basic doubts about these developments. Soon after President Carter took office, an assessment of the Federal Regional Councils (FRCs) was launched; while the results indicated the need for some form of regional "presence" and FRCs were given an additional "probationary" year, neither state or local officials nor federal administrators were clear as to whether FRCs ultimately would be continued and, if so, what role they would play in federal aid administration.

Of even greater concern to some observers was the action by the Secretaries of HEW, HUD, and Labor to strip their regional offices of any real authority over grant decisions, and the moves by the Attorney General to close the LEAA regional offices and by the Secretary of the Interior to abolish the regional representative offices. These decisions, which for the most part were made without consultation with state or local officials, suggested a recentralization of authority at the national level.

The attachment of various across-the-board requirements to grant programs such as antidiscrimination, citizen participation, environmental quality, prevailing wage rates, uniform relocation, merit principles, historic site preservation, and freedom of information also has complicated intergovernmental relationships. While, taken individually, some of these requirements may be desirable, their cumulative effect often has been to delay the implementation of programs, raise administrative costs, or force jurisdictions out of the federal aid business. These procedural strings represent further centralization of decisionmaking at the national level and, to some observers, reveal a basic distrust on the part of the federal government regarding the motivations and capabilities of state and local officials.

Are local governments becoming too dependent on federal aid? One of the major ironies of the 1970s is that despite avowed efforts to curb governmental growth at the national level, the number of federal programs and the dollar amounts of grants-in-aid have burgeoned. Although the grant system has been growing rapidly since the mid-1960s, it has taken a quantum leap in the past few years, largely in response to economic crises triggered by the recession and rising energy costs.

As a result of this development, federal aid now accounts for a substantial portion the revenues of many governmental units. The intergovernmental "partnership" has been expanded greatly by the newer forms of assistance, especially General Revenue Sharing and countercyclical aid, so that virtually all states and localities now receive some federal financial assistance. And, the gap between the pleasure of spending and the pain of taxing has been widened considerably.

Particularly due to the Carter administration's "stimulus package" programs, federal aid now accounts for about half of the own-source revenue of the large central cities of the country. To some, these jurisdictions increasingly are becoming the "creatures of the state and the fiscal wards of the federal government." In view of the political clout of these units in the Congress, there is ample reason to question whether the "temporary" stimulus programs can be phased out. If indeed this is the case, further doubts may be cast on the President's desire to achieve a balanced budget. Moreover, the direct dealings between Washington and city hall have placed the states in an awkward "odd man out" position. To some students of federalism, this phenomenon has stood traditional federal theory on its head.

Has the recent increase in federal aid eroded the states' power position in the federal system? The states traditionally have occupied a pivotal position in the grant system; approximately 70 percent of all federal aid currently flows through the states, and state agencies have significant planning, fund disbursement, and administrative responsibilities in many federally assisted programs. While bypassing can be traced back to the 1930s, the "direct federalism" of 1977 has a number of distinctive features. First, substantial amounts of funds go directly to local governments—almost 30 percent of the FY 1976 aid total. Secondly, most of these monies are discretionary and highly fungible in nature, in the sense that recipients enjoy wide latitude in determining how they are to be used, both on paper and in practice. These two factors create management, as well as policy, headaches for the states, as coordination of plans and projects, monitoring of expenditures, development of statewide strategies, and accountability for the use of funds are greatly impeded.

Perhaps most troublesome—and ironic—is the fact that bypassing has accelerated at precisely the time that most states have modernized their executive and legislative branches along the lines advocated by reformers over the years. Even more frustrating is the fact that many of the innovative federal management approaches which command national headlines—reorganization, zero-based budgeting, and sunset legislation—were pioneered by the states.

A TILT TOWARD WASHINGTON

Our federal system never has been completely decentralized or completely centralized. Federalism, after all, involves a dynamic and delicate balance between these forces. This balance shifts in response to changing social, economic, and political conditions, and the philosophies of the nation's political leaders.

Many observers of federalism believe that during the first half of the 1970s, power in the intergovernmental system seemed to shift more in the direction of decentralization than centralization. To be sure, there were major examples of action of the latter nature—such as the 55-mile-per-hour speed limit, air and water pollution standards, occupational safety and health regulations, and various energy conservation programs.

But during these years, policymakers at all levels were concerned about how the system could be wound down—how power, funds, and responsibility could be returned to states and localities. General Revenue Sharing, block grants, and the Federal Regional Councils illustrate this desire to decentralize. Today, there is evidence that a different intergovernmental balance is being sought. The increasing tendency to define "national interest" to include virtually any activity that was at one time the exclusive domain of state or local governments, the explosion of federal aid and attendant conditions, the leapfrogging of state governments, the recalling of authority from federal agency field offices, the involvement of a variety of new local participants in the grant system, and the tightening of strings associated with General Revenue Sharing, all have raised concerns about this development. While most of these trends began to emerge years ago, 1977 was the year in which their broader implications began to be recognized and understood. Unquestionably, the role of the federal government in the day-to-day lives of most citizens and most state and local governments has grown. Fiscally and functionally, the federal government is becoming more and more the senior partner in intergovernmental relations, and grants-in-aid have become the cornerstone of the system. There is still a tremendous amount of interaction within and between the levels, and states and localities still play major roles in public service delivery. But there are clear signs of recentralization. While it is too early to determine how far it will go, the flow of intergovernmental power, funds, and responsibility has begun to move in a different direction.

FEDERAL INITIATIVES AND IMPACTS

Despite a decline in the public sector growth rate in 1977, the trend during the past quarter century has been toward an unparalleled expansion of government. State and local governments in particular have grown rapidly, as demonstrated by the nearly threefold increase in their work forces, from about 4.1 million to 12.2 million between 1953 and 1976, and the nearly tenfold increase in their own revenues during the same period, from about $27 billion to approximately $200 billion. The roles of these governments also have expanded and diversified greatly, supported in part by federal aid.

But while the size and scope of state and local responsibilities have grown, policy initiatives, allocational decisions, and administrative authority increasingly have been centralized at the national level. Paradoxically, this shift began to accelerate at a time when two national administrations were proposing policies designed to facilitate decentralization.

THE DOLLARS AND THE SENSE

The expansion of the federal government's role has taken a variety of forms. Recent trends in aid programs, regulations and supersessive laws illustrate the dimensions of this phenomenon:

—In 1950, federal grants-in-aid to state and local governments amounted to about $2.3 billion; but by 1977, the total has risen to over $70 billion. The forms of federal assistance also have changed, with General Revenue Sharing and block grants now comprising almost one-fourth of what was once an entirely categorical system. These newer grant forms also have expanded greatly the contemporary intergovernmental partnership, as virtually all state and local units are recipients of federal aid and are, therefore, bound by the accompanying conditions and controls.

—As the modified version of the golden rule goes, "he who supplies the gold makes the rule," and federal aid is no exception. At least 33 crosscutting regulations routinely are attached to most aid programs. These deal with such subjects as environmental protection, relocation, citizen participation, prevailing wages, and affirmative action, and they are in addition to specific programmatic requirements.

—And, federal supersessive laws—which in various ways remove jurisdiction from the states—have enlarged the sphere of federal influence and decisionmaking. Over 40 such laws have been enacted by the Congress in such diverse areas as the environment, occupational health and safety, consumer protection, and civil rights.

These developments in federal assistance, regulations, and law have increased the interdependence of federal, state, and local governments. They also have raised concerns about the degree of dependence of states and localities on the federal partner. Federal aid as a percent of state and local own-source general revenue rose from 11 percent in 1957 to 28 percent in 1976. Large cities have registered the most dramatic increases. Direct federal aid as a percent of municipal own-source revenue has virtually doubled every five years over the last two decades—rising from about 1 percent in 1957 to over 23 percent by 1976. It is estimated that federal aid to cities over 500,000 population will zoom from 28 percent of their own-source revenues in 1976 to about 50 percent in fiscal 1978.

Several major factors have contributed to this dramatic growth in direct federal assistance: General Revenue Sharing, the manpower and community development programs, and the Carter administration's economic stimulus package. Others include:

—the economic and fiscal plight of the older central cities, and the basic political fact of life that in order to win sufficient congressional support for aid to these jurisdictions, it is usually necessary to extend federal assistance to a wide range of local governments;

—the development of strong "urban" lobbies in Washington;

—the relatively poor performance of the states in facilitating and assisting urban problem-solving; and

—the growing hope that direct federal aid to poor cities also will help poor people.

In 1977, with a new President in the White House (whose public career included service at both the state and local levels) and the 95th Congress convening on Capitol Hill (with new leadership and members in both chambers), these and other dynamics of the federal system were the focal point of attention by citizens and public officials alike.

INTERGOVERNMENTAL CONSULTATION INITIATIVES

According to Jack H. Watson, Jr., Assistant to the President for Intergovernmental Affairs, "there is virtually nothing that the Federal Government does, domestically certainly, that does not involve the immediate participation and partnership of state and local governments." Within five weeks of assuming office, the President directed the heads of all executive agencies and departments to make provisions for a "genuine and timely" consultative process with state and local officials, noting that:

—State and local sectors constitute the delivery mechanisms for most of the actual services the federal government provides;

—State and local concerns, as well as their expertise, should be considered as programs are being developed in order to ensure the practicality and effectiveness of the programs;

—Such early participation by state and local officials in our planning process will help ensure broad-based support for the proposals that are eventually developed; and

—It will ensure that priorities developed at the federal level will work in conjunction with, and not at cross purposes to, priorities at the state and local level.

The effectiveness quest is closely associated with reorganization efforts and various administration initiatives to increase the effectiveness of the federal government's programs and operations.

"Zero-based" budgeting (ZBB) is one of the most heralded of these initiatives, and was utilized during the preparation of the first "Carter budget" for FY 1979. ZBB techniques have been used by businesses for several years, and first were applied to government in Georgia during the first term of then-Governor Jimmy Carter. While it is too early to rate the success of ZBB, administration spokesmen do say that "an honest try" was made during this first year and that the process fulfilled its promise in some agencies.

Critics of ZBB, however, argue that this approach may be inappropriate. Robert W. Hartman of the Brookings Institution, for example, has contended that it "makes no sense" to rank the food stamp program against research within the Department of Agriculture, when it is not ranked against HEW's welfare programs. Hartman maintains that ZBB concentrates attention on the budget for the coming year, which largely is "locked in place," at the expense of a focus on multiyear budgeting—another Carter goal. He suggests that the best method for identifying budget reductions "should be specially designed approaches in different areas."

The first year's experience of ZBB will be evaluated during the months ahead. One concern is state and local involvement in the ZBB process for future fiscal years, since some believe that in view of the substantial amount of the budget that is considered "uncontrollable," grant programs to states and localities may be the most susceptible to change.

In addition to ZBB, three other features characterize the Carter administration approach to the federal budget:

—multiyear budgeting—the goal is to move to a two to three-year budget focus in an attempt to evaluate the "out-year" implications of "close-year" decisions;

—better use of existing programs—the view is that unless the existing program base is sound, additions to that base will be ineffective and a waste of resources; and

—a balanced budget by 1981—according to administration spokesmen, the President "understands the implications—both economic and political" of working toward a balanced budget by 1981; however, he is still committed to it, "and will do nothing now to jeopardize that goal."

Achievement of a balanced budget by the end of the President's term is easily the most controversial of the budget goals. It is of particular concern to local and state officials who are calling for an increase in domestic aid programs. In an appearance before the Joint Economic Committee in early December, Congressional Budget Office (CBO) Director Alice Rivlin cautioned that continuing attempts to reduce unemployment through economic growth would preclude balancing the budget by 1981.

In August, the CBO released a report entitled *Troubled Local Economies and the Distribution of Federal Dollars*. The report responded to a request from Representatives Elizabeth Holtzman (NY) and Louis Stokes (OH) for an analysis of federal spending, with an emphasis on geographic distribution and the relative well-being of recipient local economies. The study categorized local economic problems into two general areas: those related to low income and those resulting from low economic growth. While the characteristics of individual localities vary, two paradoxical patterns emerged:

—low income appears to be concentrated in the south and southwest regions, despite fairly high growth rates in recent years, and

—low economic growth is a condition in the northern regions (New England, Great Lakes, and mid-Atlantic), but personal incomes are relatively high.

These two patterns highlight yet another concern which has expanded—regionalism. The diverse economic trends in various parts of the country have led some pundits to coin phrases such as "the Second War Between the States" and "Sunbelt vs. Frostbelt." The controversy implied by these terms has tended to center on the role that federal aid and direct outlays, and national policy, play in regional economic disparities. Regionalism has spawned at least a dozen regional organizations of state and local public officials in the past few years—including the Coalition of Northeast Governors, the Council for Northeast Economic Action, and the Southern Growth Policies Board.

THE LIST OF CAUCUSES LENGTHENS

One of the more interesting intergovernmental developments in Congress during 1977 has been the emergence and activities of even more special interest caucuses. For example:

—The Rural Caucus, composed of 101 Congressmen, was founded in 1973 to "insure orderly growth and development of rural communities." The caucus held its first conference in 1977 to help dramatize the needs of rural areas and to urge full funding for *Rural Development Act* programs. Approximately two-thirds of the nation's substandard housing is located in rural areas, and it is expected that the caucus actively will support the reintroduction of the proposed "Rural Housing Act of 1977" early in the 1978 session.

—The Steel Caucus was formed in late 1977 to provide "a strong watchdog to protect this endangered basic American industry." The caucus became quite active when steel plants closed in several cities, allegedly because of unfair foreign competition.

—The Suburban Caucus was formed in October to support tax relief for suburbanites and more federal projects for middle income families who live outside cities. The primary impetus for the group came from Rep. Ronald Mottl of Ohio when 22 suburban communities in his district failed to receive money during the second funding round of the *Public Works Act*. The caucus has a potential membership of 150 Congressmen whose districts have 60 percent or more suburban population.

These caucuses, some of which have overlapping membership and at times competing interests, join such other groups as the Irish, Black, Blue Collar, Hispanic, and New Members Caucuses; and the Northeast-Midwest Economic Advancement Coalition. The emergence of these special interest groups adds a new dimension to the competition for favorable congressional action—including the sweepstakes for federal aid and the articulation of an urban policy.

Thus, there already is important grist for the 1978 federal legislative mill, as the Congress and the President consider economic recovery, tax reform, urban policy, and other major issues. If the past is prologue, the outcome of these deliberations will have significant implications for the condition of American federalism. In particular, the actions in 1978 should provide a clearer indication of whether the tilt toward Washington will continue, and how far it is likely to go.

1978: The Year of the New Populism

SUMMARY AND HIGHLIGHTS

The 1978 California ballot initiative known as Proposition 13 was a revolt by the state's taxpayers against the level of local property taxation. Throughout 1978, and over the next decade, it would be replicated across the country in those states with constitutions providing for ballot initiatives and referenda. Although these revolts were aimed directly at state and local taxes, in retrospect most observers believe that they were the result of public frustration with the combined level of taxation of all three levels of government. As inflation was causing a spiraling of real estate prices, and thus property assessments for taxing purposes, middle income citizens were likewise being pushed into income tax brackets once the province of the rich.

The next four articles are interrelated in that they document the severe fiscal stress that had occurred by 1978. This article relates to the confusion and consternation (or celebration) that Proposition 13 and its offspring wrought among public policymakers at all levels of government. The second article concerns the simultaneous inability of Washington to respond to growing fiscal constraints. The third article offers a political analysis of the balanced budget movement to curtail Washington's spending authority that had gained considerable momentum by 1978. And the fourth article details the political maneuverings that were occurring to end Revenue Sharing for the states—a debate that was part and parcel of the fiscal squeeze.

Indeed, the taxpayers revolt which this article describes was only the second of four shockwaves that befell the intergovernmental system in less than a decade. The first had been the bankruptcy of the nation's largest city, overwhelming New York State's ability to deal with the problem, and causing federal government intervention. The third shockwave, occurring concurrently with the taxpayers revolt, was federal retrenchment in discretionary domestic spending. And finally, all levels of government were rocked by back-to-back recessions in the early 1980s.

This article first appeared in Winter 1979 issue of *Intergovernmental Perspective.*

* * * * *

There can be no doubt that the headliner in the 1978 intergovernmental drama was California's Proposition 13. Not only was it momentous in its impact on fiscal and functional intergovernmental relationships in California, but it had major spillover effects for other states and the federal government as well. It is these spillover effects and certain ironies connected with Proposition 13 that led ACIR to label the movement "The New Populism," a term that captures the fact that this new grass roots populist movement is advancing its cause through use of propositions on ballots across the nation.

The New Populism is more than a citizen revolt over high taxes. In a much larger sense, it is a response to a perceived breakdown of the traditional mechanisms, such as the representational processes and the party system, for discerning public sentiment and forging consensus. At the same time, it illustrates the effectiveness of other channels provided for citizen and interest group access, principally the initiative and referendum, as well as the overall adaptive capacity of the American federal system. Above all, it reminds us that "by and for the people" is more than a constitutional principle—it is a vital operational characteristic of our federal system.

At the outset of 1978, the intergovernmental agenda was dominated by concerns about the worsening condition of the nation's cities. At the national level and in some states, considerable attention was focused on "targeting" funds to distressed communities, and on coordinating governmental policies and programs that impacted on them. President Carter's announcement of a national urban policy in March drew both kudos and complaints. Mayors, civil rights groups, and others were pleased that an attempt had been made to pull together and define an urban strategy. On the other hand, some were proclaiming that there was no need for a national urban policy, and that in fact Congress and previous administrations had already fashioned a very effective system of targeted assistance, characterized by the *Comprehensive Employment and Training* and the *Housing and Community Development* acts, countercyclical fiscal assistance, the public works jobs program, and even General Revenue Sharing. Still others were claiming that the nation's cities were no longer "sick," and that many were undergoing an economic and social revitalization featured by the return of young and middle class taxpayers to occupy new or renovated housing within city limits.

By mid-year, these concerns had been effectively eclipsed by the tax revolt. Only a few of the measures proposed by the White House as part of a national urban policy were enacted in 1978. And, as the year ended, it appeared that several key urban programs would be dropped from the 1979 legislative agenda as the mood of fiscal restraint that was part and parcel of the New Populism seemed to take hold of both the Congress and the administration.

THE IRONIES OF PROPOSITION 13

There are at least two overarching ironies associated with the New Populism, as expressed by Proposition 13 and related tax or spending measures passed in 11 states in 1978.

1. While supporters argued that tax and expenditure limits would help give citizens more control over their government, the reverse effect is likely. Instead of increasing governmental independence, especially at the local level, greater dependence on higher units may well result. As California's experience suggests, when local revenue sources are constricted, localities turn to the state for help. And the accompanying state funds tend to carry with them controls over recipient activities. Furthermore, pressures to increase local aid or assume a larger state fiscal or administrative role in the delivery of certain local services can put considerable pressure on state resources. Thus, both states and local governments can end up turning to Washington for help. If these developments take place, then more centralization of fiscal decisionmaking and more dependence on outside funds can result from citizen efforts to limit the taxes and expenditures of their governments. In addition, greater state or federal involvement in services performed at the local level may occur. Some previously local activities may even be taken over by state or regional agencies, reducing even further the amount of local control. This is a much different type of urban policy than that which was being developed by the Carter administration and some states earlier in the year.
2. At a time when more and more state and local governments may be turning to Washington for financial assistance, efforts are under way to reduce federal expenditures. There are strong signs that the rapid growth of federal aid to state and local governments that has marked the past decade will be slowing, as the President and Congress seek to apply the fiscal brakes in order to reduce budgetary deficits and help curb inflation. Federal aid may well be the primary target of executive budget cutters attempting to reduce the federal deficit in fiscal 1980 since it represents one of the few major "controllable" areas of the federal budget.

These national level developments, coupled with the effects of tax or expenditure limits, could well put some state and local governments in a fiscal strait jacket in the years ahead.

THE SPILLOVERS FROM PROPOSITION 13

For a variety of reasons, Proposition 13 successfully captured the mood of the country and the attention of the press. Politicians and pundits alike lost little time jumping on the Proposition 13 bandwagon. Thus, it is not surprising that the effects of Proposition 13 extended beyond California's boundaries. Indeed, its "spillovers" are apparent in current or anticipated activities across the country and in the nation's capital.

One spillover in many states and Washington is a heightened awareness on the part of policymakers that government should somehow be made more efficient and they themselves made more accountable to the electorate. While some states already have installed taxing or spending limitations or will consider doing so in 1979, other approaches to containing government revenue and expenditure increases, reducing and making more equitable individual tax burdens, and relieving jurisdictions of costly servicing commitments also will be seriously considered. The specific mechanisms for achieving these purposes include indexation of income taxes, "truth-in-taxation" procedures, property tax circuit breakers, selective functional reassignments, and governmental reorganization. In the long run, these mechanisms could have a significant effect on relieving tax pressures and ensuring greater public official accountability for revenue and spending decisions.

A second spillover effect of Proposition 13 will be witnessed at the national level, especially if state surpluses dwindle further and local financial conditions deteriorate. There will likely be an increase in vigorous special interest lobbying campaigns in Washington as advocates "circle the wagons" around the more vulnerable programs. Lobbying efforts on the part of the state and local associations of public officials probably will increase, not only to retain major fiscal relief programs such as General Revenue Sharing, but to secure the adoption of new or "reformed" big money programs such as welfare and national health insurance. While to the Carter administration these efforts may have a "budget busting" nature, nevertheless they may be a necessary counter to legislative or citizen-imposed shackles on state and local revenues.

These intergovernmental lobbying efforts could well have serious implications for the federal system:

—they could enhance the regional rivalries between the so-called "Sunbelt" and "Frostbelt" states and renew the "battle of the formulas" that in recent years have been waged in Congress with increasing ferocity;

—they could make attainment of the President's goal to reduce the federal budget deficit to $30 billion politically infeasible in the coming fiscal year;

—they could generate increased friction among the state, county, and city interest groups over eligibility for federal aid; and

—they could exacerbate the tensions between state and local elected officials and top administrative generalists, on the one hand, and program specialists and their congressional and interest group allies, on the other, as proposals to cut back, reorganize, consolidate, or terminate programs and regulations are considered.

With the citizen pressure for increased governmental efficiency that is explicit in Proposition 13 came still another spillover: renewed interest in curbing governmental regulation, a major source of inefficiency. Intergovernmental concern was focused on the federal aid system. While there has been considerable rhetoric over the past decade about standardizing, simplifying, and streamlining, in reality the number of federal regulations, their penetration into state and local policy areas, and their "compliance costs" have steadily risen. And, in spite of strong executive branch and congressional interest in curbing the negative aspects of governmental regulation of both the public and private sectors, many of the actions that have been taken to date have been viewed by state and local observers as "band aid" solutions to a problem that requires major surgery. Significantly, as the year closed, two national associations representing state elected officials urged the President to intensify efforts to streamline the federal aid system and offered to "trade" their active support for the President's fiscal 1980 budget for relief from federal aid regulations and paperwork burdens.

Finally, a major spillover from Proposition 13 deals with how states will respond to this "era of limits." Actions to limit tax revenues or impose expenditure ceilings present both a challenge and an opportunity to state governments. As the California case shows, under conditions of fiscal restraint, the leadership role of the state as it relates to local units becomes paramount. For example, the state is in a position to:

—take positive action to reduce local fiscal stress by providing increased amounts of state aid or giving these jurisdictions greater authority to raise revenues;

—influence and, if necessary, mandate more fundamental reforms in the governance, fiscal, and service delivery systems at the local and substate regional levels;

—make special districts and public authorities more accountable to general purpose local governments and the citizenry;

—provide a solid justification for a reexamination of the pattern of functional responsibilities among the state regional bodies, counties, cities, and other local units and to make reallocations that will bring about greater economy, efficiency, effectiveness, and equity in their operations.

These structural and functional reforms have been long overdue in most states, and probably would not be placed on the public policy agenda, let alone be acted upon, were it not for the fiscal pressures generated by tax or expenditure limits and the climate of public opinion that sustains these curbs. In addition to improvements in local and regional operations, the states have an excellent opportunity to upgrade their own structures and processes. Thus, it would seem that prospects for achieving executive and legislative branch reorganization, fiscal reform, and other changes are now enhanced, thanks to the post-Proposition 13 spirit that pervades much of the country.

Whether the states will rise to the occasion remains to be seen. It appears that many are still reeling from the effects, real or imagined, of Proposition 13-type activity on the part of their citizenry. Others are girding themselves for a tough legislative session where poorly conceived and hastily adopted bills to forestall stringent citizen-initiated measures will probably be the order of the day. But amidst all of the chaos and confusion that has followed in the wake of the New Populism, it still can be said that the federal system has provided effective channels for citizen dissatisfaction to be expressed, that remedial actions are being taken in response to these feelings, and that the long-term outlook for representative government is not bleak, but may indeed be promising.

In Washington: Not Many Answers

SUMMARY AND HIGHLIGHTS

For all the concerns of state and local officials over the lack of adequate federal dollars for their jurisdictions in 1978, it is paradoxical that federal grant-in-aid funding peaked that year. This was true by all measures: in absolute constant (1982) dollars grants peaked at $109.7 billion; as a percentage of the federal budget they peaked at 17 percent; and as a percentage of state-local total spending they peaked at 26.5 percent. Nevertheless, there was a general suspicion, if not genuine conviction, that federal-state-local fiscal relationships could not go on meeting like this. There was mounting exasperation over programmatic complexities; there was less faith in Washington to deal with the myriad of domestic problems; and most importantly, there was no more money.

The overriding economic concern in 1978 was inflation. Although the 7.6 percent rise in the Consumer Price Index that year paled in comparison to the 11.3 percent increase in 1979, and the 13.5 percent increase in 1980, it was believed that the budget deficit—$59 billion, or 2.4 percent of GNP in 1978—was a large part of the inflation problem. To solve it, grants to state and local governments were considered a likely target.

In an effort to offset potential hardships from expected funding reductions, state elected officials were calling for efficiencies—grant consolidations and regulatory reforms. However, local officials were much less enthusiastic about widespread programmatic changes, fearing that they would lead to a diminished federal-local relationship. This confrontation between state and local officials over efforts to reorder the federal system would be repeated (and intensified) during the Reagan administration.

For big city mayors, the top priority was the Carter administration's national urban policy. To a considerable extent, mayors saw their population bases dwindling—thus diminishing the political clout of their jurisdictions—relative to the suburbs and rural areas. It was a demographic change that was to accelerate in the 1980s.

One seemingly small event that receives a cursory mention in this article proved to be in its embryonic stage: the call for federal income tax cuts. Republican congressional candidates campaigned on the theme during the 1978 mid-term elections, as would Ronald Reagan two years later. Along with the balanced budget movement discussed in the next article in this volume, federal tax cuts were an integral part of the new populism discussed in the previous article.

This article first appeared in the Winter 1979 issue of *Intergovernmental Perspective.*

* * * * *

The growing public restiveness with raising taxes and ineffective programs at the state and local level was also manifested at the national level in 1978. The inability of the President and the Congress to deal effectively with major public policy concerns such as inflation, the budget deficit, and the slowdown in economic growth led to calls for ways citizens could make their own laws through national initiatives and to a further drop in public confidence in the ability of our governmental institutions to solve domestic problems. Bureaucracy was a target of citizen dissatisfaction as well. Protests of too much government regulation and red tape and too little performance continued to mount.

It was against this background of increasing economic pressures and public anxiety and activism that the Carter administration and the Congress dealt with a broad range of public policy issues—some more successfully than others—which directly affected intergovernmental processes, policies, and programs in 1978.

This summary considers the intergovernmental impact of such issues as inflation, reductions in government expenditures, balancing the federal budget, and Proposition 13.

PROPOSITION 13, INFLATION, AND FEDERAL AID

While clearly not impacting on Washington with the same force as in California and elsewhere across the nation, the Proposition 13 earthquake did, nevertheless, cause numerous aftershocks along Pennsylvania Avenue.

"The two-to-one margin of approval by the California people to restrain public spending and taxation is obviously a message that's been well received and observed by all of us throughout the country," President Carter said the week after the California vote.

"The antitax sentiment that surfaced in California is sweeping across the nation from west to east, posing challenges to government at all levels," said Representative Henry Reuss, chairman of the House Committee on Banking, Finance and Urban Affairs as he introduced hearings on Proposition 13 in July.

The effect of Proposition 13 and related measures on the nation's capital was primarily two-fold. First, the possibility of granting immediate federal assistance to California's localities facing severe revenue cutbacks was considered. Bills were introduced to assure that California received no less federal aid than it did before Proposition 13. Other bills would have prohibited the use of federal dollars to perform services which might be cut back as a result of Proposition 13. None of these bills passed.

The second area, and considered more serious in Washington, concerned the potential shift in the attention of the electorate from state fiscal issues to federal taxing and spending policies. An immediate response from the White House came in the form of restrictions on hiring by federal executive agencies. In the Congress, a measure to cut federal income taxes by 33 percent over three years, sponsored by Senator William Roth, Jr. (R-DE) and Representative Jack Kemp (R-NY) was debated in both houses. A related measure, sponsored by Senator Sam Nunn (D-GA), proposed to cut taxes $142 billion between 1980 and 1983, if the government met stringent targets for holding down spending. The Nunn bill was passed by the Senate in the waning days of the 95th Congress, but did not survive the conference committee. Similarly, a "sunset" measure providing for the automatic termination of government spending programs every ten years, unless specifically reauthorized, was passed by the Senate but was not considered by the House.

By the end of 1978, however, the attention of Washington was concentrated on inflation. In October, President Carter announced a major new anti-inflation program. Under the plan, employers were asked to hold wage increases to 7 percent and to limit price increases during the coming year to half of a percentage point below the 1976-77 average. In a surprise move, the President also proposed a tax rebate to workers who observe the wage guideline if the inflation rate exceeds 7 percent.

The White House urged state and local officials to observe the voluntary guidelines in setting salaries for themselves and their employees. There also has been some discussion of tying compliance with the guidelines to the receipt of General Revenue Sharing funds, but no White House policy or proposal has been announced.

FEDERAL AID AND THE BUDGET

Federal aid will exceed an estimated $85 billion in fiscal 1978—an increase of nearly $12 billion over 1977 aid totals. Moreover, this new spending appears to be mainly in the form of specific, narrow categorical grants rather than in programs offering considerable discretion to states and localities. With this increase in aid has come predictable increases in the reliance of state and local governments on that aid. ACIR estimates that federal aid to state governments in fiscal 1978 will amount to 38.8 percent of the revenue the states generate on their own. Federal and state aid will account for over 76 percent of the total revenues raised solely by local governments.

At the same time, it appears that 1978 well may represent the last of the big time federal aid spending. In an October session with state officials, Office of Management and Budget (OMB) Director James McIntyre, Jr., cautioned: "The time is right for a slowdown in federal spending. Public opinion favors reduction in federal spending more than tax cuts at this point, and we plan to reduce the federal deficit as much as we are able to." McIntyre added that all federal aid programs are undergoing a careful review for the purpose of identifying programs which could be cut or consolidated, or their growth reduced.

Indeed, in the closing days of 1978, speculation abounded as to what programs would be cut as the administration sought to reduce the federal deficit to $30 billion. Initially, the White House announced that no cuts would be made in the defense area, thus forcing greater reductions in many domestic programs—perhaps by as much a $12 billion according to some federal budget officials. However, the White House has backed away from this position, stating that "no aspect of the government will be sacred or sacrosanct" during the development of the budget.

President Carter personally repeated this message in a speech at the National League of Cities annual meeting in November, warning that the federal budget "will disappoint those who do not take inflation seriously. . . . And it will disappoint those who expect constantly expanding numbers of federal programs and agencies." The President pledged that "wholesale arbitrary spending cuts" would not be made, and that useful programs would not be "starved." While he cautioned that "there will be little new money for new initiatives," the President reaffirmed his promise "that the cities will bear no more and no less than a fair share of budget restraint."

In December, two national organizations representing state elected officials proposed a "trade" with the administration, saying they would back proposed cuts in some programs if the administration actively would pursue consolidation and reform of federal grants-in-aid. The National Governors' Association and the National Conference of State Legislatures asked the President to consolidate and simplify programs and procedures, "to insure that at least part of the reduction in federal spending comes out of the bureaucratic costs of running programs and not merely out of services to the public." In response, they pledged, "We will deliver more services for less money."

However, some of the initial appeal of the state officials' proposals for grant reform was tempered by the sharp response of many of the nation's big city mayors. In an 11th hour appeal made directly to the President, the mayors termed the state officials' support for budget cuts in return for grant reforms as "just another way to get control of the funds at the (state) level." Boston Mayor Kevin White cautioned: "I'd fight that almost as much as I'd fight the cuts."

Cuts in federal aid programs also may put further strain on the relationship between Frostbelt and Sunbelt governments. As Alan Beals, executive director of the National League of Cities, noted at the opening of the NLC annual session: "The debate between the regions has always existed. But it was subdued because the federal aid pot kept expanding. Now the pot is being limited, so the debate is more intense." Specifically at issue are the eligibility criteria for the major aid programs which might tend to favor one region over another.

In addition to the austerity moves by the administration, many observers expect that the 96th Congress will perpetuate the "budget cutting mentality" demonstrated in 1978. While the administration to some extent may be bound to its commitments in such areas as the urban policy and welfare reform, the Congress has no such commitments. Some believe that many program authorizations—particularly those which have been targets in the past—may very well fall victim to the budget-cutting ax.

REVENUE SHARING

One such target may well be General Revenue Sharing, which will be up for reauthorization in 1979. While the public interest groups have established reenactment as their major legislative goal, it would appear that the combat lines are forming.

The program never has been an overwhelming favorite of Capitol Hill, and this next year is not expected to be an easy time for those who are seeking reauthorization. An ominous note was struck when the somewhat similar countercyclical program renewal was defeated late in 1978. And it would appear that the various legislative actors in the drama already are signaling their intentions. For example, Representative Henry Reuss, who chairs the House Banking Committee, has stated that the renewal of General Revenue Sharing should have some new conditions. Specifically, Chairman Reuss wants the program linked to the "willingness" of state legislatures "to do more for their cities." The chairman has iterated his long-standing belief, for example, that in order to receive funding, states should be requested to adopt long-range plans for broadening their cities' revenue bases and for modernizing local governments.

There also is a question about the administration's position concerning the reenactment of General Revenue Sharing. President Carter was against states participating in the program when he served as governor of Georgia. Both OMB and the Department of the Treasury have been exploring alternatives to the reenactment of General Revenue Sharing. And there is some talk of using Revenue Sharing as a possible trade off for welfare reform. More optimistic observers cite a statement by a top White House aide in October before a task force of city officials that she "couldn't even conceive of anything less than total reenactment" of General Revenue Sharing being proposed by the White House.

At a year-end strategy session, one city official observed: "We are now in a game where we have to give things up, and we should toss out the ones that are less likely to work." From all indications, it would appear that this observation aptly describes the "sorting out" process in which officials will be engaged as they weigh the public policy options for 1979 against the hard realities of inflation and a strong public sentiment favoring reductions in government spending.

THE QUEST FOR A NEW PARTNERSHIP

Urban Policy

One of the most important events of intergovernmental significance in 1978 was the announcement in March of President Carter's Urban Policy. The policy, called "A New Partnership to Conserve America's Communities," was made up of more than a dozen new program initiatives plus a pledge to reorient and revise over 150 existing programs. The "partners" were all levels of government, the private sector, and neighborhood and voluntary organizations.

In his message to Congress, President Carter explained that the policy was designed to encourage states to redirect their resources to support urban areas more effectively and equitably and to encourage local governments to streamline and better coordinate their activities. He outlined proposals to "make federal actions more supportive of the urban policy effort and develop a process for analyzing the urban and community impact of all major federal initiatives." He also described incentives to the private sector to make new investments in economically depressed neighborhood and voluntary organizations in meeting the economic and social needs of their communities.

An underlying constraint of the policy was that comparatively little "new money" was to be earmarked for the urban programs, with a budget authority of $4.4 billion recommended for fiscal 1979. This was a matter of particular concern to state and local interest groups. Instead, the administration emphasized targeting, coordination, and streamlining programs. In light of the rather limited funding and the significant nature of the programs designed for revamping, some—including the President—felt that program revision and redirection well might prove to be the most important component in the urban policy.

Legislative Action

The basic set of legislative and appropriations requests presented to Congress through June included a range of programs from investment and employment tax credits for businesses in urban areas to a "livable" cities imitative for cultural programs; from a restructuring and reauthorization of criminal justice assistance programs to an urban parks and recreation measure.

Of particular intergovernmental significance were these five proposals:

—a four-year, $11 billion annual reauthorization and restructuring of the *Comprehensive Employment and Training Act* (CETA), with a new private sector demonstration program and with clearer distinctions between structural and cyclical unemployment programs;

—a $3 billion a year "labor intensive" public works program;

—a $1 billion a year renewal of the antirecession fiscal assistance (ARFA) program for a two-year period, modified to provide aid only to localities, not to states;

—$400 million over two years for incentives to states to develop plans to aid their distressed communities; and

—a new national development bank jointly administered by Commerce, Treasury, and HUD to provide loans and grants for investments in distressed areas.

The only one of these proposals to pass in 1978 was the CETA reauthorization. The labor intensive public works and countercyclical proposals both died amid heavy debate in committees about their fundamental objectives. The other two measures—the state incentive program (described by the administration as being "very critical to the overall success of the urban policy") and the national development bank (identified by a top White House aide as the "centerpiece" of the private sector initiatives)—received only cursory review and stalled in committee. The other measures—such as employment and tax credits, urban intermodal transit programs, and housing rehabilitation—fared better, with most of the program and money requests passed in at least some form.

Executive Initiatives

Where the administration could act on its own, the results appear to be more encouraging. For example, a status report issued by the White House in August detailed a number of actions taken to improve existing federal programs impacting upon urban areas. The improvements centered around targeting formulas and reorienting programs to urban and community needs, intensifying intra and interagency coordination, and streamlining administrative processes and procedures. Many of the improvements were the result of a review of about 40 programs during the initial development of the urban policy. These programs represent about $30 billion—or over 70 percent of all funds going to urban areas—according to the report.

In Retrospect

"We won some and we lost some" said John Gunther, executive director of the U.S. Conference of Mayors, "but the truth is that most of us in the urban lobby realized that much of the President's new program would not be enacted this year." Less positive observers have opined that the proposals simply got lost in the shuffle, not only in Congress but in the administration as well, in part because of the quantity of other domestic and foreign policy issues on their agendas. For some of the proposals it was in part a question of timing.

Another problem faced by the President's proposal had nothing to do with the makeup of the policy, but was related to Congress and its ability to deal with an area as broad as an urban policy. Of particular concern is the fact that Congress simply is not organized to deal effectively with such packages of interrelated proposals, especially those which cut across committee jurisdictions. Questions also have been raised about Congress' low level of resistance to special interest groups which work to scatter federal dollars among too many classes of recipient communities.

An added factor that is gradually impacting upon Congress' willingness to focus on urban issues in the future is reapportionment. Given the outmigration patterns from cities to suburbs and nonmetropolitan areas, there may be fewer central city spokesmen in the halls of Congress in future sessions.

The 1979 Outlook

Of key interest to many public officials will be the fate of those proposals in the President's "New Partnership" which were not successful in the last Congress. Currently, the major "leftovers"—state incentives, a national development bank, a labor intensive public works program, and countercyclical assistance—are undergoing White House reassessment, particularly in light of the current economic and federal budget situation. While it is expected that at least the countercyclical and national development bank proposals will be reintroduced in some form—and probably scaled down from their original levels—the administration is continuing to warn that the nation's distressed communities will have to depend less on federal help and more on their own resources. At a year-end session of the Conference Board, for example, a Treasury official cautioned business leaders that many communities will face the need for "innovation amidst scarcity" in light of less federal aid, a slowing national economy, and dwindling state surpluses.

The success of the remaining urban initiatives will depend in great measure upon the degree of coordinated support they receive from the state and local government and private sectors. The lack of such support largely explains the failure of several of these measures during 1978. A blow, for example, was dealt to the national development bank proposal when the National League of Cities membership declined by about a 2-to-1 vote to endorse the proposal at its November meeting.

The area of grant reform well may be the brightest item on the intergovernmental horizon in terms of possible congressional action in 1979. In a time of austerity and cutbacks, interest in making programs more efficient can be heightened. And a great deal of congressional campaign rhetoric was voiced that an efficient and streamlined government will be a goal of many members of the new Congress.

As 1978 ended, there was considerable attention being paid to the need for reform of the grant system, much of it stemming from the National Governors' Association and National Conference of State Legislatures' position that they would support the President's efforts to reduce domestic spending only if the administration actively pursues the consolidation of federal grants and efforts to reduce paperwork and red tape in the administration of those grant programs.

The Balanced Budget Movement: A Political Perspective

SUMMARY AND HIGHLIGHTS

In 1979, the year of the second oil crisis, advocates of federal tax increases were as rare as unoccupied gas pumps. Numerous measures had been proposed in Congress to impose fiscal restraint on Washington through tax and/or spending limitations. Prominent among these were:

—A House resolution to index the federal income tax introduced by Rep. Willis Gradison (R-OH);

—A Senate bill to establish a ten-year schedule for reauthorizing all federal programs (sunset provisions) introduced by Sen. Edmund Muskie (D-ME);

—Companion bills sponsored by Sen. William V. Roth (R-DE) and Rep. Jack Kemp (R-NY) to reduce individual income tax rates by 10 percent for three consecutive years (with indexation thereafter), and to reduce federal outlays to 18 percent of GNP by FY 1983;

—A Senate bill introduced by Sen. Robert Dole (R-KS) requiring that budget resolutions be balanced unless overridden by two-thirds of both houses;

—Three different resolutions for amending the Constitution to require a balanced federal budget (or make it very difficult to have a deficit), and/or to limit spending. They were introduced by Rep. Tennyson Guyer (R-OH), Sen. John Heinz (R-PA), and Sen. Richard Lugar (R-IN).

In addition, a grass roots movement had emerged of states petitioning Congress to call a constitutional convention for purposes of proposing a balanced budget/tax limitation amendment.

At the time, this proclivity to shorten government's leash through structural means seemed to be a new phenomenon; in reality it had only been in dormancy. This article argues that populist sentiment against unfettered government taxing and spending authority is as old as free societies, and certainly has a long heritage in the United States. It was written by former ACIR Assistant Director David Walker, and first appeared in the Spring 1979 issue of *Intergovernmental Perspective*.

*　　*　　*　　*　　*

From what pollsters, politicians, and commentators tell us daily, most Americans think that government has gotten "out of hand," that there is no one at the throttle, that seemingly there are no throttles.

In a broad sense, Proposition 13 and its offspring elsewhere are one manifestation of this pervasive sentiment. Another, of course, is the drive for a balanced federal budget through constitutional or statutory means. Still another is the campaign to reduce federal revenues as a way to force expenditure reductions. The continuing campaign for "sunset" legislation, the Carter 1980 budget, and the greater seriousness with which members now view and participate in the congressional budget process provide additional evidence of Washington's awareness of this popular criticism.

Embedded in all these approaches (save for sunset) is the assumption that greater fiscal constraint will restore popular confidence in the national government's sensibility and self-control, that fiscal restraint is a proxy for responsible behavior. To make such an association is to ignore two important factors in our intergovernmental system—the structure of the system itself and the way it functions.

The broader issue raised here is as old as the history of free systems itself: how can government be made representative and responsive, as well as responsible and restrained?

A LEGACY OF CONSTRAINTS

The Constitutional Convention of 1787 grappled with this pivotal question, as have various state constitutional drafting and redrafting efforts before and since. A range of formal and informal changes in our governmental system since Washington's First Inaugural have attempted to perfect and reconcile one or more of these primary and sometimes conflicting hallmarks of an orderly, free system that also is federative (involving geographic division of powers).

In a certain sense, contemporary advocates of new constitutional restraints at both state and federal levels are but latter-day adherents of a venerable tradition in our political annals. The Founding Fathers and most of the drafters of the original state constitutions, while faithful to the ideal of popular sovereignty, proclaimed so eloquently in the Declaration of Independence, were not really disciples of direct democracy. Instead, they endorsed the principles of representation and opposed simple majority rule. They did so on grounds that there are certain actions that a majority or even the whole electorate should not do (abolish the constitution, for instance) and there are certain actions that should require a greater majority than a mere 50 percent plus one.

Thus, the Founding Fathers constituted a system founded on popular sovereignty but geared to curbing the potential excesses of a temporary political majority. This system, of course, includes the combination of a written constitution, the partial separation of powers among the three government branches, the checks that each has regarding certain actions of the others (Presidential vetoes, congressional overrides by a two-thirds vote, bicameralism, fixed and staggered terms, judicial review, and the federal principle with its geographic division of power).

These cardinal features of our distinctive federal republic were designed to assure that national governmental actions would be limited primarily by internal operations and the relationships of its institutions. External popular checks were acknowledged, of course, but the emphasis that "ambition must be made to counteract ambition" indicates the system would achieve its limited majoritarian goal by largely self-containing actions.

The Critics

Critics of this system of checks and balances have attacked it from wholly opposite extremes.

Too Many Constraints

One group has argued that the system is excessively constraining and a prime deterrent to necessary, timely, or desirable national action.

While history is replete with examples of those who make this argument—from Jefferson to Franklin Roosevelt; Henry Clay to congressional Democrats in the Nixon era—recent critics point to a number of more recent congressional legal and procedural hurdles facing an activist President with a supportive political majority. These hurdles include the whole range of informal and formal congressional procedures and "folkways" (the committee system, seniority rule, Senatorial courtesy and cloture, the House discharge and suspension of rules and procedures). There are others who go beyond the formal institutions and procedures of the national government to those of our nation's political parties and find additional protection built into the heavily decentralized, weak programmatic, and undisciplined features of our national party system. The ever increasing interest group pluralism is also frequently noted as a major constraint.

These analysts then have found a frustration of the popular will, a denial of real accountability, and an absence of meaningful responsiveness in a system that requires extraordinary and prolonged efforts to achieve the concurrence of a wide range of interests and institutions before authoritative action can be taken. "Stasis," the "deadlock of democracy," and "impasse government" are but a few of the negative results that these observers have found in our Madisonian system.

Too Few Constraints

The opposite group of critics has contended that the current system provides few, if any, real curbs on an overriding political majority or in periods of deep crisis. The most recent members of this group are those who are currently seeking new constitutional curbs that would add to the obstacles now confronting majorities seeking to act. They join a less numerous and far less prominent group that is probably best represented by John C. Calhoun.

For this great South Carolinian, the complicated Madisonian edifice had been reduced to a shambles by the early 1930s. All the traditional institutions were there and none of their powers had been abolished. But a new institution had arisen: the well organized political party. The operations of a majority party with its emphasis on numbers, power, and appointments had eliminated the older constraints that had operated internally to frustrate the will of a mere simple majority. A determined, continuing political majority, he thought, could and would negate the separation of powers and checks and balances principles and, in time, the federal precept itself, since ultimately the Supreme Court also would become the creature of this political majority.

Only if the constitution institutionalized a veto system wherein each major interest group could and would check the actions of a numerical majority did Calhoun feel that the representational idea of the framers would be sustained and a system of accommodation and adjustment—not just simple majority votes—assured.

Calhoun's rigidly legal (and basically unworkable) theory died for all practical (and constitutional) purposes at Appomattox. But the theory of concurrent majority—wherein the acquiescence of all the major interests represented formally or informally must be had before any really significant new policy initiative can be launched—has lived on. It has been called an "informal, highly elastic, and generally accepted understanding," by John Fischer a quarter of a century ago or, in the words of Peter Drucker, "the organizing principle of American politics."

With these observers, the application of this principle was descriptively realistic, as well as systemically idealistic, and its chief byproducts were moderation, accommodation, a special brand of responsibility, and nonfanatic, nonideological politics.

A Constrained or Unrestrained System?

Clearly, the mood of the country today is more in line with the second group of critics.

Implicit in current drives to put constitutional curbs on congressional spending and deficits as well as requiring extraordinary majorities when voting for an unbalanced budget, is the assumption that the restraints of the traditional checks and balances no longer exist or are not functioning properly. Explicit is the belief that Congress' internal curbs on spending and its allied interest groups are not effective or nonexistent. Hence, the need, as some view it, for constitutionally required extraordinary majorities to sanction a federal budget deficit.

As Sen. Richard Lugar (IN) has explained it:

> The heart of the overspending dilemma is political and structural. The growing awareness by numerous groups that they can organize successful raids on the public treasury, and their increasing sophistication in doing so, has rendered a simple majority for the spending of public money far too easy to attain. The pressures for more spending are as intense and tightly focused as a laser; the sentiment for restraint is as diffused as ceiling light.
>
> In situations where restraint is difficult and pressures intense, an often-used legislative device is the supermajority—the requirement of more than a mere 50 percent plus one vote. That requirement is ideally suited to the most crucial single decision made by Congress each year, passage of the federal budget.

But why should an extraordinary majority requirement be necessary in a system which only a brief time ago was described by nearly all of its closest observers as one that was dominated (if not cursed) by the informal application of the concurrent majority principle? Why the need of raising the specter of Calhoun's constitutional rigidities, if Calhoun's concept informally is already operational?

The answer may be that Calhoun's veto group politics apply to certain issues and under certain circumstances and that a new style of coalition-building politics operates with still other issues and under other circumstances. More specifically, old style, veto group politics still seem to apply when wholly new policy questions are debated for the first time, yet once there has been a federal piercing of a policy or a program barrier through an enactment, then a special brand of incremental, cooptive politics comes into play in the second, third, and fourth rounds of renewals and appropriations. But more on this later.

The Dynamics Behind Recent Developments

To arrive at a better understanding of how this complex, confusing, if not schizophrenic (to borrow a James Q. Wilson description) condition arose, other recent developments need probing. Our present perplexities can be traced to four fundamental dynamics relating to political ideas and issues, organized interests and even disorganized interest groups, representation and representatives, and the legislative process and its product.

Political, Social Changes

Perhaps the most dramatic of the recent developments has occurred in the realm of political ideas and issues. Over the past decade and a half, most of the lines of demarcation between what is a purely private issue and what is a public concern have eroded badly—to the point where some would say that they have been erased completely. Hardly any facet of our society's primary unit—the family—has escaped public scrutiny, debate, legislative enactments, and court cases. Other social institutions have experienced a similar fate. Witness the politicized position in which private institutions of higher education, our religious bodies, the great foundations, and even some of our fraternal and athletic associations now find themselves. How much of this trend is a product of the progressive weakening of many of these institutions and how much of it hinges on radically transformed concepts of individual rights and of the "police power" of governments is open to debate. But it is unarguable that the orbit of what is political and public has expanded massively since the mid-1960s.

Similarly, there has been the steady erosion of any real distinctions between what is a state and local issue and what is a federal concern. The last genuine efforts to debate and define national purposes and aid programs in a constitutional contest took place in the 1950s and early 1960s. The need to defend or rationalize new federal assistance efforts vanished in the mid-1960s with enactment of a wide range of aid programs (over 240) by the 89th and 90th Congresses, several of which involved wholly new departures for the national government and some of which were novel to any government. While many of these were limited in their scope and appropriations, the "legitimacy barrier" had fallen. Hence, subsequent actions in these program areas, while frequently more expensive, intrusive, and specialized, were not viewed as major departures from the largely collaborative and simple purposes of the initial legislation. Instead, they were treated largely as mere extensions of the original enactments.

In the 1970s, the federal influence spread still further through involvement in more and more subfunctional areas, new regulatory thrusts, sustained stimulation of greater state and local program and personnel endeavors, and greater efforts to achieve more supervisory authority. As a result of this increased federal activity, the bounds of the national government's current domestic agenda span issues of concern to neighborhood, municipal, or county councils, state legislatures, and the U.N. General Assembly—with concerns of a national legislative body occasionally sandwiched in.

Interest Group Politics

Not unrelated to these changes in the scope of what is "public" and what is "national" are equally pronounced shifts in the role of interest groups in American politics. Political scientists writing before the mid-1960s generally described this role as one of "crucial conditioner" of the American political system. This view—and their material—now seems dated, if not dubious.

Today's pressure groups bear only a faint resemblance to their predecessors of less than a generation ago. In the earlier period, only those interests that were large, organized, and relatively well financed were able to pay the price of participating in national politics, and this meant that those representing basic economic forces (i.e., business, labor, agriculture, and medicine) tended to dominate this scene. Today, all types of issues, organizations, and movements are represented. There has been, as economic historian Douglas C. North has phrased it, "a drastic reduction in the cost of using the political process," and all manner of groups have taken advantage of the bargain.

It is the advent, then, of newer types of pressure groups concerned with largely social, moral, and environmental topics along with the growing proliferation of programmatic groups and the final arrival of all state and local government associations that has created the impression—and the reality—of contemporary Washington awash with specialized interests.

The new interest groups share some of the objectives of the pre-1960 groups such as subsidies, favorable regulations and court decisions, preferential tax programs, as well as program (typically categorical) enactments, and expanded reenactments (as well as earmarks). But they frequently want more. Commonly sought items include the advancement of certain social objectives by conditions attached to grant programs and to procurement, the establishment of executive branch agencies and units based on demographic—not economic—characteristics of our population, the promotion of procedures in governmental and intergovernmental bureaucracies that ostensibly will sensitize them to one or more pet pressure group concerns, the promotion of greater public visibility, and the achieving of better access to new funding sources as well as to the national media.

The near eclipse of the party mechanisms in and out of Congress, the frequently fluctuating, yet steadily issue-oriented mood of the electorate, along with the easier access to the Presidency, bureaucracy, Congress, and the courts (when compared to the closed door, or partially closed door conditions of a generation ago) have combined to provide expanded opportunities for pressure group campaigns of either the single or multi-issue variety.

Above all, perhaps, hardly any of these groups now can be discounted as irrelevant, unimportant, or irresponsible since practically all of them claim, fairly accurately, that a body of public opinion supports their particular position. Few Washington politicians in this age of freshman and sophomore Senators, Congressmen, and department heads are openly willing to controvert their respective claims.

The current interest group scene in Washington is a not-too-cloudy mirror image of the profuse specialized pluralism of the nation as a whole. For some, this is as it should be, in that countervailing forces have established to negate the actions of the traditional establishment interests. For others, the national government resembles more a vastly expanded representative New England town meeting.

Representation

The third dynamic involves representation as a principle of American federalism and our national representatives as the people's spokespersons in Washington. Both have experienced major changes since the early 1960s.

Perhaps the most important shift in the representational concept is the growing popular habit of rejecting the legitimacy of the very process by which representatives are selected. Despite populist-oriented efforts to democratize these processes both in the Presidential and congressional arenas, the low voter turnouts and the growing awareness of the influence of appointed national officials have combined to cast a long shadow of doubt over the significance and representativeness of these electoral contests. Hence, the greater aggressiveness of interest group activity, the ill-concealed contempt on the part of some for the Congress, the increasingly skeptical view of the President's role as tribune of the people, and the much more steady focus by nearly all on the administrative process and access to it.

Elections, of course, are not ignored, but they now are only one facet of any group's effort to influence the national government. Thanks in large part to the broadened scope and increased influence of pressure groups, all interests in Washington can lay claim to being "representative" of some group, and the formal, duly elected representatives of the people are having increasing difficulty in asserting a superior, more legitimate claim to that designation.

The people's formal representatives in Congress today clearly have an infinitely more complicated task in discharging their representational function than their predecessors in the 1950s or early 1960s. Their constituencies are much more heterogeneous; today's issues are much more panoramic and cross-cutting; Washington-based interest groups are much more numerous and assertive; and the formal and informal changes in Congress along with the relative lack of tenure on the part of a majority of the members have left most of them in an embarrassingly exposed position. And, all this in an era that questions some basic assumptions of the representational principle itself.

The National Decisionmaking Process

A fourth fundamental shift since the mid-1960s is reflected in the process and product of current national decisionmaking. The process of course, is one that has become heavily overburdened. The expanding concerns of the national government and the volume of legislation with abbreviated debates, inadequate legislative oversight, and excessive demands on a member's time and private life have combined to form a legislative process that gives only a hint of keeping up with the dynamics now built into it.

To further complicate matters, the process currently involves two contrasting stages. The first relates to consideration of entirely new public issues; and, here, ideology, questions of the appropriate federal role, veto group politics, procedures to protect minorities, and delay still come into play.

The second stage involves renewals and reauthorizations, and the stakes are frequently high. Players—each with something to lose—include those pressure groups actually or potentially associated with the program (or its general functional area), affected administrators and recipients, the range of interests on the substantive and funding committees (or subcommittees) and sometimes a President and a Cabinet secretary. Questions of legitimacy, overall direction, and impact typically are not accorded probing attention. Instead, the size of outlays, to whom, under what conditions and above all, what additionally is needed to establish a solid coalition for reenactment—these are the issues that dominate this now major portion of national lawmaking.

The politics of cooption, then, are paramount in this renewal phase of the process. Hardly a specialized interest or particular issue subsumed under the functional area affected by a reauthorization is ignored, and final votes on the typically omnibus measures usually exceed the two-thirds mark with little evidence of ideology or mere issue orientation reflected in its passage. Recent enactments in the areas of primary and secondary education, vocational rehabilitation, and public health are but a few of the examples of multifaceted measures with numerous titles, mandated procedures, and conditions, and a new range of specialized and general beneficiaries. Old style veto group politics in these instances has been replaced with a new style (but not totally unfamiliar) brand of logrolling.

What product results from this process? In a word, it is "hyperlexis," to borrow Bayless Manning's term. What has resulted is a "pathological condition caused by an overactive lawmaking gland," as Manning defines it.

Functionally, this hyperlexis at the national level has produced grant statutes that deal with practically every aspect of what used to be deemed wholly state or local (or even private) program concerns, with nearly every activity of domestic American government intergovernmentalized as a result.

Fiscally, it has generated, in this decade, increases in direct federal expenditures and in assistance outlays which have surpassed the rate of growth of the Johnson years, and it had a stimulative effect on state and local expenditures and personnel at least through 1974. Moreover, until the congressional budgeting process, it never really forced a confrontation between estimated revenues and projected outlay.

The Current Dilemma

Thus, fundamental changes in political ideas and issues, in the interest group basis of contemporary national politics, in our understanding of the representative principle, in the behavior of our representatives, and in the national legislative process provide a set of casual explanations as to how we got where we are today.

Now we need to know what to do. There are three possible approaches. The two most commonly discussed are fiscal in nature. The third offers a much broader, systemwide dimension.

Constitutional Revisionists

Advocates of this school of thought believe that a constitutional amendment, complete with an extraordinary majority vote, is the only reliable method of instilling discipline into what they feel to be an undisciplined, simple majority decisionmaking process. This group notes the greater power of special interests, the hyperresponsiveness of Congress and the breakdown of the old system of internal constraints as a major systemic defect. All this, they warn, takes on alarming dimensions in periods of inflation with their escalating income tax windfalls and strenuous pressure group efforts to keep ahead of earlier appropriation levels. Statutory and procedural alternatives are rejected on grounds that the political forces that have produced the near-unbroken record of budget deficits will undo any such minor reforms. With a required two-thirds or better vote for an unbalanced federal budget, old style veto group politics would reappear, they contend, and discipline would deliberately be reintroduced into the system.

Incremental Fiscal Reformers

The other group of fiscal conservatives rejects the amendment remedy as being too drastic, too rigid, and too oblivious of real world corrective forces already at work in the system. The amendment approach is too drastic, they feel, since our basic character in its entirety would be up for potential revision. They also attack the rigidity of the proposed remedy, stressing its potentially disastrous effects in times of recession and of crisis (even though some of the proposed amendments afford special opportunities to surmount such difficulties).

Equally important, many in this group find the means to achieve greater fiscal responsibility in some of the very political dynamics that the constitutional amendment advocates condemn. Washington's greater responsiveness, the greater ease in establishing a new interest group base, and the new style pragmatism and eclectic voting behavior of many Representatives and Senators have become, for this group, the practical bases for effectuating incremental, yet important, responses to the call for reducing the deficits and achieving slow growth.

The President's proposed "no growth" (in terms of inflation) budget, the recent congressional debates on expanding the debt and especially on the first budget resolution, the fiscal conservatism of many of the junior members (regardless of their ideological or party label), the recently acquired retrenchment belief of some of the senior members, and the heightened aggressiveness of existing and recently arrived economy-minded groups sometimes are cited to support the contention that the system still is restrained, responsive, and responsible. Some in this group also stress that the votes on the budget resolutions force a new kind of riveted congressional attention to overall fiscal actions and these help to undercut the spendthrift ethic that seemingly (if not actually) dominates the reauthorization and continuing appropriations processes. Countervailing forces of fiscal constraint, then, are emerging, so their basic argument runs, and reasonable, nondisruptive remedies to the dilemma of deficits will be forthcoming.

Systemic Reformers

Apart from these two schools of current opinion, however, stands a third—one that believes that both, perhaps out of desperation, are dealing largely with symptoms, not the real sickness. Most in this group concede that heavy federal outlays and deficits are important national issues, but they warn that an exclusive preoccupation with them in no way addresses the root problem. For them, recent political developments have produced a new, feebly functioning, poorly programmed, badly managed, inadequately accountable nonsystem of intergovernmental relations, which also happens to be excessively expensive. They point out that today's nonsystem represents the national government's primary efforts in the domestic arena and that budget cutting is only one of many weapons that must be utilized if some resemblance of management, some hint of cost effectiveness, some signs of political accountability in it are to be regained.

Budget cuts, they point out, will necessarily involve a sorting out of the effective from the ineffective programs. They need not engender a debate or a decision over what is genuinely a national concern. They need not enforce a greater discipline on cooptive politics and on interest groups who have the habit of always seeking more. They need not involve anything more than across-the-board proportional cuts with no reassessment of national priorities, no gauging of real impact of programs, and no weighing of the actual (and potential) fiscal/servicing positions of the states, their localities, and the private sector.

These critics of the current federal role in our federal system clearly focus as much on critical managerial, programmatic, structural, political, and basic attitudinal concerns as they do on money matters. If the running debate over deficits generates some grant consolidations, helps eliminate doubtful—if not debilitating—programs, restrains the tendency to run amuck with regulations, and restores the capacity to deny funds to the fanciful and the freeloaders, then some real remedies will have been found. Put differently, if the debate triggers a sober sorting out of what managerially, fiscally, and ethically is within the reasonable and realistic reach of the national government, then, in their view, some of the most enervating effects of recent political developments will have been checked.

Will the emerging countervailing forces of constraint be powerful enough and penetrating enough to go beyond the basics of budgets to rebuilding the system itself? This is the key question these reformers pose. If these deeper issues are not faced, they fear it will make little difference which of the fiscal groups superficially prevails.

Hopefully, the emerging process of "accommodation and adjustment," to borrow Calhoun's phrase, will recognize that his ideals of political and governmental constraint now have attitudinal, party, administrative, regulatory and programmatic, as well as fiscal, dimensions. A single constitutional amendment or the mere strengthening of the fiscally conservative bloc in Congress, however, is a feeble guarantee, they warn, that these other facets of our enfeebled federalism will even be considered. Yet at least the current climate of discontent, they concede, is a good one in which to raise these basic issues.

Revenue Sharing for States: An Endangered Species?

SUMMARY AND HIGHLIGHTS

When General Revenue Sharing was enacted in 1972, some economists were predicting that the federal income tax would soon be generating revenue surpluses, which, many said, would be a drag on the economy.

When General Revenue Sharing was fully terminated in 1986, the federal government was running huge deficits, which, many said, were a drag on the economy.

In retrospect, however, General Revenue Sharing might have been that rarest of federal programs: one that Congress found easier to terminate than to enact (though not by much).

Beyond the perceived need to avoid federal surpluses in the late 1960s and early 1970s, part of the divergent objectives of both liberals and conservatives could be achieved through Revenue Sharing, but at the expense of other objectives. For liberals, it was a way to keep the money in the public sector, but by sacrificing the goal of centralization, and with no assurance that the money would be used to help the poor. For conservatives, it was a way to engender more decentralized spending decisions and perhaps state and local tax reductions, but by sacrificing the goal of federal tax reductions. As the deficits mounted, eventually the bitter overpowered the sweet in both camps.

This article joins the debate over GRS at the half-way point. By the late 1970s, the funds earmarked for state governments had come under attack, but those for local governments were still fairly secure. State Revenue Sharing was, in fact, terminated in 1980; local Revenue Sharing survived another six years. The article was written by former ACIR Executive Director John Shannon, and former Senior Analyst Will Myers. It first appeared in the Summer 1979 issue of *Intergovernmental Perspective*.

*   *   *   *   *

The recent congressional debates on General Revenue Sharing represent early and inconclusive skirmishes in what may well be a long, hard-fought campaign to establish the contours and character of the federal aid system for the 1980s. They also highlight the truly unique characteristics of the General Revenue Sharing program.

No other major federal aid mechanism has engendered such cohesive state-local support. In 1972 and then again in 1976, a powerful coalition of state-local elected officials overcame strong congressional resistance to Revenue Sharing. Despite vigorous attempts by the opponents of Revenue Sharing to split it, this state-local coalition still holds.

The federal Revenue Sharing program dramatically illustrates the dilemma of reconciling two conflicting objectives—political decentralization and fiscal accountability. The sharing of federal revenue with states and localities on a "no strings" basis becomes an act of power sharing. Many believe this action also divorces the pleasure of expenditure from the pain of taxation and thereby promotes fiscal irresponsibility.

The General Revenue Sharing program has been given the slow strangulation treatment—allowed to twist slowly in the inflationary winds. Although the opponents of Revenue Sharing were not successful in killing this program in 1976, they were able to prevent its growth. Thus, inflation has eroded 40 percent of the purchasing power of federal Revenue Sharing dollars over the last eight years.

In sum, no other federal aid program is as unpopular in Washington or as popular with state and local governments. An outspoken foe of General Revenue Sharing—Congressman Jack Brooks (TX)—is reported to have said if Congress had taken a secret vote at the time it was considering the renewal of Revenue Sharing back in 1976, the program would have been voted down in both houses by a margin of at least 2 to 1. If Congressman Brooks' assessment is correct, then the federal Revenue Sharing program with the states and localities can be characterized in Churchillian terms:

Never in the long history of federal largess have so many (40,000 governments) owed so much ($50 billion) to so few . . . cheerful givers.

What, then, are the current prospects for renewal of General Revenue Sharing?

CONGRESSIONAL DEBATES

On two occasions since January, Congress seriously considered proposals that would have pulled the General Revenue Sharing rug out from under state governments as of September 30, 1979, despite the fact that their entitlement was not scheduled to expire until the end of the 1980 fiscal year.

The supporters of Revenue Sharing had expected a real fight over the renewal of this program in 1980. While it was widely recognized that continued state participation would be a major battleground, most of them never dreamed that the struggle would begin so early.

The Attack on State Revenue Sharing

The debate in both houses of Congress brought out both fiscal and philosophical arguments. The opponents of Revenue Sharing have sharply defined the fiscal issue—why should a deficit-ridden federal government continue to provide unrestricted aid to state governments that have moved to easy street? The philosophical aspects of the debate centered on the traditional issues—accountability, national priorities, and state and local government fiscal dependency.

Federal Fiscal Squeeze

The cutback advocates argue that the federal government can no longer afford the full-scale program because its fiscal position has shifted radically from one of relative fiscal ease to that of fiscal stress.

The floor manager for the cutback proposal, Sen. William Proxmire (WI), put the issue this way: "The overwhelming majority of the American people feel, and I think they are right about it, that excessive federal spending is one important element—not the only one, but one important element—in the rise in prices, in keeping them as high as they are, and in keeping government big, burdensome, and often as inefficient as it is."

The growing stringency of the federal budget situation was underscored by Sen. Edmund S. Muskie's (ME) explanation for his decision to support the proposed cut in the Revenue Sharing entitlement: "Mr. President, I wish to point out that two programs which I sponsored and I have strongly supported over the years would be funded in this bill at levels which I consider undesirably low. The first of these programs is the General Revenue Sharing program. . . . In my mind such a reduction ($684 million) amounts to reneging on a federal commitment to the states. The second program is the EPA waste-water treatment construction grant program. . . . As I have said time and time again, bringing federal spending under control and balancing the federal budget will not be easy. It is not simply a matter of cutting out a few programs that are clearly unnecessary or wasteful. It means making deep and painful sacrifices in each and every area of federal activity. Each of us here must accept such sacrifices in programs which we hold near and dear, or we will never get this budget under control."

State Fiscal Ease

The reported state surpluses and instances of state tax reduction provide heavy ammunition for those who want to reduce federal Revenue Sharing payments to states.

Sen. Lloyd Bentsen (TX) put the issue this way: "Nineteen states cut taxes since January 1978. That is great fun for the governors because they had surpluses. As of March of this year the cumulative state surplus was $2.6 billion. It makes little sense for the federal government to worsen its deficit position by paying billions of dollars in Revenue Sharing funds to states that are cutting taxes and running large surpluses. The $684 million reduction (proposed by the Senate Appropriations Subcommittee in July) would be a constructive step toward eliminating this inequity."

In an earlier debate in the House on a similar issue, Rep. David R. Obey (WI) described the paradox of state tax reduction and federal deficits more starkly: "We heard all this talk about how only three or four states have half the surplus. It is a funny thing, I never hear my state listed in those three or four states. My state passed out over $900 million in tax relief. I am not having any income tax withheld from my check this month or next month because my state was able to abolish all income taxes for two months. They did that in part because Uncle Sugar sits out here borrowing $2.5 billion to send back to the states; only, we have to pay in interest over $200 million to do it. That is just nuts."

The Balanced Budget Boomerang

Former governor of Nebraska, Sen. John J. Exon identifies yet another source of congressional opposition to continued full state participation in federal General Revenue Sharing: "It is naturally of great concern to many of us when a large majority of the states have written us saying, 'We want you to balance the federal budget.' Yet, it is the same governors and the same state legislatures that appeal to us time and time again for more and more money from the federal Treasury which comes, of course, from federal taxpayers."

The congressional debate frequently dealt with the pressing need to come to grips with inflation. Again, Sen. Alan Cranston identified the issue in his remarks: "The states have been piggy-backing on the federal deficit long enough. The federal Treasury has been borrowing money and deepening the federal deficit year after year while cash piles up in state treasuries. Congress is not helping the states when it increases the deficit. The state governments are not immune from inflation. To the extent that an unbalanced budget contributes to inflation, it also contributes to a long-range worsening of state finances. The effort to balance the federal budget is forcing those who are best able to sustain the necessary cuts in federal funds to do so. This must include the state governments."

Philosophical Objections

The attack on state Revenue Sharing entitlement goes well beyond the issue of the shifting fiscal fortunes of the federal and state governments. It includes the traditional philosophical arguments against the General Revenue Sharing concept.

Former governor of Oregon, Sen. Mark O. Hatfield has raised both the fiscal accountability and dependency issues: "I must say I have very strong philosophical viewpoints that when we separate tax collecting from the spending responsibilities and authorities, we have not strengthened federalism, but we have weakened federalism, by making governors and local governments more dependent on central government rather than less dependent."

Sen. William Proxmire (WI) also has come down hard on the accountability issue: "What spending, then, should be cut? It is hard to find a place more logical to consider reductions than Revenue Sharing. I say that for many reasons: First, because this is money that does not require accountability. . . . In the Revenue Sharing area, nobody can say that they go to the needy, nobody can say that they go to a specific useful purpose, because nobody knows where they go. They cannot tell us."

The notion that the states have an inferior tax position has been challenged by Sen. Alan D. Cranston (CA): "Unlike local governments, the states have full taxing powers. Their sources of revenue are many. Their needs can be met in ways far more equitable than by increasing property taxes—the primary source of local government revenue."

The State Defense

Revenue Sharing's friends respond to the proposed cut in the state entitlement with forceful support for the program in general and state participation in particular.

State Surplus Overstated

In addition to pointing out differences in state and federal budget accounting, the supporters of continued state eligibility for Revenue Sharing claim that the importance of state surpluses is overstated. Sen. Jacob K. Javits (NY) presented statistical evidence and argumentation: "First, states do not have budget deficits because their constitutions generally prohibit such financing. Second, because of these constitutional restrictions, states are required to keep some cushion against cyclically declining revenues so that mandated expenditures do not force their treasuries into illegal deficit spending. The size of that surplus is crucial to the judgment financial interests make in underwriting state obligations. And the measure of a 'solid' surplus is better than a 5 percent surplus, according to Standard & Poor, the nationally recognized bond rating service. Mr. President, only 15 states have such a surplus—and all but two are major energy and/or food producers, so their revenues may be expected to have risen with the skyrocketing inflation in these basic commodities."

Reacting to the claim that states that cut taxes no longer need federal Revenue Sharing dollars, Sen. Daniel P. Moynihan (NY) highlighted the problem that leads to tax cuts in New York and other states: "The justification for the committee's action is the tax reductions enacted in 19 states since January 1978, and the budget surpluses that some states are alleged to have. However, for many states, including my own, whose tax rates are among the highest in the nation and which rates inhibit local economic growth and development, such tax cuts were long overdue."

Revenue Sharing—The Wrong Economy Target

House and Senate defenders of Revenue Sharing repeatedly point out that Congress is sending the wrong program to the economy chopping block. Rep. William Carney (NY) advanced this argument: "Further, I am concerned that in attacking Revenue Sharing, we are going after the wrong target. I believe that we should look to make cuts in categorical grant programs which are now almost 500 in number. These programs are much more costly to administer and involve a tremendous amount of red tape. In addition, continued growth of these programs has served to expand the role of Washington bureaucrats and their burdensome regulations in local affairs. It is highly ironic that in our efforts to balance the budget, the Budget Committee chose to pick on the one federal program which works the best. Adoption of the Conable Amendment (to restore 1980 Revenue Sharing funds to states) is essential if we are to go about balancing the budget in a prudent and orderly fashion. I urge my colleagues to support it."

In an effort to stave off a cutback, the defenders of Revenue Sharing in the House launched an unsuccessful counterattack on the categorical aid system. Rep. Olympia Snowe (ME) introduced an amendment to cut nonwelfare categorical programs by $2.3 billion in return for retention of states as GRS participants.

In the Senate, the argument took a slightly different tack. Proponents claimed that Revenue Sharing works far better and is administered more economically than other forms of federal aid. According to Sen. Daniel P. Moynihan (NY): ". . . Revenue Sharing is simple, it is easy to understand, its benefits are conspicuous and direct, and it has created no bureaucracy. There is no bureau of Revenue Sharing. It is very small. It takes up about 5 percent of the time of an assistant secretary of the Treasury, who does it beautifully. . . . We do not have that much to show for the 1970s. For heaven's sake, let us not wreck one of the really fine pieces of intergovernmental exchange machinery which we have created."

Decentralization

In an effort to save Revenue Sharing for the states, its supporters have harked back to several of the original justifications for enacting the program.

In the House debate, Rep. Barber B. Conable (NY) touched on the power sharing and decentralization themes: "There are people in this Chamber who want to have the power that goes with the categorical grant program, the centralizing effect of it because it is run out of Washington, and (who) oppose the idea of any degree of decentralization. The idea against Revenue Sharing has been heard here many times, particularly by members of the Committee on Appropriations and others who have wanted to build legislative monuments to specific categorical purposes. This discretionary money does give a fine opportunity for keeping the solution of problems as close to the people as possible, and I would hate to see us give up that idea."

Sen. Russell B. Long (LA), emphasizing that the federal government still dominates the tax field, reminded his colleagues that: "The taxpayers who support the states are the same taxpayers who support the federal government and in view of the fact that the federal government had the right to preempt all of these revenues, we would share some of that with the state governments."

TEMPORARY REPRIEVE?

While the defenders of the Revenue Sharing program turned back all attempts to eliminate or reduce the state government Revenue Sharing entitlement for the 1980 fiscal year, they can take only small comfort from this victory. Several of the most outspoken critics of the program cited the need to honor a congressional commitment as their justification for opposing, albeit reluctantly, any Revenue Sharing cutback for the 1980 fiscal year. For example, Sen. Adlai E. Stevenson (IL) concluded: "Mr. President, I continue to oppose participation by the states in Revenue Sharing, and I intend to vote accordingly when the authorization for Revenue Sharing expires at the end of fiscal year 1980. I see no justification to increase the federal budget deficit in order to contribute to state budget surpluses. However, I do not favor reducing state Revenue Sharing funds now. To make a Revenue Sharing cut now would damage states which have relied in good faith on receipt of those funds during fiscal year 1980."

Similarly, Rep. Jack Brooks (TX) stressed the need for Congress to honor its commitment to the states: "I did not support Revenue Sharing when it passed, and I did not support the states getting a single dollar of this money. I made an all-out effort in this Congress to make the Revenue Sharing program subject to appropriations. Unfortunately, I was soundly defeated, and the Congress, in its then wisdom, so-called, overwhelmingly chose to make this an entitlement program. That program still has more than a year to run. I hope the Congress in its wisdom will refuse to extend Revenue Sharing when it expires on September 30, 1980. But until then I believe we should stand by the action that we took, wrongheaded at it was, and not try to take back the money that we promised to the states."

THE PIVOTAL ROLE OF THE STATES

Although the congressional debates highlighted most of the major arguments that can be anticipated in the forthcoming controversy over renewing federal Revenue Sharing, they largely ignored a critical question: What is the role of the states in our federal system?

The recent Revenue Sharing debates largely ignored the pivotal position states occupy in the American federal system. State constitutions and statutes allocate taxing powers and spending responsibilities between state and local governments, delineate functional responsibilities, and prescribe requirements and set guidelines pertaining to local employees, elections, and boundaries. In short, state government decisions determine the character of local governments.

Moreover, the states are gradually taking over the fiscal high ground once occupied by local government. As late as 1959, 20 state governments raised less than half of state and local tax revenue. By 1977, the latest data indicate only five states where local tax revenue outstrips state tax revenue.

State governments have also improved the equity of the state-local tax structure. Twenty-nine states now partially shield homeowners from property tax overload situations through state-financed circuit breakers. More than half of the sales tax states now remove much of the regressive aspect of the sales tax with exemptions for food and drug sales or equivalent income tax credits.

The new fiscal strength of the states is largely traceable to courageous tax action by governors and state legislators in the mid-1960s and early 70s. In 1960, only 19 states made use of both broad-based personal income and retail sales taxes. Today, 37 states have this type of balanced revenue system.

Another clear indication of the growing role of the states is to be found on the expenditure side of the fiscal equation. The states have significantly increased their contribution to the "big ticket" expenditure items—schools and public welfare.

Because of the states' important legal position and also because of their growing fiscal support of local government, federal policymakers should not take an action that will be interpreted as penalizing the states now that they are assuming a far more important role in our federal system.

National Events in 1979: The New Austerity Takes Hold

SUMMARY AND HIGHLIGHTS

Though ACIR had not yet coined the term, 1979 marked year one of De Facto New Federalism—a decentralization of government, caused by growing fiscal pressures in Washington, even in the absence of any structured legislation.

Unlike the heady days of the 1960s and early 1970s, when the federal government had the financial resources to enact almost any new program proposal, Washington was now being forced to perform a basic (and politically unpleasant) task of government: choosing among competing interests. If political pressure was dictating spending in some areas (the Pentagon, and older Americans) concurrent with pressure for an overall spending curtailment (to reduce the deficit) then Washington had to single out some areas in which to slow growth. Grants-in-aid to state and local governments were among the most vulnerable, and 1979 witnessed real dollar decline in federal intergovernmental transfer payments for the first time in the post-war era.

Along with the intransigence of inflation, it was anticipated that energy shortages would continue to distort the economy for the foreseeable future, and to a considerable extent these expectations were driving domestic policy. Among other significant intergovernmental events discussed in this article are the creation of a new cabinet-level Department of Education, the continued drive for a balanced budget amendment to the Constitution, and an effort to replace the electoral college with the election of presidents by nationwide popular vote.

This article was written by former ACIR Federal Relations Associate Michael C. Mitchell, and first appeared in the Spring 1980 issue of *Intergovernmental Perspective*.

*   *   *   *   *

Governmental action rarely is marked by dramatic events like the sudden termination of programs, stark changes in policies of long standing or the launching of major innovative initiatives. In several senses, national level actions of intergovernmental significance in 1979 fit this pattern. Witness the failure of a thorough program oversight effort to materialize in Congress, the slow progress of executive reorganization efforts, and the continued inability in Washington to gain consensus on processes for program review and grant consolidation.

One intergovernmental event occurred in 1979, however, which sets the year apart from those of the recent past, and raises important questions for the future of American federalism. In 1979, federal aid to state and local governments, which had undergone a long period of rapid growth, peaked and actually declined in real dollar terms. The administration's and the Congress' desire to reduce the budget deficit and to control inflation led to a closer scrutiny of the intergovernmental assistance system. This fuller realization of the new era of limits within which government must operate in 1979 caused a redoubling of interest in the concepts of economy and efficiency through better management and greater productivity.

In opposition to these efforts toward control and restraint in government were the ubiquitous forces encouraging program growth and an expanded federal role. In 1979 these again made their mark. The clash between these conflicting forces created new friction points and rekindled old ones in the federal system. These relationships have yet to be understood and assessed fully, let alone resolved. This article will review the most prominent intergovernmental events which occurred at the national level in 1979 and will describe some of the tensions they produced.

CRESTING FEDERAL AID AND OTHER FISCAL CONCERNS

Curbing inflation was a primary objective of the Carter administration in 1979. The earliest indication—and the one perhaps most significant to state and local governments—came in January with the fiscal year 1980 Budget Message, in which grants-in-aid were a key target of efforts to reduce federal spending. The budget statement called for federal aid growth in FY 1980 of only 1 percent, from $82.1 billion to $82.9 billion, a rate far slower than that which permitted a tenfold increase in federal aid dollars in the last 20 years. The 1980 aid total represents an actual decline of some $3 billion in assistance between 1979 and 1980 when adjusted to real dollar terms. Federal aid as a percentage of state and local expenditures, which had undergone an extended period of growth, is forecast to decline from 25.4 percent in 1979 to 23.6 percent in 1980.

This apparent cresting of the federal aid wave holds intergovernmental importance for a number of reasons. First, after years of rapid growth, it represents a dramatic reversal of the expansionist trend. The last 15 years were characterized intergovernmentally by the spirit of "bigger is better" and the attitude that every societal problem can be overcome by a federal aid program and a bureaucracy to administer it. The grant system which was nurtured on this philosophy expanded rapidly in program numbers and dollars, and with it came a breadth and depth of national level influence that would have been deemed revolutionary in the early 1960s.

The dramatic slowing of federal aid growth in 1979 is significant also because all indications are that it is not a short-term phenomenon. Most economists interpret the current inflation as a factor now built into our economy that will be sustained over time. Therefore, the effort to defuse inflation by curbing federal spending may be a long-term phenomenon as well, ushering in a new era of limits in Washington. The growing pressure for increased defense and social security system spending also will restrict the so-called "controllable" budget funds and in particular will erode further the state and local share.

This prospect of shrinking resources may encourage the often invoked, but seldom acted upon, procedural and structural improvements such as regulatory reform, grant consolidation, and program elimination—improvements long needed and overdue in the intergovernmental aid system. In their exploration of regulatory reform, program review, and grant consolidation in 1979, the administration and Congress began to make progress on these reform fronts.

Another potential effect of the aid slowdown may be the delegation of functional and administrative authority to the proper governmental level instead of the fragmented and heavily shared intergovernmental responsibility for domestic services existing today. In the decades since the 1930s, the federal government has moved into program delivery areas traditionally the domain of state and local governments. This development has eroded recipient control, blurred accountability, disrupted the intergovernmental power balance, and confused the public. The capping of federal aid growth may slow or reverse this 40-year federal growth trend and begin to restore the lost equilibrium by generating more conscious attention to concerns about appropriateness of federal involvement and a greater commitment to sorting out governmental roles and responsibilities.

Ironically, the new federal aid developments are likely to have their greatest consequences at the state level. Not only will states be forced to make do with fewer federal resources, but if fiscal constraint causes a willingness to divest certain functions, the states may inherit more administrative and servicing responsibility. This development, in conjunction with the increasing centralization at the state level brought about by the efforts to limit tax and expenditure authority at the local level, could greatly enhance the states' role in our system. Pressures for more state involvement at a time of diminishing resources, however, will require difficult political decisions at the state level, as elected officials ponder the reduction or elimination of programs, the transfer of funds within program areas, or the sources of new revenues.

Congressional Budget Process

While these trenchant intergovernmental issues must await analysis in future annual reports, one clear winner—but just barely—in this year's budget cycle was the congressional budget formulation process. This process, created by the *1974 Congressional Budget and Impoundment Process Control Act*, experienced a year of false starts and delays. The appropriations bills moved at the slowest pace since the new budgetary timetable was established. There were still ten outstanding money bills on October 1, long past the early September deadline. The second budget resolution required a 23-day conference to resolve House and Senate differences, and the revised resolution, due on September 15, was not approved by the Senate until November 28.

Complicating the traditional differences between Senate support for defense spending and House support for social welfare programs were the Strategic Arms Limitation Talk (Salt II) debate, and Senate interest in five-year budget projections. The Senate's desire for "reconciliation" also caused conflict. Reconciliation is a process empowering the budget committees to order the trimming of already passed appropriations bills in order to meet the budget resolution. Although reconciliation did not receive House approval in 1979, it is a budget tool that is likely to be employed in future budget deliberations. These delays notwithstanding, the budget process did perform adequately, the majority-minority cooperation exhibited on the Senate Budget Committee was a crucial ingredient in this performance. The final conference-backed resolution placed the deficit at $29.8 billion, which, while high, is only $.8 billion over the target set by President Carter in his FY 1980 Budget Message. Compared to budget deficits in recent years, which have ranged as high as $66.4 billion in 1976, the proposed deficit is rather low.

Call for a Balanced Budget

Clearly one of the factors motivating Congress to trim the federal budget deficit was the states' effort to seek a constitutional convention to consider a balanced budget amendment. This activity provided one of the more interesting intergovernmental interplays of 1979, as the petitions submitted by the states neared the number required to call the convention.

Under Article V of the U.S. Constitution, if two-thirds of the states (34) petition for a constitutional convention, Congress must convene it. Any amendment proposed by the convention becomes part of the Constitution when ratified by three-fourths of the states (38).

State level proponents of the convention approach point to the need to prod Congress into action to control large federal deficits which they perceive to be a cause of high inflation. But critics of the budget balancing amendment cite several weaknesses in the state argument. For example, a balanced budget requirement would tie the hands of Congress during times of economic downturn or a national security emergency when deficit spending may be necessary. Some fear a constitutional "witch hunt" in the convention, creating amendment proposals wholly unrelated to budgetary issues. Others warn that a budget balancing amendment would result in the radical reduction in nominal federal aid dollars to state and local governments; aid now pegged at one-quarter of state and local own source revenues. Congressional distaste for the convention approach was echoed by President Carter, who labeled the effort "political gimmickry" and created a White House task force to head off additional state support for a constitutional convention.

Historically, unsuccessful state convention drives have elicited congressional action. In the last 80 years, state convention calls have preceded congressional submission of four constitutional amendments and passage of one major legislative program. In 1979, Washington's response to state pressure for a balanced budget was apparent not only in the rhetoric of Congress but in its close hewing to the Carter budget deficit figure and in December passage of a constitutional amendment to require a balanced federal budget by the constitution subcommittee of the U.S. Senate Judiciary Committee. Although they have not yet been considered, numerous bills that would set the ground rules for a constitutional convention are now before the Congress. Many other members of Congress have proposed legislation setting forth a variety of spending limits tied to specific percentages of a national income measure. These congressional responses seem to have contributed to a slowdown in state petitioning for a convention. In late September, however, 30 of the required 34 state petitions had been received and any congressional effort to abandon the budget balancing goal in 1980 is likely to rekindle the constitutional convention fires.

Additionally, passage of the Long Amendment in Public Law 96-5 will keep the balanced budget issue in the public policy forefront. This stipulation requires the President and the Budget Committees to submit balanced alternatives to unbalanced budgets that are developed.

"THE OVERSIGHT CONGRESS"

Congressional handling of program oversight provided one of the fundamental ironies of the last year. For, although many Congressmen came to Washington in January 1979 urging more review of existing programs and careful attention to new spending proposals, there was little evidence that the 96th Congress lived up to the hopes of those who had dubbed it "The Oversight Congress."

Instead of cutting back, Congress created more new programs, spent more money, and intruded further into the affairs of other governmental levels and the lives of the ultimate service recipients. The record of the first session of the 96th Congress affirms what journalist George F. Will has stated about government generally: that it is "responsive to a fault.... There's a sense in which the government exists only to respond to whatever felt stimulus it receives.... Government increasingly, it seems to me, looks upon itself as a burger king. It exists to take special orders from whomever comes through the door." Congressional activity in 1979 continued the trend which in recent decades has created a critical mass of policy actors in Washington, including the Congress, the bureaucracy, and an ever growing number of well articulated special interests. The continuation of this trend exacerbated one of the basic tensions in our federal system as more programs were created at the same time that financial resources were declining.

More Government, Not Less

The interaction of these forces in 1979 spawned more government, not less, particularly with energy and in the social welfare areas of education, health care for poor children, and welfare reform. Among these developments, the greatest innovation occurred in the energy area where, at year's end, Congress had nearly completed approval of a $227 billion federal "windfall" tax on oil company profits, a $20 billion program to develop synthetic fuel sources, conservation requirements to be placed on the states in times of energy emergency, and a new federal energy mobilization board.

Energy Mobilization Board

The most intergovernmentally significant of these actions was the federal energy board proposal. The purpose of the mobilization board would be to cut through red tape and bureaucratic snarls which, in this time of energy shortage, can hinder the development of energy sources and the construction of extraction, refiner, and transportation facilities. Advocates of this approach point to the years required to establish such facilities because of the duplicative federal, state, and local government review procedures. Such delays also would hinder development of the synthetic energy sources, which form a major component of the President's energy program.

State and local officials opposing the board view it as another federal usurpation of their decision-making authority. Gov. Richard Lamm of Colorado, in calling the proposal a "meat ax" approach, reflected the concern of those who fear further disruption of the intergovernmental balance. Environmentalists see the board as a tool to override natural resource compromises they worked years to achieve.

Both Houses of Congress have passed versions of the energy board proposal, but before the board is put into place, several important questions relating to its authority must be resolved in conference. For example, the committee must decide whether the board will expedite or merely encourage priority energy projects. To expedite these projects, can it waive state and local laws? How will enforcement take place and to what extent will judicial review be applicable to the board's decisions? Answers to these questions will come in the second session of the 96th Congress. Regardless of their outcome, however, the energy mobilization potentially will reorder the relationship between federal, state, and local governments in the energy area, with the likely outcome a greater centralization of authority in federal hands.

LEAA

Late in the year, the Congress approved and the President signed a measure to restructure and reauthorize for four years the often criticized Law Enforcement Assistance Administration (LEAA) program. Under the new organization, four staff units have been established: a reconstituted LEAA that retains responsibility for most state and local grant programs; a new Bureau of Justice Statistics and a new National Institute of Justice which assume the statistical and research duties formerly performed by LEAA; and a new Office of Justice Assistance, Research and Statistics that coordinates the activities of and provides direct staff support to the other three units. All four of the offices are under the authority of the Attorney General.

Of particular interest to state and local governments is the reformulated grant-making authority of the new LEAA that replaces the planning, action, and corrections portions of the former block grant program. These three "categories" have been eliminated and replaced by a formula grant program that provides assistance to state governments as well as direct entitlement to cities, counties and combinations of local units with a population of 100,000 or more. Funds will be limited to innovative programs which have been proved effective, have a record of proven success, or have a high probability of improving the functions of the criminal justice system. Twenty-two program areas are identified in the law, ranging from specific activities such as "combating arson" to the more general category of "improving law enforcement." LEAA also may authorize grants in a 23rd category for "any other innovative program" that has been proved effective, has a record of proven success, or has a high probability of improving the functions of the criminal justice system.

Countercyclical Aid

Antirecession assistance was another program which faced a rocky road in the first session of the 96th Congress. Along with the measures replicating the proposals that failed in the last Congress, the administration introduced a two-phase version of the aid plan. The first phase called for targeted fiscal relief for local governments with high unemployment rates. Part two of the plan, antirecession assistance, would have provided funds for states and localities once the nation entered a recession.

A Senate-passed version called for $340 million to localities for the targeted fiscal assistance program, and a $1 billion standby program for states and localities as the second phase. A similar two-stage bill passed the House Government Operations Committee, although there were formula changes that stressed real decline in wages and salaries and tax effort, rather than unemployment figures. On December 14, the House considered the bill, which was later withdrawn after a call for reduced funding from $250 million to $150 million for the first phase was adopted.

The original countercyclical aid program, which expired September 30, 1978, distributed some $3.5 billion to states and localities between 1976 and 1978.

Mortgage Revenue Bonds

Congressional efforts to curb state and local use of housing mortgage revenue bonds was another important intergovernmental issue of 1979 that remained up in the air at the end of the year. In the past year, more and more local governments have issued mortgage revenue bonds to allow middle and moderate income buyers to purchase houses at below-market interest rates. The loser in such transactions is the federal treasury, since the interest on the bonds is exempt from federal taxation. The U.S. Treasury Department states that by 1984 these bonds could finance as much as 50 percent of the single-family mortgage market and could cost the federal government as much as $11 billion a year.

The original intent of legislation to correct this situation was to restrict severely the issuance of these bonds by states and localities. An amendment to the bill, which was added as an alternative to housing bonds, calls for a tax break for savings accounts as a way of encouraging savers, thus providing more money for home mortgages. The House is expected to consider the measure in January.

Electoral College

In 1979 Congress turned back another attempt to do away with the electoral college. This much criticized system for selecting presidential winners is now 190 years old and has been used in 48 Presidential elections. Critics who describe the system as archaic and undemocratic point to the potential constitutional crisis that would arise if the electoral college selected a candidate who had not garnered a majority of the popular votes. In 1976, for example, if less than 10,000 votes had shifted from Jimmy Carter to Gerald Ford in Ohio and Hawaii, the electoral college would have selected Ford as President, despite his 1.7 million popular vote deficit.

Supporters of the current system, on the other hand, argue that it has proven itself through its lengthy and successful period of evolution. To alter the system, they argue, would permit other unforeseen constitutional problems by disrupting the balance between total vote numbers and the geographical dispersion of votes, concurrent majorities, and its check on third, fourth, and fifth parties.

The language of the constitutional amendment to abolish the electoral college was simple, calling for election of the President by direct popular vote in place of the existing state appointed electors. Should no candidate receive 40 percent of the popular vote, a runoff would be held between the top two candidates. But when the decisive Senate vote came on July 10, the proposal tallied 15 votes shy of the required two-thirds of those present and voting to receive approval.

Federal Aid Reform

A third area of congressional action dealt with the procedural and structural aspects of the system by which $83 billion in federal aid funds are distributed to state and local governments. Numerous commentators—including ACIR—have pointed to the inefficiency of this system and its improper use as a vehicle for the recent wave of federal policy dictation. Governors and state legislators have publicly stated they would sacrifice some federal aid funds in return for increased flexibility and a reduction in the complex procedures by which the funds are dispensed. The statements of these officials and others encouraged a modicum of congressional action on this front in 1979.

In the House, concern was expressed over the growing tendency of the federal government to mandate activity by lower level governments. This concern was reflected in two pieces of legislation. Rep. Elizabeth Holtzman (NY) introduced a measure to require the Congressional Budget Office to estimate the cost to state and local governments of all federal legislation. This fiscal note approach to controlling mandates received the support of over 100 cosponsors, and companion legislation may be introduced in the Senate early in the new year. The second bill, H.R.2842, sponsored by Rep. John Burton (CA), permits members of Congress to request the Congressional Budget Office (CBO) to estimate additional costs to state and local governments that might be imposed by proposed federal legislation. The costs estimates would cover the first five years the proposed legislation would be in effect. Should the CBO identify additional costs to state and local governments, the Congress would be prohibited from considering the legislation until federal appropriations are authorized to cover those costs.

Under the leadership of Sen. James Sasser (TN), the Senate Subcommittee on Intergovernmental Relations moved on legislation confronting several of the fundamental weaknesses in the federal assistance system. The focus of the subcommittee's action in hearings and markup was S.878, "The Federal Assistance Reform Act." This five title proposal deals with structural, procedural, and basic management aspects of the aid system. Title I calls for simplification of the more than 30 national policy requirements. Title II would create a process to expedite the consideration of grant consolidation proposals in Congress. Title III renews and strengthens the 1974 joint funding act by mandating fuller federal agency participation in the process. Title IV encourages advanced appropriations to facilitate recipient planning, and Title V calls for standard maintenance of effort provisions, better information on grant funds disbursed to local as well as state governments, and a more inclusive waiver of the single state agency requirement. This legislation was marked up in conjunction with Sen. John Danforth's (MO) small communities legislation (S.904), and the combined proposal will go to full committee early in the second session of this Congress.

While this legislation has undergone lengthy deliberations, the Sasser subcommittee successfully moved a simple renewal of the *1974 Joint Funding Simplification Act*, due to expire in 1980. This renewal was passed by the full Senate on December 18. Joint funding, which had a disappointing record in its early years of existence, has experienced greater success in recent months. Twenty-seven of the 40 funded joint projects are less than two years old. Nine of these are at the substate regional level, and 18 originated at the federal level in response to the administration's urban policy initiatives.

The omnibus grant reform proposal and the simple joint funding renewal are now before the House Subcommittee on Intergovernmental Relations and Human Resources. While these proposals were not considered by the subcommittee in the first session, supporters of grant reform are seeking hearings in the house during 1980.

ADMINISTRATIVE PROPOSALS

A primary aim of the Carter administration is a restoration of the American public's confidence in its federal government by improving the organization and the processes of government. The national urban policy, which experienced a troubled birth in 1978, was targeted increasingly in 1979 to distressed communities in nonurban as well as urban locales. As the urban policy became more targeted, programs were developed as well for troubled rural and suburban communities.

Department of Education

President Carter fulfilled a campaign promise in the field of education, as Congress approved legislation to establish a new cabinet-level Department of Education. The new Education Department will be the smallest of the 13 Cabinet departments in terms of employees, but will have the fifth largest budget ($14 billion). The new department will be made up of the old Office of Education, which was formerly in the Department of Health, Education, and Welfare, employees of the Defense Department's overseas schools, and some smaller educational programs. The department will not contain child nutrition, "head start," and Indian education programs, which were included in earlier versions of the plan.

Critics of the Education Department proposal cited it as one more example of federal intrusion and control and an opportunity for more bureaucratic procedure and pressure group dictation instead of any real focus on teaching and learning. Of primary intergovernmental significance to this development is the fact that a cabinet department was created for a function that historically has been a state responsibility and for which 93 percent of the money is supplied by state and local governments. Some wags even tagged the new unit the Department of Public Education (DOPE) to express their dissatisfaction with its creation.

Advocates of the reorganization counter that national education programs will no longer get lost in the HEW labyrinth and that this will have a beneficial effect on our national education system.

Several points are clear even at this juncture. First, the organizational plan which was designed to unite the education community did indeed fragment it over the issue of degree of federal control. The administration and the new department's head, Judge Shirley M. Hufstedler, must salve these wounds before the Education Department will ever function as a cohesive unit. Secondly, the trauma of this reorganization fight graphically illustrates the difficulties encountered in altering complex bureaucratic institutions. The intensity of this effort does much to explain why the Carter reorganization task forces, which began with such high hopes in a broad range of functional areas, have experienced three years of frustration and limited success.

Urban Policy

A national urban policy, the subject of so much Washington attention in 1978, was given a much lower profile in 1979. Only two of the four major legislative components of the policy not passed in 1978 were reintroduced. These modified versions of countercyclical aid and urban development bank failed to receive congressional approval once more. The urban policy which came forth in 1979 was distinguished by federal programs targeted to notably distressed communities. The primary vehicles for distributing this aid were the reformulated *Comprehensive Employment and Training Act* (CETA) programs, the community development funds provided in the 1978 program expansion, the urban development action grant (UDAG) program, and a collection of economic development initiatives.

Seemingly, the administration enjoyed better success as the urban policy was reformulated into a distressed community policy. While the administration's announcement of its Small Community and Rural Development Policy contained no legislative proposals and was purely administrative in nature, it apparently offered promise of better targeted federal funds to rural communities exhibiting the most need and to facilitate communication between federal agencies operating in the same jurisdiction. The original six program areas dealt with in the rural initiatives were water and sewer, communications, energy, transportation, housing, and health. The November announcement added management capacity building, rural credit, legal services and small town business district revitalization components to the program.

The rural initiative in the health area is representative of this new approach. The core of this effort is an agreement between the Department of Health, Education, and Welfare (HEW) and the Department of Agriculture (USDA) that provides for loans to construct needed health care facilities for people in the underserved areas. The Farmers Home administration (FmHA) in USDA provides the loans to build, expand, or better equip nonprofit health care units in the chosen areas. The Bureau of Community Health Services (BCHS) in HEW ensures that these facilities are appropriately staffed and that operating expenses will be provided for the life of the loan. The architects of this agreement hope that the combined federal agency effort will overcome the current health care trend toward specialized training and the development of sophisticated technology, neither of which meets the basic health care needs of rural people. This new rural emphasis is placed instead on developing primary health care disciplines and encouraging individuals with this training to locate in rural areas.

Another administration policy announced in late 1979 would analyze the economic effect of proposed suburban shopping malls on small town as well as large urban business districts. Historically, suburban mall development has lured business away from downtown areas and contributed to urban decline. Under this new policy, which received wide acclaim from mayors and environmentalists, local officials can request an economic impact analysis of proposed mall projects under provisions of the Urban Conservation Policy and the *National Environmental Policy Act*. If such an analysis finds that a proposed suburban mall would undermine an urban or small town business district, or significantly increase gasoline demand, federal funds would be withheld. This administration policy has been used successfully in Charleston, WV, where suburban mall construction was halted and development funds went instead to a downtown shopping project.

CONCLUSION

National events in 1979 clearly depicted the tension between continued pressures for growth of the federal government and the realities of fiscal constraint that will characterize the 1980s. Spurred on by powerful special interests and entrepreneurial policymakers, the federal role continued to expand in 1979, both in terms of program numbers and influence. Greater centralization and further erosion of the autonomy of subnational governmental units were results of this growth.

Washington in the last year, however, also showed an increased awareness of, and responsiveness to, the new austerity embodied in the weakened national fiscal capability. This dimension of national events in 1979 is reflected in response to the balanced budget pressure percolating up from the states, the cresting of the federal aid wave, and a reemphasis on management efficiency techniques. The manner in which this tension between the forces of growth and constraint is resolved holds great impact for the future of American federalism. Continued categorical expansion during this period of shrinking financial resources will compound the managerial and structural problems manifested in the general public dissatisfaction with government. If, however, an awareness and understanding of the new austerity gains a foothold in Washington, this pressure for expanded government will be counteracted. This development might lead to a clearer division of programmatic responsibilities and the trading off of functions between governmental levels. This clarification and untangling of each government's role represents the most favorable intergovernmental scenario for the 1980s.

Washington Grapples with the Budget Crunch

SUMMARY AND HIGHLIGHTS

The election of 1980 took place in an atmosphere of general discontent. Inflation was raging. Unemployment had risen. The dollar was being battered on foreign exchange markets. International trade was stagnating. Many observers believed that Americans would have to accustom themselves to a lower standard of living. In foreign affairs, defense capabilities were thought to have deteriorated to a dangerous level, and each day brought the bitter reality of 52 Americans being held hostage in Iran.

Against this backdrop, intergovernmental relations would seemingly be a tertiary issue, at best. Yet, Ronald Reagan did make federalism an issue in his campaign. In his acceptance speech at the Republican National Convention he said: "Everything that can be run more efficiently by state and local governments we shall turn over to state and local governments, along with the funding sources to pay for it." Although federalism was subordinate to the overall thrust of curtailing growth in federal domestic spending, the campaign did provide momentum for sorting out proposals during President Reagan's first two years in office.

The election year of 1980 was, therefore, somewhat transitional from an intergovernmental standpoint. The fiscal pressures of the late 1970s continued to drive intergovernmental relations that year, to be followed by two years of efforts at structural reform; in turn, there was later to be a return to fiscally driven policymaking.

This article was written by former ACIR Federal Relations Associate Michael C. Mitchell, and first appeared in the Winter 1981 issue of *Intergovernmental Perspective*.

*　　*　　*　　*　　*

National events in 1980, more than in most years, were not marked by strong trends and clear labels. The effort to come to grips with a deteriorating economy, instability overseas, and the anticipation of the Presidential election outcome conditioned most aspects of national life, including intergovernmental relations. In Washington, the key intergovernmental question throughout most of 1980 was the longstanding one of how dollars and power should be distributed in our intergovernmental system. The stakes were dearer and the bidding more shrill than ever before, however, as economic concerns forced reductions in federal expenditures.

Attention to the game of power and money shifted, however, with the year's most important intergovernmental event—the decisive election of former Governor Ronald Reagan to the Presidency. The Republican takeover of the Senate and the increasingly conservative nature of the House of Representatives provided additional signals to Washington that the American people are ready for a change. Equally clearly, for many, the message of change is the desire for less governmental intrusion into people's lives and the devolution of power and resources from Washington to state and local governments.

The post-election period, as is usual, was an hiatus marked by much unfinished business being shelved temporarily, and great uncertainty as to what will unfold under the new administration. At the same time, there was in Washington in December 1980 a strong sense of anticipation; an awareness that the results of the November election signified not merely a pendulum swing in voter mood, but the beginning of a new era in governmental direction.

This article will review the major intergovernmental events of 1980 within this context of uncertainty and anticipation and will offer some speculations about what the next year might hold for American federalism.

FISCAL ISSUES CONTINUE TO HOLD CENTER COURT

Intergovernmental relations in 1980 cannot be understood apart from broader economic issues. They were the dominant concern of the administration, and the focal point of congressional debate, as tough alternatives were considered concerning where to reduce government spending to help ease inflationary pressures. At the state and local level, the prospect of fewer federal aid dollars presented officials there with the Hobson's choice of tax increases or service cutbacks. Moreover, these fiscal developments raised the irritant level of state and local officials over federal policy dictation, stimulating increased pressure for a reordering of power within the federal system.

While the nature of the reasons for our current economic decline are both complex and not fully agreed on, the results are the now familiar symptoms of economic stress including built-in inflation, declining productivity and growth, high unemployment, unstable exchange rates, and stagnating international trade.

Related to these economic concerns in 1980 was the increase in worldwide political instability and the growing belief that our national defense capability must be stepped up dramatically. The thrust for increased defense spending in a time of strenuous efforts to cut the budget caught domestic spending in a strong pincer. The efforts to cut expenditures and the classic guns versus butter debate which ensued in the second session of the 96th Congress dominated the legislative agenda and threatened to derail the entire congressional budget process.

The Budget Process

The congressional budget process, designed to help make rational, knowledgeable policy decisions, was almost undone by the lengthy congressional deliberations over where to cut federal spending and the inability of the members to pass appropriations bills before the end of the fiscal year.

Development of a budget, and thereby of the nation's fiscal policy, was extraordinarily difficult in the circumstances which characterized 1980. Goals were clear but the means were less than certain, as the remedies put forward for the various economic maladies were to some extent contradictory. For example, a reduction in the budget deficit is likely to have a beneficial effect on the inflation rate. But decisions to increase taxes, or lower spending, were both politically difficult (especially so in an election year) and carried with them the likelihood of prolonging the economic recession and thereby, paradoxically, further worsening the budget position. At the same time, Congress was considering proposals to reduce taxes as a means of spurring investment and addressing long-term productivity problems. Such a course of action, however, is likely to be inflationary at least in the short run.

Budget formulation is ever more difficult as the uncontrollable portion of the budget increases. Largely responsible for this situation are the formula-based entitlement programs which guarantee recipients a certain level of benefits. Social Security is the largest of the entitlement programs. Equity arguments, the political clout of special interest groups, the desire of some authorizing committees to end-run the appropriations committees, changing demographics (the aging of the population) and difficult economic conditions, have combined to result in a two-thirds growth in the entitlement programs' share of the budget in 13 years—from 36.1 percent in 1967 to 59.1 percent in 1980. In reality, however, entitlements are not truly an uncontrollable aspect of the budget. Despite the political obstacles, Congress can alter an entitlement law to reduce eligibility and/or benefit levels, thereby producing budget savings. In the 96th Congress Sen. Joseph Biden (DE) introduced S. 1434, legislation that, if enacted, would have ended the entitlement status of all programs except Social Security and Medicare. Despite the fact that the Biden bill did not receive much attention, and that Congress did not alter the entitlement picture, in the 97th Congress there will be increased pressure to modify certain entitlement programs.

The Balanced Budget

With the spotlight on budgetary gymnastics and the attendant economic concerns, the concern for a balanced budget, so strong in 1979, was forced from the center stage. Legislation sponsored by Sen. Robert Byrd (VA) and passed by Congress in 1978 required a balanced budget for fiscal 1981, but this was ignored in the face of the recession. On March 18, a proposed constitutional amendment to balance the federal budget was voted down 9-8 by the Senate Judiciary Committee. Similarly, a measure proposed by Sen. William Roth (DE) to limit next year's spending to 21 percent of gross national product failed in Budget Committee. Those in Congress urging a budget balancing amendment approach did slacken their support in 1980 in the light of revised deficit estimates and the threat to important programs like the state portion of Revenue Sharing. But the sense of the importance of balancing the budget is strong, and this issue, like a review of entitlement programs, should resurface in Congress next year.

General Revenue Sharing

While the exact content of the fiscal 1981 budget remained one of the primary unanswered questions at the end of last year, state and local governments had ample reason for concern about their future funding levels. The administration's March revision of the budget for fiscal year 1981 pegged intergovernmental aid at $91.1 billion, a slight increase over the $89.8 billion for fiscal 1980 but an 8.3 percent reduction in purchasing power or real dollar terms.

No issue better compared these budgetary concerns of state and local officials than the struggle to renew the General Revenue Sharing (GRS) program. This general purpose program, first passed in 1972 and renewed in 1976 in a slightly modified form, was up for reauthorization again in 1980. Supporters of GRS, describing it as the most desirable of all intergovernmental aid transfer mechanisms, began to push hard in early 1979 for its renewal. Their efforts to secure early passage failed, however, as the program became embroiled in the larger battle over the federal budget.

The first Carter budget proposal contained the state share but provided for a more targeted approach. Additionally, the continuation of each state's participation in the program was made contingent on its creation of a broadly based, independent commission to assess two fundamental sources of local fiscal problems—disparities in access to fiscal resources relative to service responsibility and imprudent financial management practices.

When economic and political conditions forced a revision of the administration's budget proposal, plans for the Revenue Sharing program changed. To save funds, it was proposed that state governments be eliminated from the program's purview. Thus began a series of proposals and counterproposals, some including the states and others not. The rapidity of these changes by year end had left observers of the process a bit dizzy.

When Congress finally acted in December, it reauthorized the program for three years in roughly its present form with one glaring exception. It excluded state governments from participation in the first year. In fiscal years 1982 and 1983, the state share is authorized, but funding is dependent upon the appropriations process. Furthermore, the Congress accepted an amendment authorized by Representative Levitas (GA) which requires that in order for states to receive GRS funds in FY 1982 and FY 1983, they must return to the federal treasury an equal amount of categorical grant funds. The Levitas proposal was accepted in lieu of a Senate amendment calling upon the ACIR to study this concept of funding trade-offs and to report to the Congress on its desirability and feasibility.

Local governments will continue to receive funds on an entitlement basis. The Revenue Sharing legislation specifies that $4.6 billion—the same amount as in past years—be distributed in fiscal years 1981, 1982, and 1983. Of course, in inflationary times, this implies a cut in real terms. Indeed in FY 1981, local governments will be able to purchase only two thirds as much with their Revenue Sharing dollars as they were able to in FY 1976, the year in which this funding level was first reached. The Congress authorized $2.3 billion in both FY 1982 and FY 1983 to cover state participation. This amount too is the same as authorized in past years.

Congress failed to include any provision for antirecession fiscal assistance in the GRS renewal legislation. Committees in both the House and the Senate felt that some form of stand-by assistance in times of economic downturn was desirable, but the programs they backed looked somewhat different. In later deliberations, the concept was dropped entirely. State and local officials ranked the reauthorization of GRS as their preeminent legislative goal. While disappointed at the exclusion of state governments, they were relieved that Congress finally passed the renewal legislation in time to ensure a continuous flow of payments to local governments. While requirements added in 1976 mean that GRS is no longer a truly no-strings program, it still allows greater flexibility to state and local officials than any other federal program. As such, it represents an important symbol of state and local autonomy and identity in the intergovernmental system.

Value Added Tax

One means of alleviating the fiscal difficulties by increasing revenue was suggested by House Ways and Means Chairman Al Ullman, who urged adoption of a value added tax (VAT). The VAT is a multistage sales tax on consumer goods and services. A tax is applied at each successive stage in the production process or, in other words, whenever value is added to the product. The consumer ultimately bears the burden of the tax by paying higher prices for the final product. Advocates of VAT argue that it would provide a more rational, ordered tax system and would permit a reduction in income and Social Security taxes. Opponents of the consumer tax point out that while the corporate income tax is mildly progressive, the VAT is a regressive tax because lower income taxpayers spend a higher portion of their income on taxed items than do middle and upper income taxpayers. Additionally, the public interest groups generally view the VAT with disfavor because it would increase the difficulty of making sales tax increases in states and localities. The National Governors' Association is on record against VAT because it would compete directly against state sales taxes. The point that finally determined the fate of VAT, however, was its projected inflationary impact. The European experience with this consumer tax indicates that when it replaces an income tax it spurs inflation. As one journalist pointed out in 1980, this reason alone was enough to pull VAT off the back burner and into the freezer.

PROGRAMS, PROPOSALS FALL TO THE FISCAL AX

Law Enforcement Assistance Administration

If the future of GRS was clouded at year end, that of the Law Enforcement Assistance Administration (LEAA) was far clearer—and bleaker. This agency, which administered the sizable block grant, in addition to categorical programs, over the last 12 years has sent $7.7 billion to state and local governments to help fight crime and improve the justice system. The January budget included $571 million for a restructured LEAA, but when the budget crunch came in March, the $400 million for the agency's grant programs to the states was completely eliminated. In early November, congressional conferees settled on a Justice Department appropriations bill including only $148 million for LEAA. Thus, while LEAA retains its authorization, it is just barely alive and is a far cry from the agency that at one time administered nearly $900 million annually.

Welfare Reform

Recession concerns reflected in the budget fight and the push for defense spending increases moved a number of other issues of intergovernmental significance off the legislative agenda. Welfare reform, which had shown some signs of progress in early 1980, became an early casualty when President Carter removed $859 million targeted for welfare reform from his March budget. The two primary spending provisions deferred by this move were the substitution of federal funds for a portion of the matching funds states must pay for the Aid to Families with Dependent Children program, and guaranteed benefit levels in all states to at least 60 percent of the poverty line.

Energy Mobilization Board

Another legislative casualty was the Energy Mobilization Board (EMB), the third part of President Carter's energy program, which also included the windfall profits tax and the synfuels program, both of which were passed. The intent of the EMB was to speed the development of needed new energy sources and facilities by eliminating unnecessary procedures and modifying regulatory requirements. While some business interests viewed the proposal as a salve to the energy industry, others predicted it would become one more example of ineffectual and bloated government. State and local officials opposed the board because they favor their existing relationship with energy interests and because they were very leery of provisions in the legislation allowing the board to waive state and local statutes and regulations in order to expedite energy projects.

REGULATORY, GRANT SYSTEM, AND MANDATES REFORM

Last year Congress considered an array of measures designed to control governmental growth and simplify various aspects of administering the system. In addition to topics examined in earlier years such as regulatory reform, grant reform, and a sunset process, Congress in 1980 also considered a proposal requiring cost estimates for mandates imposed by Washington on state and local governments.

Regulatory Reform

Regulatory reform legislation received a generally favorable treatment in Congress, but not all proposals moved. Those measures that did advance dealt primarily with the alleviation of regulatory requirements placed on specific private sector activities. Building on earlier successes providing for economic deregulation in the airline, fossil fuel, and banking fields, Congress in 1980, with strong administration support, passed trucking deregulation and neared an agreement on railroad deregulation.

The *Regulatory Flexibility Act* is one measure approved by Congress which deals with the regulatory process rather than a specific economic activity. This measure too had strong administration backing. The law requires federal agencies to assess the impact of their rules and paperwork requirements on certain government jurisdictions as well as small businesses and to publish advance notice of proposed rules, including alternative regulatory approaches to minimize the burdens placed on smaller units.

Paperwork Reduction

On December 11, 1980, the President signed into law H.R. 6410, the *Paperwork Reduction Act of 1980*. The new legislation requires a 25 percent reduction in government paperwork within the next three years. The Office of Management and Budget is delegated authority in the act to review and approve all reporting requests placed on state and local governments, to review all federal information requests to avoid duplicative requirements, and to deny agency requests for information which are unwarranted.

Grant Reform

Like regulatory reform, the effort to improve our massive federal aid system made uneven progress in 1980. Those in favor of grant reform noted that reduction of the complexity and fragmentation in this system would complement the various regulatory reform strategies and, by reducing administrative costs, would free up more funds for actual service delivery. The centerpiece of this effort was companion legislation, S. 878 and H.R. 4505, "The Federal Assistance Reform Act of 1980." The provisions of the bill included processes for grant consolidation and simplification of national policy requirements attached to aid programs, simplification of audit procedures, renewal and strengthening of the *1974 Joint Funding Simplification Act*, and a group of miscellaneous provisions to improve information on aid availability and to permit greater regulatory flexibility for state and local governments. The bill passed the Senate on December 1 after lengthy negotiations over the consolidation and national policy requirements provisions of the bill. While the House did not advance the legislation, Senate passage of the bill may bring increased pressure to bear on the lower chamber to consider the measure in the 97th Congress.

Sunset Legislation

While grant and regulatory reform proceeded slowly last year, the sunset process, an apparent sure legislative winner at the outset of the session, faded in the stretch. As initially proposed, sunset provided for the periodic review of all federal programs and the automatic termination of all programs not specifically reauthorized by Congress.

The intent of this process is to encourage Congress to exercise its oversight prerogatives and to slow the growth, if not diminish the number, of federal aid programs. Riding a tide of support for this concept, the Senate Governmental Affairs Committee near mid-year cleared S.2. A sequential referral, however, sent the bill to the Committee on Rules and Administration where the environment was not as friendly. Here the automatic termination provision and the requirement that committees review similar programs at the same time were removed.

House activity further dimmed hope for a viable sunset process. The primary proposal there, H.R. 5858, contained no automatic termination procedure and designated authorizing subcommittees to select from their own jurisdiction the programs to be reviewed. The cumulative effect of these changes in both houses was a major legislative setback for the sunset process, which many feel is a desirable tool for halting governmental growth and, eliminating outdated and marginal programs.

Mandate Proposals

As the sunset proposals faltered, however, another reform issue dealing with federal mandates gained stature in Congress. The proposal responds to the high costs and loss of autonomy experienced by state and local governments in doing business with Washington.

The issue of mandates was of paramount importance to states and localities in 1980, for as federal aid dollars became scarcer the number and intrusiveness of federally imposed regulations became more burdensome. Too often, say states and localities, the federal government uses regulations attached to federal grants to penetrate into the policy process, the organizational structures, and even the personnel systems at the state and local level. Although attention in 1980 was focused primarily on several particularly expensive mandates, such as those requiring extensive changes in transportation facilities to permit equal opportunity for access for the handicapped and certain requirements relating to education of non-English speaking children, the sheer numbers of these types of requirements were also at issue. Concern over the implications of mandates for costs and shifts in intergovernmental power fueled efforts in Congress to evaluate these requirements. The focus of this push was legislation to require a cost estimate, or fiscal note, on all proposed federal laws that would impose substantial financial burdens on state and local governments.

The states have pioneered in the development of the fiscal note concept, and several of the major public interest groups last year lent strong support to the efforts to secure federal fiscal notes and reimbursement for future mandates. However, as the budget negotiations heightened and the Presidential election neared, the momentum for legislation stalled.

Convocation on Federalism

One set of proposals introduced last year would take a comprehensive approach to restoring balance in the federal system. Joint Congressional Resolutions introduced by Commission member Senator Roth (DE) and Congresswoman Snowe (ME) would establish a National Conference on Federalism to, in Senator Roth's words, "assess the roles of the federal, state, and local levels of government." The concept stems directly from the recently completed ACIR research on the federal role in the federal system. One recommendation from that study calls for the creation of such a convocation, including on the panel elected and appointed representatives from all three levels of government. It would be the charge of this group to develop an intergovernmental agenda for the next decade which, through legislative, administrative, and possibly constitutional changes, would restore order, balance, and flexibility to our federal system. Congressman Bolling (MO) introduced similar legislation in the 96th Congress. The convocation concept received healthy support from several of the major public interest groups, including the National Governors' Association, the National Conference of State Legislatures, and the National Municipal League. Senator Roth has indicated that as chairman he will make the convocation a priority item on the agenda of the Governmental Affairs Committee.

Urban Policy

Late last year an alternative strategy for luring business back into depressed areas began to collect national support. The concept is that of urban enterprise zones, which would involve a series of tax write-offs by federal, state, and local governments to encourage businesses to move into distressed communities. In return for the tax breaks these businesses would be required to hire a portion of their employees from the surrounding neighborhood.

Specifically, as proposed in the "Urban Jobs in Enterprise Zone Act" (H.R. 7420, S. 2823), a local government could apply to have portions of its jurisdiction designated a jobs-and-enterprise zone, depending on tests of poverty and unemployment and on the reduction of the local government property taxes within each zone, by 5 percent a year for four years. Other incentives for business relocation are found in the provisions for a 50 percent reduction of Social Security payroll taxes on employers for workers 21 years and older, and by 90 percent for those under 21. To aid the expansion of businesses already in the zone, the proposal would reduce their corporate tax rates by 15 percent and would accelerate depreciation of the first $500,000 of capital investment by each business each year. The urban enterprise zone concept received bipartisan support in Congress last year and is part of President Reagan's strategy for dealing with the knotty problems of our nation's cities.

Politicians and policy analysts have criticized many of the existing urban programs for what they view as meager and often exaggerated returns on the enormous amounts of money poured into our decaying cities. Recent studies at Princeton and the University of Michigan indicate that older American cities are in a worse state of decay than they were in the early 1960s. This, despite the fact that in fiscal 1979, nearly one-quarter of nondefense federal spending was in central cities. Others have questioned statistics cited for the UDAG program that $8.6 billion of private investment has been leveraged and 234,000 permanent private sector jobs have been created in qualifying cities.

Such criticisms led to some rather provocative conclusions and recommendations late last year, from the Commission for a National Agenda for the Eighties, a group appointed by President Carter in October 1979. While the commission's final report had not been issued at year end, its draft report recommended in part the reversal of current policy directed toward saving our central cities, and instead advocated assisting the migration of their residents to developing areas, particularly in the south and southwest. The commission staff characterized this as a "people-to-jobs" rather than a "place-oriented" strategy which will inject a free market concept into the development and decline of urban centers. These recommendations, which constitute a stark disavowal of much of the conventional thinking on urban affairs, have been highly criticized by some members of the National Agenda Commission as well as by members of the Carter administration.

CONCLUSION

Events in 1980 had one very clear and constructive impact in that they impressed upon the American people the reality of the new era of fiscal constraint. The ill-health of an economy so greatly affected by foreign oil prices, and the need for increased defense spending in response to political instability overseas, graphically displayed to our people the fiscal bind in which governments at all levels are caught. Perhaps the most beneficial effect of this experience will be a conducive environment for bringing about real change in our governmental system.

Several strong signs of this environment for change are evident now. At the national level, the outcome of the November elections spoke loudest. The Reagan victory, the Republican takeover of the Senate, and the conservative gains in the House of Representatives all reflect the desire for new policy direction, and at the same time provide a more unified philosophical base from which to bring this change about.

Less conspicuous but still of high importance was the appearance in 1980 of a state and local governmental sector far more united than ever before in its desire to change its relationship with Washington. State and local officials, as individuals and through their national organizations, in 1980 became much more assertive about their displeasure with federal laws, regulations, and officials that dictate policy decisions at the subnational level. The states were particularly vocal in pointing to their improved fiscal, administrative, personnel, and programmatic capabilities as they argued for reduction in federal intrusion in their operations.

In the forthcoming period of reduced federal expenditures, this line of argument will not abate, but will be amplified. Moreover, the new administration, which has expressed interest in state and local governments shouldering more administrative responsibility, is likely to encourage the devolution of authority and responsibility to subnational units of government. While the exact nature of these policies has yet to be defined, in all likelihood there will be fiscal and programmatic trade-offs between Washington and governments at the state and local level, slower expansion of categorical grants, the consolidation of some grants, the elimination of other programs, and some cutting back on the regulations accompanying federal money.

Those in favor of these intergovernmental strategies will be confronted, however, with the traditional strong obstacles to change. The iron triangles of congressional committees, federal agencies, and special interest groups will continue to protect their programs and regulations. Additionally, the courts show no sign of curbing their tendency to limit state and local fiscal autonomy and decisionmaking authority.

Governmental decisions as well as the state of our nation in the next year perhaps will be affected most of all by economic factors which in turn will be influenced as much by international circumstances as by events at home. For many Americans these developments in the foreseeable future will mean a decreased standard of living, including fewer government services and benefits. Such sacrifice, however, appears to be essential for the economic recovery that will stabilize many other aspects of our national life. The essence of leadership in this period of austerity will be to encourage the acceptance on the part of the American people of this decreased living standard, including reduced governmental programs, to achieve the desired economic recovery. In other words, we must live with short-term pain in return for long-term gain. This is the message that began to be transmitted in 1980. Its reaffirmation will be a fundamental task of public officials at all levels of government in the coming years.

The New Formula for Fiscal Federalism: Austerity Equals Decentralization

SUMMARY AND HIGHLIGHTS

The post-World War II era of an ever-expanding federal domestic presence had been over for a number of years by the time this article was written in 1982. Yet, some observers were still contending that federal retrenchment remained essentially political—almost totally a by-product of the election of Ronald Reagan as President. This article, while recognizing the importance of the 1980 election, shows that the roots of retrenchment were not just political, but fiscal and systemic as well. It measures the forces that caused a dramatic reversal in the financial fortunes of the federal government, which, in turn, portended a shift in intergovernmental responsibilities.

Yet, it is also clear that prognostications about where this would lead politically and programmatically were somewhat inaccurate. While it is true, as predicted in this article, that fiscal austerity in Washington induced a sustained squeeze in federal domestic spending growth, it did not result in less government. Between FY 1982 and 1987, inflation-adjusted federal domestic spending (excluding defense and interest payments) grew modestly—from $2,159 per capita to $2,189 per capita (1982 constant dollars). More importantly, with a sustained national economic expansion, inflation-adjusted state and local revenues increased from $1,572 per capita in 1982 to $1,911 per capita in 1987. Thus, the prediction in this article that "for the next several years [state and local governments] are likely to do less with less" would not come to pass.

Somewhat amusingly, the posturings of liberals and conservatives related in this article have undergone contortions over the Reagan years. Back then, some liberals argued that a retrenchment in federal spending would decimate the domestic public sector because state and local governments would have fewer grant-in-aid dollars to spend on services; now, some liberals argue that the growth in state and local spending from their own tax sources represents a rejection of President Reagan's policies of less government (though most liberals still bemoan the decline of national direction in domestic policy).

Back then, many conservatives argued that retrenchment in domestic spending was necessary to shrink the overall public sector and stimulate economic growth; now, many conservatives argue that activism at the state and local level proves that President Reagan's New Federalism thrust of decentralization has worked (though most conservatives still bemoan the fact that overall government has grown).

This article first appeared in the Winter 1982 issue of *Intergovernmental Perspective*. It was written by ACIR Senior Analyst Susannah Calkins, and former ACIR Executive Director John Shannon.

* * * * *

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

THE GREAT SLOWDOWN IN STATE-LOCAL SPENDING

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

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

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

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

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

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

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

GROWING FISCAL STRESS AT THE FEDERAL LEVEL

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

The Defense Trump Card

The federal government's ability to finance expansion in social programs, as well as some tax reductions, by cutting defense has come to an end. Now there is growing sentiment that during the 1970s we "under invested" in defense. The Reagan administration has placed top priority on a greatly increased level of defense expenditures in real terms. The generals and admirals will be claiming an increasing share of the federal budget for the next several years.

The Social Security Trump Card

For years Congress could increase social security tax rates with little opposition. Now there is concern that the social security trust fund may not have sufficient funds to meet retiree and Medicaid claims, and also growing opposition to steadily rising social security taxes. Confronted with this situation, Congress will have to cut benefits or siphon off general tax revenue—or both—to maintain the solvency of the system.

The Taxation Trump Card

In recent years Congress has allowed inflation to push taxpayers into higher and higher tax brackets; the result was an ever-increasing tax take. Now Congress has enacted substantial tax rate reductions which will eventually turn into a tax indexation system. As a result, heretofore politically painless inflation-induced revenue increases will no longer be available.

The Deficit Finesse

During the 1954-79 period, there was little public objection to federal policymakers covering revenue shortfalls with deficit financing, thereby avoiding the political pain caused by tax hikes or expenditure cutbacks. In 19 of the last 20 years, Congress spent more than it collected; these deficits cumulatively total about $400 billion. Now, confronted with chronic inflation of major proportions, the deficit finesse can no longer be worked with the same ease as in earlier years. The Congress, the middle class, and the business community all regard perennial deficits as convincing evidence of poor fiscal discipline and a major contributor to two of the nation's most serious domestic problems: inflation and high interest rates.

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

FISCAL DISCIPLINE— THE BUDGET CONTROL ACT

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

Before the enactment of the landmark *Congressional Budget Impoundment and Control Act of 1974*, there was no process by which Congress could set overall budget policy. Once an administration's budget had been sent to Congress, it was carved up into individual segments subject to the jurisdiction of the various appropriation committees, and the segments were never put together again in the course of congressional action. The 1974 act established standing budget committees in both houses which were given the responsibility of developing and enforcing a target budget total by May 15 of each year and the final budget total by September 15. The bill also contained a little-noticed provision which gave authority to the budget committees to request the individual authorizing committees to make substantive changes in order to "reconcile" estimated spending levels with budget targets.

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

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

FISCAL PROGNOSIS: CONTINUED AUSTERITY

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

Continued Stress at the Federal Level

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

—a dramatic lessening of international tensions, thereby permitting a major reduction in federal defense outlays;

—a rapid and long-sustained economic recovery, with negligible inflation and modest interest rates, that would generate substantial additional revenues and outlays, especially for income maintenance programs;

—a major increase in federal revenue yields either by deferring both the scheduled income tax reductions and indexation or by the imposition of a major new tax such as a value added tax; or renewed public acceptance of massive deficit financing.

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

Federal Aid—Most Vulnerable to Cutbacks

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

States—Fiscally Conservative

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

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

INTERGOVERNMENTAL PROGNOSIS: LESS FEDERAL INFLUENCE

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

Federalism: The Great Debate

The cutback in federal funds and the tax revolt at the state level have prompted renewed attention to the goals and nature of federalism in general and the need for a thorough overhaul of the federal aid system in particular. Increasingly, federal dollars and accompanying dictates have invaded all phases of state-local operations. Instead of bringing clear-cut federal control, however, legislative and administrative directives have resulted in a mishmash of federal-state-local authority with the resultant loss of efficiency, accountability, and public confidence. Thus, the federal aid system, with its 500 programs and thousands of "strings," has become both highly intrusive in character and repugnant to state and local governments and much of the general public.

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

Cutbacks in Federal Aid

No matter how the debate on federalism is resolved, one fiscal development is likely—there will be a progressive reduction in federal support to state and local governments.

As noted earlier, the period between 1954 and 1976 saw federal aid to states and local governments grow at a faster rate than any other major component of the state-local system. In addition, the stimulative effect of these grants was far greater than suggested by the dollar amounts. Equipped with matching ratios and expenditure maintenance requirements, many of the older federal grant programs were designed to increase state and local spending and to change their budgetary priorities. Federal aid is estimated to drop to 25.7 percent of state-local own source revenues in fiscal 1982, and will probably fall well below 20 percent in the not-too-distant future. The quantitative decline in the federal fiscal presence is accompanied by an insistent state-local demand for a commensurate reduction in federal aid strings. Moreover, these demands certainly find a receptive audience in the Reagan administration. In short, no matter what form the reform—block grants, tax turnbacks, or program sortouts—the federal government will certainly play a diminished role in recent and current grant-in-aid areas of domestic government, whether it relates to dollars or mandates.

A Bigger Role for States

Cutbacks in grant-in-aid programs and the trend toward block grants instead of a multitude of narrow categorical grants have pushed the states into assuming a more important role on the intergovernmental scene. Not only are the states compelled to be less dependent upon Washington for financing, but the transfer of a number of categorical programs to block grants and the administration's efforts to relax federal mandates and release federal "strings" gives the states increased freedom and greater responsibility to manage their own affairs and those of their political subdivisions.

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

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

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

POLITICAL PROGNOSIS: NO CONSENSUS

There are two sharply opposing interpretations of just what fiscal austerity means for America over the next several years. While labels are sometimes demeaning and often deceiving, major thrusts of current public opinion can be explained in considerable measure through contrasting conservative and liberal viewpoints.

The Liberal View

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

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

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

The Conservative View

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

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

The "Do It Yourself" Era

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

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

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

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

SUMMARY AND HIGHLIGHTS

Along with income tax rate reductions and increased defense spending, reordering intergovernmental relationships was a top priority during the early Reagan years. Indeed, "New Federalism" represented much of the breadth of federal domestic policy initiatives during 1981 and 1982.

However, the two years were markedly different relative to intergovernmental initiatives. 1981 was a year which could be characterized as incremental change; 1982 was a year in which the administration proposed a fundamental restructuring. 1981 was also a year in which the administration achieved a great deal of success, while the restructuring proposed in 1982 did not reach legislative fruition.

This article covers most of the 1981 period. The two basic administration initiatives detailed are: (1) the consolidation of categorical grants-in-aid into block grants in an effort to give more flexibility to state and local officials; and (2) relieving state and local governments from many federal regulatory burdens.

Three things should be kept in perspective to appreciate the significance of "New Federalism" during 1981. First, the consolidation of categorical grants into blocks had been proposed by both the Nixon and Ford administrations, but those efforts met mostly with failure. Thus, the Reagan successes were a dramatic departure from the recent legislative history. Second, because the amount of funding for the newly created blocks was approximately 25 percent less than the previous year's funding for the categoricals which were consolidated, FY 1982 represented the first post-World War II decline in actual (current) dollar grant-in-aid funding—as opposed to only an inflation-adjusted decline in each of the preceding three years. Finally, the successes of the Reagan administration during 1981 laid the groundwork for a major federalism initiative that the President proposed in January 1982, and which is detailed in the next two articles in this volume.

Like the preceding article, the following article first appeared in the Winter 1982 issue of *Intergovernmental Perspective*. It was written by former ACIR Assistant Director David B. Walker, former ACIR Senior Analyst Albert Richter, and former ACIR Analyst Cynthia Cates Colella.

*   *   *   *   *

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

CHANGES IN THE GRANT SYSTEM

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

The Fiscal Dimension

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

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

The administration did not rely solely on the grant consolidation process to reduce the size of the grant system, however. It moved to terminate or withhold funding for grant programs other than those included in the blocking, mainly through the *Omnibus Budget Reconciliation Act of 1981*. In October 1981, OMB reported that some 62 categorical programs funded in FY 1981 would not be funded in FY 1982 and therefore would be deleted from OMB's *Catalog of Federal Domestic Assistance*.

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

Functional Effects

The changes in the fiscal dimensions of the grant system wrought by Reagan Federalism have affected different functional areas. An illuminating comparison is between the Carter projected FY 1982 budget and OMB's estimate of the enacted Reagan program for that year. The greatest reduction has come in education, training, employment, and social services—a $7.1 billion drop between the Carter and Reagan budgets. Major decreases here were in employment and training assistance and rehabilitation services and handicapped research. The second general area of marked decline was Income Security ($2.4 billion), with principal reductions in the child nutrition program, public assistance, and low-income energy assistance. The $500 million of unallocated "contingencies for entitlement reform" in the 1982 Reagan budget is part of the administration's 12 percent cut.

BLOCK GRANTS: THE SHIFT IN RESPONSIBILITY

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

The Reagan Proposals

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

The administration proposed funding the seven new block grants at a level about 25 percent below that of the superseded categorical, on the grounds that handing over the money without many of the restrictions associated with categorical grants would realize savings through improved administrative efficiency. The administration argued, for example, that the health and social services programs proposed for blocking were uncoordinated, were based on varying criteria, and had separate planning processes and other administrative requirements. The new blocks, on the other hand, would enable the states to plan and coordinate their own service programs, establish their own priorities, and exercise program controls over resources provided to localities and nonprofit recipients. Similarly, the social services block would drop the plan approval process and matching and maintenance of effort requirements, would not require a pass-through, would require auditing and reporting only every other year, and would permit transfer of 10 percent of the blocked funds to other HHS blocks. The Community Development Block Grant, while eliminating only one categorical, would offer savings by replacing detailed applications with a statement of objectives, plus periodic certification by recipients of compliance with primary program goals and civil rights protections.

Essentially, the absence of strings in these proposals gave them more of the look of special revenue sharing than of the earlier block grants.[1]

The Nine That Made It

Nine block grants were created or revised. Two involve existing block grants: the Health Incentives Grant for Comprehensive Public Health, incorporated in the Preventive Health and Health Services block, and the Title XX Social Services block, expanded into the new Social Services block. In two cases (Primary Care and Low-Income Home Energy Assistance), a single categorical was transformed into a block; at the other extreme, the Education program consolidated 37 categoricals.

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

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

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

The block grant proposal which apparently met with least success is Local Education. Major elements of this proposed block were dealt with in the *Reconciliation Act*—specifically, those for which entitlements are provided in Title I of the *Elementary and Secondary Education Act of 1965*. The *Reconciliation Act* declared a congressional policy of lifting the burden from school personnel of overly prescriptive regulations and administrative burdens, but the act itself continues the separate funding and eligibility arrangements of the education programs for the handicapped and of the Title I Elementary-Secondary Education programs. It also retains such significant restrictions as maintenance of effort, nonsupplant, and comparability of services. For all practical purposes, then, components of the administration's Social Education block grant were not consolidated, nor were some of the basic restrictions lifted.

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

—Only three require matching—State Community Development, Maternal and Child Health, and Primary Care.

—Six carry some type of fund earmarking—all but State Community Development, Education, and Low-Income Home Energy Assistance.

—All seven of the human services blocks prohibit use of funds for certain activities or eligibles.

—Four (Preventive Health, ADAMH, Community Services, and Low-Income Home Energy Assistance) explicitly prohibit the federal government from prescribing how the states will

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

comply with the required performance assurance.

—Three contain a maintenance of effort or nonsupplant provision—Education, Preventive Health and ADAMH.

—Four (Preventive Health, ADAMH, Primary Care, and Community Services) are subject to general procedural requirements as to proposed use reports, public hearings, and biennial financial and compliance audits, as set forth in Title XVII of the *Reconciliation Act*; but it may be noted that these requirements actually liberate the recipients in that they are less stringent than similar requirements imposed on earlier categorical programs.

—Seven require state applications—all but State Community Development and Social Services.

—All but Social Services mandate various assurances to be submitted with the program application or the statement of proposed activities. These are generally modest, however, merely assuring minimum compliance with generally accepted administrative practice.

—Three (Preventive Health, ADAMH, and Primary Care) require an annual report and an annual independent audit, and the other six have somewhat less rigorous requirements.

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

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

State-Local Roles

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

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

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

CHANGES IN THE REGULATORY CLIMATE

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

State and local officials have expressed increasing concern about the growth of this type of federal regulation, complaining about mandated, unreimbursed costs and unreasonable intervention into their affairs. Consequently, they have a vital interest in the

Reagan administration's plans for reducing the burden of regulation.

The Reagan Approach

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

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

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

In congressional testimony in April 1981, Chairman Murray L Weidenbaum of the Council of Economic Advisers, a leading authority on the economic impact of federal regulations and a member of the Presidential Task Force, submitted a list of 34 specific actions designed to "either decrease directly the overhead costs of state and local governments or increase the discretion of state and local governments over regulatory matters with a state and local impact." They were divided into three groups: regulatory changes (5 items), regulations postponed for further review (15 items), and existing regulations or regulatory programs targeted for review (14 items).

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

—Revised rules to permit local authorities more discretion in providing the handicapped with access to mass transit.

—Withdrawal of DOT rules relating to urban transportation planning analysis, uniform traffic control devices among the states, and procedures for governing bus rehabilitation and emergency stockpiling.

—Withdrawal of the Education Department's rules requiring local school districts to instruct children not proficient in English in their native languages.

—Review of the Education Department's rules requiring schools and colleges receiving federal grants to spend as much on women's athletic programs as men's.

—Proposed changes in administration of the *Davis-Bacon Act* establishing prevailing wages for federally aided construction projects.

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

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

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

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

. . . there is no solid evidence that these regulatory programs are even modestly effective. In most instances, the statutes mandate tasks so extensive that the agencies cannot meet deadlines, enforce the rules they set, defend themselves in court, and conduct retrospective evaluations of their effectiveness. More important, the statutes often forbid the use of a cost-benefit test in standard setting, encourage economically inefficient regulations, and contain a strong bias against economic growth.[2]

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

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

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

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

Congressional Action

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

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

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

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

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

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

The Presidential Advisory Committee on Federalism

One of President Reagan's most visible steps toward a restructured federal system was the establishment of the Presidential Advisory Committee on Federalism. The Committee, chaired by Senator Laxalt, consists of 51 members drawn from the White

[2]Robert W. Crandall, "Has Reagan Dropped the Ball?" *Regulation*, September/October 1981, p. 16.

House staff, Cabinet members, senators and representatives, governors, state legislators, county commissioners, mayors, and private citizens. Its two major functions, according to Richard Williamson, Assistant to the President for Intergovernmental Affairs and a member of the committee, are:

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

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

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

HIGHLIGHTS: THE FIRST TEN MONTHS

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

On Grants-in-Aid:

—While the upward trend of grants-in-aid, adjusted for inflation, reached its peak in FY 1978, the climb in nominal dollars continued uninterrupted through FY 1981. The first year of the Reagan administration will see a sharp reversal of that trend: a drop of 9.5 percent in nominal dollars. The drop stems from merging 77 categorical grants into block grants, termination of some 60 additional categoricals, and funding cutbacks in many others.

—The conversion to nine new or modified block grants and the administration's record to date in implementing the enacted legislation represents a real devolution of power and responsibility from the federal government to the states. This is despite the fact that, as enacted by Congress, the blocks do not grant as much flexibility to the states as the administration originally had proposed.

—In terms of state-local relations, the move to blocks has strengthened the role of the states, particularly vis-a-vis counties, school districts, small cities and rural communities, and nonprofit organizations. Medium and large sized cities were less affected since they generally were involved in a direct federal-local relationship in few of the categorical replaced by the blocks. The state role was made no stronger relative to localities, because Congress assured localities an opportunity to be heard on the allocation of block grant monies that formerly were distributed as direct federal-local categoricals.

—The administration's intentions with respect to General Revenue Sharing are not clear at this point. During the election campaign the President said he would not disturb GRS. He indicated a possible change of mind when looking for places to make further budget reductions in September 1981, but the threatened cut was protested vigorously by state and local officials.

—The eventual value of the Presidential Advisory Committee on Federalism as a forum for furthering the President's goal of devolving authority to states and localities is still unpredictable. Developing a consensus on turning back functions and revenue sources to the states may be a fruitful field for constructive action by the group.

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

On Regulation of State and Local Governments:

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

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

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

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

Perspectives on a "New Day" for Federalism

SUMMARY AND HIGHLIGHTS

In his 1982 State of the Union Address, President Reagan condemned the existing "maze of interlocking jurisdictional and levels of government" and the "jungle of grants-in-aid." He proposed restructuring the intergovernmental system in a "single bold stroke."

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 Aid to Families with Dependent Children (the basic cash welfare payment) and food stamps, in return for federal assumption of state contributions to Medicaid (medical care for the poor). Second, the President proposed a temporary program to replace with a trust fund approximately 40 federal programs "turned back" in the fields of education, health, social services, community development, and transportation. Revenues for this fund were to come from proceeds from 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 were to 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.

The President presented the proposal as a "conceptual framework," with details to be negotiated with state and local officials, and the plan was soon joined by two other major proposals. This article, written during the height of the negotiating process, discusses the philosophical, political, and practical issues attendant on any "sorting out" effort. The next article in this volume, written a year after the President's announcement, will recap the negotiating process.

This article was written by former ACIR Executive Director S. Kenneth Howard, and former Senior Analyst Albert J. Davis. It first appeared in the Spring 1982 issue of *Intergovernmental Perspective*.

* * * * *

On January 26, 1982, President Reagan made federalism, once dubbed the "Dismal Swamp" of intergovernmental relations, the centerpiece of his State of the Union Address. In doing so, the President launched what he said would be a "new day" for American federalism and described his framework for a "program to make government again accountable to the people . . . accomplishing a realignment that will end the cumbersome administration and spiraling cost at the federal level."

Like a powerful depth charge, President Reagan's New Federalism proposal is raising to the political surface several perennial and thorny issues of federalism:

a. *The Philosophical Issue*—What should be the relative importance placed on the values of equity, accountability, and efficiency? Variations in the mix of these values can tilt federalism toward either greater centralization or decentralization. Determining which level of government should finance income maintenance programs for the poor puts these competing values to the acid test.

b. *The State-Local Relationship Issue*—Have local governments (the "creatures" of the states) become so emancipated that they should be allowed to cut the best deal they can with Washington from now on?

c. *The Fiscal Equalization Issue*—Can Washington turn back more and more responsibility to the states without recognizing that some states are rich while others are poor?

d. *The Fiscal Balance Issue*—Now that the federal government is moving into a period of fiscal distress, will the proposition survive that the federal level is obliged to distribute a fiscal dividend to states and localities?

This article seeks to provide a framework within which to appraise these thorny issues.

THE PHILOSOPHICAL ISSUE

Any working federalism reflects a practical consensus on three major, but often overlapping and conflicting, values: equity, accountability, and efficiency. Each of these values is not one-dimensional but multifaceted: equity for whom? accountability to whom? and greater or lesser efficiency or effectiveness compared to what? The number of options and possible combinations of programs that could provide varying degrees of balance among these values is almost endless. It is that very plethora which motivates this article's attempt to sort out the variables and issues so that readers can better understand and assess individual specific proposals.

Equity

As a concept, equity focuses on fairness, impartiality, and justice. Typically, the equity emphasis is on assuring basic rights or supports for poor individuals or jurisdictions; it tends to have a centralizing effect. For these purposes, equity has both fiscal and procedural aspects.

Procedurally, there is a long-standing fear that a small but like-minded group, which may be a majority in a particular setting or area, will deny certain basic rights to individuals, actions that could not be tolerated in a larger context. James Madison's classic arguments about the tyranny of a local majority clearly ring with equity sounds. Support for many of the federal government's actions arises from fears that smaller units of government, especially states and localities, would deny certain rights or protection to some of their citizens. Certain "crosscutting" requirements in federal grants (equal hiring practices, public participation, prevailing wage levels, and so forth) arise from these concerns.

Fiscal equity, in the current context, asks what can be done to help "poor" people, localities, and states. Whatever the clientele, whether individuals or governmental entities, to what extent should those relatively better off aid those who are less blessed? Debates over redistributions of money, power, or other resources have equity issues at their heart.

Accountability

It is a basic tenet of a democracy that public officials, whether elected or appointed, should be accountable in some way to the electorate. The federalism issue is whether or not it is easier to hold officials accountable if they are closer to home. The more a national government does, the less the populace may feel it can hold its officials sufficiently accountable. Political accountability tends to favor decentralization.

Several important issues of fiscal accountability also arise in current debates. Does the federal penchant for spending more than it has in revenues mean that state and local governments are more fiscally accountable? To what extent should elected officials at one level of government raise money solely for distribution to governments at a lower level? Are the officials at the more central level accountable and responsible if they simply pass on resources without strings? Should those who enjoy the pleasure of spending feel the full pain of levying the supporting taxes? Accountability may argue against broad general purpose grants, perhaps even all grants. Fiscal accountability helps bolster congressional preference for narrow purpose grants with their multitude of requirements that state and local officials often find too rigid and inefficient. Fiscal accountability, unlike its political cousin, may encourage centralization. Furthermore, if the more centralized level has the more equitable ways to raise money, equity may demand a centralized approach. The potential conflict between equity and political accountability is clear.

Efficiency

The third value, efficiency, cuts across the other two to provide a third point of tension in this struggle among competing values. At the simplest level, the public wants program results at least equal to the money they cost. Citizens want to believe that they are not paying for fraud, waste, or abuse. They tend to believe that smaller units closer to the people (and therefore more politically accountable) are freer of these undesired characteristics.

Allied logic supports the contention that smaller and closer governments, although they may be more tyrannical in a Madisonian sense, can better promote citizen participation—a quality democracy tries to encourage. But if redistribution of any sort is desired for equity reasons, it is usually larger and more centralized governments that can deal most effectively and justly with such issues. Similarly, responsibility for general economic well-being and stability is typically and more effectively carried out by larger units of government, ordinarily national in breadth. In these latter examples, program effectiveness urges centralization even though, generally, program and administrative efficiency may favor decentralization.

Although these values of accountability, equity, and efficiency are multidimensional and are perhaps no better measuring devices than rubber yardsticks, they do provide a broad conceptual framework within which to evaluate more specific proposals of change.

MAJOR PROPOSALS IN THE NEW FEDERALISM DEBATE

The President's plan outlined in his State of the Union Address was soon joined by two other major proposals: one put forward by state interest groups; and the other, by Sen. Dave Durenberger (MN). Negotiations, under way since the three plans were offered, have sought a compromise so that the administration could transmit broadly supported legislation to Congress. Notably, the White House has tentatively accepted the governors' insistence that the federal food stamp program not be "turned back" to the states, but a complete agreement had not been reached as of this writing.

The three initial proposals highlight areas of common agreement and of conflict. All provide for a federal takeover of Medicaid and significant returns of responsibilities to the states. A large dollar block of federal grants, up to $35 billion as of 1982, for particular services or facilities—transportation, education, social services, and the like—would be terminated. All establish a transitional "hold-harmless" period of several years during which state and local governments are to be protected against fiscal losses. The transitional period is managed in all cases by a "trust fund," from which allocations would be made to the states until the end of the hold-harmless period. The trust fund would be used to offset any net imbalances among the states caused by federal assumption of state Medicaid costs on the one hand and state assumption on the other hand. In addition, protections are to be worked out so that localities would receive aid from the states to replace amounts lost by termination of federal grants. Finally, where plans called for Aid to Families with Dependent Children (AFDC) and food stamp responsibilities to go back to the states, states would be temporarily required to maintain minimum levels of public assistance for individuals.

The plans differed sharply on who should be responsible for major welfare programs other than Medicaid, and in their concern for fiscal equalization among the states. In the President's original proposal, major welfare-type responsibilities—AFDC and food stamps—were to be turned back to the state level. In a sharp departure from his long-standing insistence that all welfare programs be turned back to the states, the President proposed federal assumption of Medicaid. As the governors had long advocated, the President partially accepted the idea that "accountability-blurring" grants should be swept away by trading-off, not just turning back, responsibilities.

The National Governors' Association (NGA) and other state interest groups advocated adoption of ACIR's long-standing recommendation of full federal assumption of welfare programs and Medicaid. Both the National Conference of State Legislatures (NCSL) and the National League of Cities (NLC) have basically supported the ACIR welfare recommendation, but, as part of the recent negotiations, have adopted policy positions allowing more compromise on the issue of state assumption of AFDC.

Senator Durenberger's proposal provided for the same reallocation of responsibilities as the President's, but differed on the trust fund provision. The President proposed a temporary trust fund to be phased out as selected federal excise taxes were lowered to make "tax room" for the states. The emphasis was on fiscal accountability—if states found programs worthwhile they should be willing to tax for them. Senator Durenberger, soon joined by state and other interest groups, instead advocated establishing a permanent rather than a temporary trust fund financed through the federal income tax. The trust fund would be a revenue sharing device, distributing funds directly to state governments according, among other possibilities, to differences in their capacities to raise taxes on their own. The fund could also be a vehicle for expressing continued national interest in minimum standards for state welfare programs. Equity concerns were clearly more predominant in these proposals.

With the three major plans on the table, negotiators from the administration, NGA, NCSL, and other relevant groups set about to find a common ground. The question about which level of government should be responsible for welfare proved to be the most difficult.

INCOME MAINTENANCE: AN ACID TEST OF PHILOSOPHY

The fact that assigning income maintenance responsibilities has been a major hurdle for the intergovernmental negotiators is not all that surprising. Indeed, it might be difficult to pick out a combined social policy and financial issue over the last 20 years that has produced less consensus than which level of government should have primary responsibility for aiding the poor and how such aid programs should be designed. Since the Great Depression, the responsibility for financing welfare programs has shifted from the family to local governments, toward the states, and then toward the federal government. However, complete federal takeover was never achieved because of cost considerations and disagreement over what would constitute welfare reform.

Strongly held and opposing views about the appropriate role of the federal government in the welfare area are now colliding. Involved are the food stamp, AFDC, and Medicaid programs, which account in 1982 for nearly $60 billion of combined federal, state, and local spending. Additional related and auxiliary programs, such as child nutrition and the work incentive program, are also part of various New Federalism proposals but are somewhat less controversial.

The ACIR, NGA, and NCSL, among others, have argued that the federal government is the one best able to bear the financial burdens of income maintenance programs and to finance them appropriately, and that it is the only level that can redistribute income without driving taxpayers out of some jurisdictions and poor people into others. Just as the national government assumes paramount responsibility for managing the economy, it is argued, it should also accept responsibility for meeting the basic human needs of those whom the economy has failed.

Yet widespread public dissatisfaction with federally aided welfare programs has encouraged advocates of a smaller federal role in income maintenance. Strong public sentiments sustain key members of the Reagan administration as they argue against providing nationally set benefits to people as a matter of "right," regardless of their ability to support themselves through work. The administration argues that decisions and rules must distinguish among potential welfare beneficiaries, separating those who can work or get assistance elsewhere from those who cannot. Presidential Assistant Robert Carleson, former California Welfare Director, argues that such decisions can only be made fairly and effectively at the state or local level. Finally, the argument goes, if state or local officials are going to make the decisions as to who receives benefits and how large those benefits will be, they should be held fiscally accountable. Strict fiscal accountability, in this view, rules out the present system in which the federal government pays for a considerable portion of any expanded benefits or eligibility. Fiscal accountability also argues against the present AFDC or Medicaid systems in which costs are imposed on the states by federally mandated requirements.

AFDC and Food Stamps

State decisionmaking and conditions vary in the AFDC program. The key question under the administration's proposal is what would happen if the program were fully state funded? In 1980, annual state spending (including that financed from federal aid) per AFDC recipient ranged from $380 in Mississippi to $1,706 in Wisconsin. For 1980, per capita annual state AFDC costs ranged from $11 in Arizona to $170 in Washington, DC. Although federal assumption of Medicaid costs would release funds that states might use to pick up the current federal share of AFDC costs, it is not clear whether existing differences might not widen further and whether such a result would be acceptable politically.

Because the federal food stamp program is now uniform throughout the nation, and its benefits automatically change in tandem with those under AFDC, combined benefits vary far less across the states than do AFDC payments alone. While the ratio of New York to Mississippi maximum combined food stamp and AFDC benefits was 5-1, the ratio of maximum combined food stamps and AFDC benefits across these states was about 2-1. Although the food stamp benefits formula is nationally uniform, the expenditures vary in each state because of differing concentrations of poverty. For example, 1980 annual food stamp outlays per capita ranged from $14 in Wyoming and several other states to $78 in Mississippi. Accordingly, if responsibility to replace food stamps were assigned to the states, potential financial burdens would vary considerably. Unfortunately, those with heavy potential burdens are not generally the states with higher capacities to raise tax revenue. For example, average 1980 Mississippi per capita income was 69 percent of the national average, compared to 115 percent for Wyoming.

Transferring full financial responsibility for food stamps to the states, while withdrawing the "open-ended" match formula now used under the AFDC program, would tend to produce lower benefits than are available currently. Because the federal AFDC matching rate is now preferentially high for states with low tax capacity, a turnback proposal that makes states wholly responsible for AFDC could result in greater benefit cutbacks in the states with the fewest resources to tax. For example, whereas California would lose its federal matching rate of 50 percent, Mississippi would lose its 77 percent matching rate. Nevertheless, a clear distinction can be made between the possible effects of returning only AFDC responsibility to the states and returning both full AFDC and food stamp responsibilities. Because AFDC benefits are far less uniform now than food stamp ones, the variation under full state control of AFDC is not likely to increase all that much from the present pattern. Because states are already funding at least part of AFDC, it will take fewer resources overall to provide 100 percent state AFDC support than to provide 100 percent state food stamp support. In the latter program, states currently provide practically no support; in other words, states are more likely to cut back when they must go from nearly 0 percent to 100 percent of costs, than from 50 percent to 100 percent.

Although federal retention of food stamps would allow a continued equalizing influence on benefit levels, pressure for a federal influence on AFDC-type benefit standards also may persist. The challenge under a New Federalism will be to find a point of compromise so that some federal role can be maintained, while making reasonable allowances for differences in factors like the cost of living, differing wages available from work, and concerns about excessive dependency. At least equally challenging will be the task of designing a federal role that minimizes charges of fiscal unaccountability. The federal government may want to assert a national interest in mandating "adequate" or minimum benefit levels, but can probably do so only if it maintains some fiscal participation. Standards imposed without financial participation are not likely to be acceptable politically even if other actions, such as federalizing Medicaid, free up resources. Complete turning back of either AFDC or food stamps would show less emphasis on some of the equity considerations that gave raise to federal participation in the first place. Turnbacks without standards permit greater cutbacks and encourage variation.

The approach to be used in decentralizing income maintenance responsibilities,especially AFDC, is under debate. Block grants could be used to provide clearly appropriated amounts as determined and allocated by Congress to finance welfare programs. The block grant approach would put more emphasis on fiscal accountability by ending present open-ended state cost-matching grants. Robert Carleson, in the past, has advocated this approach. In his State of the Union speech, President Reagan advocated a complete "turnback" of responsibility for AFDC to the states. Either approach decentralizes, but the latter does so more radically.

Medicaid

In the case of Medicaid, President Reagan clearly altered his general view on allocating income maintenance responsibilities by proposing that the federal government fully finance Medicaid. If Medicaid is construed as a program to insure against medical cost catastrophes, rather than as a welfare-type program, there need not be as much emphasis as under AFDC or food stamps on categorical eligibility determination—whether beneficiaries could obtain work or not, whether they were "truly needy" or not, and so forth. Furthermore, the federal government already has major medical responsibilities through Medicare and through its tax treatment of the employer's share of employee medical insurance.

More complete federal control in the medical field might permit greater health care cost containment by using federal power to encourage more competition among health care providers.

Current Medicaid expenditures among the states vary in the extreme, making the task of "federalizing" the program especially difficult. In 1980, average state Medicaid outlays per beneficiary ranged from a low of $646 in Oregon to $1,985 in New York. Average 1980 Medicaid spending on the elderly, per recipient, was 3.5 times as high in Minnesota as in Florida. The average 1980 program expense per capita ranged from $30 in Wyoming to $263 in Washington DC. These variations reflect differences in the number of potential eligibles, in health conditions, in services and groups actually covered, in cost levels, and in reimbursement policies. A more uniform federal program would undoubtedly lower benefits in some states and raise them in others.

If complete federal takeover of Medicaid means a more uniform program, states experiencing lowered benefits for their residents would be under enormous pressure to supplement the federal program. Conversely, residents of states in which benefits are now relatively low could benefit under a more expansive federal program. Without more details, it is impossible to predict with any precision how full federal responsibility for Medicaid will affect benefit levels across all the states. For example, Medicaid benefits now can depend upon whether an individual is eligible for AFDC benefits in a state. Full federal responsibility for Medicaid and full state responsibility for AFDC might sever this connection—otherwise state determinations could drive federal Medicaid costs.

A completely federalized Medicaid program could require considerable restructuring. Medicaid covers varied recipients—elderly persons with more chronic health problems as contrasted with juveniles having dental disorders—and a variety of services—acute care compared to nursing home care. Clearly, the federal financial role might be shaped differently in different health service areas or for different clientele. These thorny issues of eligibility and benefits under a fully federalized Medicaid program have yet to be worked out, nor will they be easily determined.

TREATMENT OF LOCAL GOVERNMENTS UNDER NEW FEDERALISM

Advocates of a "New Federalism" must decide not only who is responsible for income maintenance but also who—Washington or the states—is responsible for local government problems. In particular, to what extent should state governments be given future responsibility for those local problems that up to now have been addressed by direct federal-to-local grants? Direct federal aid to the cities grew rapidly, faster than most other components of federal aid, throughout the late 1960s and most of the 1970s. As a result, in many larger cities, federal funds in the late 1970s equaled 50 percent of the amounts raised locally. Localities also receive federal funds that are "passed through" to them by state governments. The ACIR staff last estimated that, for 1976-77, excluding education, 20 percent of federal aid to state governments was passed on to local governments. When both education and public welfare federal aids are excluded (local governments have public welfare responsibilities in only a few states), the percentage of federal to state government aid passed through was, on average, 12 percent.

Not only are local governments considerably reliant on federal aid, in certain states they would be affected by a realignment of responsibilities for public assistance. In 1977, the local government share of Medicaid costs exceeded 10 percent in three states: California, Nebraska, and New York. (The California situation has changed since 1977, however, because the state has now assumed the lion's share of Medicaid costs.) The President's proposal to federalize Medicaid could lift financial burdens from some localities but still, depending upon state responses, increase local government financing burdens in a few others (such as in those nine states where localities fund over 10 percent of AFDC costs).

The issue of whether the national or state governments have primary responsibility for localities is highlighted by the President's proposal to eliminate major federal grants to cities, counties, towns and townships. Included in the list of grants that would be terminated are General Revenue Sharing, Community Development Block Grants, mass transit grants, and Urban Development Action Grants. These four grants together account for approximately 75 percent of all expected FY 82 direct grants to local governments, including school districts, and account for about 90 percent of expected totals for cities and counties, excluding AFDC and Medicaid grants. Furthermore, the CETA components and waste water treatment grants that are slated for termination go substantially to local governments either directly or through the states.

Because states are constitutionally responsible for the structure, functions, and fiscal resources of their local governments, one can argue that states should face all the dimensions of that responsibility. States already allocate major aids to local governments, assign responsibilities for public services, set the taxing authority, and control the ability to expand boundaries by annexation. State aid to local governments in the aggregate exceeds total direct federal aid to these units, although state aid is heavily concentrated in education. However, critics of the President's approach cite the record of state governments in the past and question whether state governments generally will respond reliably enough to their cities' needs. Understandably, leaders of the national public interest groups representing local officials have expressed concern. Ferd Harrison, president of the National League of Cities, called the greatest risk "that the cities will not be treated fairly or equitably by the states."

Because of local sensitivity to lost or reallocated federal aid, all of the New Federalism plans employ some temporary protections for local governments. The scope of the New Federalism proposals, the length of the transition period, and the early warning offered, make it difficult for state governments to be unaware of local concerns. In addition, states might be required to provide aid to local governments nearly equal to what they had been receiving from the federal government. Discussions also have been under way concerning the "pass-through" issue.

To be guaranteed, all such protections would have to be mandated upon the states by the federal government and specified in law. How long they would apply is an issue. Given widely varying circumstances among the states, extremely different degrees to which federal aid is "passed through" and the great differences in how responsibilities are assigned among different types of local governments, designing complete protections for local governments everywhere will be most difficult.

Alternatives to the President's original proposal have been suggested. For example, some major federal-to-local grants could simply be exempted from termination. Or, a variety of federal-to-local categorical grants might be eliminated in favor of a more general method of transferring federal resources directly to localities.

FISCAL EQUALIZATION ISSUES

Unwinding a major portion of today's federal grant system is bound to eventually leave some states relatively better off and others relatively worse off. A large-scale plan will not be acceptable to those who focus exclusively upon this issue, nor to those who will support a New Federalism only if their state will not lose any federal funds. New Federalism requires tolerance for at least small changes in states' relative condition. Concerns can be allayed, but not eliminated, by protecting states during a transition period. After the "hold-harmless" phase, some protection could be directed to certain types of states through such devices as formula allocated revenue sharing, although none was included in the President's original proposal.

Different states would ultimately be affected differently under any proposal. States vary in the savings they would realize from no longer financing Medicaid; in the financial burdens they would face in financing food stamps or AFDC; in the revenues they raise per capita from excise taxes on motor fuels, alcoholic beverages, and tobacco product sales; or the federal aid amounts they would receive from a revenue sharing formula.

A crucial factor in implementing any trust fund arrangement is how the fiscal effects upon the states will be counted. How much a state will lose from termination of federal grants can be fairly easily estimated. However, measurement of the offsetting gain a state will obtain from federalization of Medicaid is much more difficult. During a transition phase, the federal government would probably begin to restructure Medicaid so that eligibility criteria and benefit levels would be more uniform across the states. Although state governments would have their financial responsibilities under the current program eliminated, individual state residents would be subject to changes in benefits. For example, a state with a very expensive Medicaid program could be relieved of considerable cost but its residents would find their coverage cut under the new national standards. What, then, is the proper measure of the net effect on the state as a whole?

Conversely, a state with a restrictive Medicaid program could see its state government relieved of less cost but its residents would benefit from a more generous federal program. In the first case, the state government would probably be pressured to supplement federal benefits and erode its initial savings. In the second case, the residents might be better off, but this improvement may not translate directly into an improved state budget fiscal condition. For the trust fund to prevent winners and losers, these realities would have to be reconciled while simultaneously keeping in check federal costs to operate the trust fund.

After the hold-harmless period, states would experience different effects under the various New Federalism proposals. It is not yet possible to predict precisely by what dollar amounts states might be better or worse off. Those measurements cannot be made without more detailed specifications on how a fully federalized Medicaid program would work. ACIR staff did attempt such projections, not to predict how any particular state might fare, but to illustrate the possible scope of differences among the states under alternative assumptions, including those concerning the distribution of benefits under a Medicaid trade. Under the President's plan, one projection of restructured Medicaid benefits shows the standard relative fiscal displacement to be about $75 per person in 1984 dollars. This shift represents a significant, but not overwhelming, amount in comparison with likely levels of personal income and state and local taxes. A few states, however, would be affected by 125 percent or more beyond this amount. Such jurisdictions are sometimes doubly affected, losing both very high (or low) per capita amounts of federal aid and realizing relatively small (or large) savings from federalizing Medicaid.

Rather then relying only on federal excise tax cuts to make room for the states, Senator Durenberger and the state interest groups proposed that federal trust fund amounts be allocated by formula among state governments. The revenue-sharing-type approach would allow much greater control over the distribution of New Federalism's fiscal effects than would the President's original proposal. If the trust fund became permanent, its distribution could be targeted by formula. Funds could be directed toward states with high public assistance burdens, with high burdens in other program areas, with low ability to raise tax revenues on their own, or with combinations of these factors. Under this approach, there would be less emphasis on fiscal accountability and more on equity and fiscal equalization.

Of longer range and deeper concern than the design of a temporary hold-harmless period is whether responsibility should be further decentralized without recognizing that some states would face those greater responsibilities with relatively meager resources—the fiscal equalization problem. If one insists on 100 percent strict fiscal accountability, states would have to go to their taxpayers and not Washington for funds to meet their added responsibilities. Less strict accountability would allow the federal government to attend to equity concerns by directing resources toward lower capacity or higher need states.

Unless a federalized Medicaid program were both expanded considerably and selectively targeted to the low-income populations, turning back food stamps and AFDC responsibilities and rolling back federal excise taxes tend, on average, to hurt states with lower fiscal capacity. This result occurs partly because federal food stamp dollars are directed more toward lower than higher fiscal capacity states and because federal tax revenues used to finance grants are extracted more from higher than lower capacity states. Such decentralization would require lower capacity states to work harder to replace food stamp dollars and terminated federal grants. They would either have to make greater tax effort measured against their lower-than-average fiscal capacity or cut back more on programs. Among the 14 states with the lowest fiscal capacity, from four to ten could experience a loss of 5 percent or more relative to what they could raise from a standard set of tax rates; and, from zero to four states could gain 5 percent or more. "Lowest fiscal capacity" states are those with 90 percent or less of the average fiscal capacity per person, as measured in 1979 using the ACIR's Representative Tax System approach. If, as proposed by the governors, there were no turnback of food stamp responsibilities, or resources were directed by formula to poorer states, the average effect on poorer states would be less or even turn favorable.

CURRENT FEDERAL FISCAL STRAINS AND THE ISSUE OF FISCAL BALANCE

Concern about fiscal capacity does not focus just on state and local governments. Current economic conditions have put the federal "fisc" under great duress. Some critics fear that all the discussion about reshuffling responsibilities under the guise of New Federalism is just a way to mask large cuts in the state and local grants part of federal domestic spending. Do the New Federalism plans create a fiscal imbalance against the states? A fiscally balanced plan would neither help solve nor aggravate federal budget problems, nor would it help or hurt the state governments in the aggregate.

Fiscal balance cannot be unequivocally determined because uncertain future costs under a New Federalism have to be compared with hypothetical costs and federal grants levels that would otherwise prevail. Nevertheless, because the issue of fiscal balance has been controversial, ACIR staff made some initial projections of aggregate state gains and loses from the three initial federalism proposals. If all new federalism plans were to begin in fiscal balance on their 1984 starting dates, as originally proposed, all seem likely to protect the states from fiscal losses through 1987. This finding assumes that no substantial expansion in the grants to be terminated, other than AFDC, food stamps, and Medicaid, would otherwise take place. It further assumes that Medicaid costs would be growing faster than those to maintain real public assistance levels.

After 1987, the plans have different fiscal outcomes. Under a variety of fiscal assumptions, the Durenberger and National Governors' Association proposals soon show surpluses for the states while the administration proposal shows interim shortfalls for the states as a whole. However, depending on the rate of increase in medical costs that would be lifted from the states, the administration plan could, sooner or later, eliminate the yearly shortfall.

Conventional wisdom holds that changing policy dramatically during times of great resource scarcity is difficult—if not impossible. Those who would lose from the change will want funds to prevent such losses. If permitted, this logic would cause the federal price tag for New Federalism to rise at a time of apparent federal revenue shortage. On the other hand, without the pressure of fiscal austerity that argues for federal budget relief, sweeping priority shifts might not be possible.

Thus, like it or not, debate over restructuring governmental roles is inexorably intertwined with debate over what the federal government can afford to do and should do. The attitude of the Congress, the mood of the people, and the overall state of the American economy will all play major roles in determining how equity, accountability, and efficiency concerns get balanced out in New Federalism. With so many elements still undetermined, the question of a new day for federalism remains just that—a question.

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

SUMMARY AND HIGHLIGHTS

Although President Reagan's 1982 federalism initiative received wide media coverage and was the subject of much national debate, after months of negotiations between the administration and state and local officials no agreement was ever reached on a unified legislative package to be sent to Congress. Nevertheless, the fact that the proposal was considered seriously at all was an indication of how much the public policy debate on intergovernmental relations had changed in just a few years.

In and of themselves, the New Federalism negotiations were historic in that they represented a comprehensive effort by officials at all levels of government to fashion a major sorting out of responsibilities within the federal system. While it is conjecture as to whether an agreement could have been reached under any circumstances, this article relates that the deepening recession of 1982 seriously compromised the negotiating process. In addition, the mid-term elections eventually overran the negotiations.

This article first appeared in the Winter 1983 issue of *Intergovernmental Perspective*. It was written by former ACIR Assistant Director David B. Walker, and former Senior Resident Timothy J. Conlan

* * * * *

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.

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. 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," and Governor Bruce Babbitt of Arizona called the proposal "elegant and imaginative." 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."

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: "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." 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 grass roots and the people it serves."

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." 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. 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 poor and sick, but a Texan when you're just poor." 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.

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. Governor 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. 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, 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: "Where 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?" 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."

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 facilities and services on which all Americans depend and jeopardize the health and welfare of millions of the poor." "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."

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. 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."

All of these opposing views were fully represented in Congress, where one observer reported that "long knives are out," ready to kill the initiative. Even some strong congressional supporters of the sorting-out concept were troubled by specific features of the President's proposal. Sen. Dave 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?" 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.

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." A few months later, the *New York Times* reported the proposal had "become entangled in the [budget] stalemate." "Budgetary problems are taking more and more of Congress' attention, and elections are coming on," agreed one administration adviser. With the fate of the economy affecting almost 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 percent 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.

In return, several state leaders indicated a willingness to reverse their earlier position and to accept full financial responsibility for the AFDC program. 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 National Governors' Association annual meeting in August, and disappointed governors decided to develop their own federalism proposal. Governor 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." 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. To ease 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.

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.

A NEW BLOCK GRANT

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 new *Job Training and Partnership Act* (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.

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 percent, from 6,500,431 paperwork hours in FY 1981 to just 1,086,056 paperwork hours in FY 1982. 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 percent of the federal regulations initially selected by the President's Task Force on Regulatory Relief for review. As of August, action and possible modification 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. 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.

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 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 turnback 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. 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.

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. 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 where Congress authorized federal aid spending levels 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 more than $2 billion above FY 1982 levels, and almost $7 billion above the President's request.

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 or modified form? If so, will it prove more successful than the 1982 version? Will the President renew his attempts to achieve further reductions in federal aid to 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 troubles and chronic high unemployment continue to overshadow federalism issues and fuel renewed federal 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, the 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.

De Facto New Federalism

SUMMARY AND HIGHLIGHTS

In the 1970s, a Congressional Budget Office report stated that, "If grants-in-aid are the engine that drive, the intergovernmental system, then the income tax is its fuel." In the years after the New Federalism initiative languished, a retrenchment in grant-in-aid funding was, in part, driving the intergovernmental system, and the deficit was the fuel. But there was another powerful engine with its own energy source. State and local governments were readily—if not always happily—reclaiming responsibilities from Washington, with a large measure of public support.

This article, and the one that follows, relate events during 1983—the year immediately succeeding the New Federalism negotiations, and the first year of the economic recovery. The next article will detail legislative developments during the year. This short article, written by former ACIR Executive Director S. Kenneth Howard, sets the stage for the growing recognition in most quarters that the course of American federalism had been permanently altered.

This article first appeared in the Winter 1984 issue of *Intergovernmental Perspective.*

* * * * *

Following as it did on the heels of the year that perhaps generated more debate and discussion about federalism than any since our founding, it is not surprising that 1983 appeared inert in changing how our federalism works. Indeed, President Reagan's proposals for his version of New Federalism barely saw the legislative light of day during 1983. This inaction, and a diminution in the standing of federalism as an issue on the national political agenda, misled some observers into concluding that a New Federalism is dead. To be sure, certain proposals are probably lifeless, but the basic underlying trends that are altering American federalism are still very much alive. In short, 1983 was a year of De Facto New Federalism.

A broad impetus toward decentralization has been perceived by many observers. Vermont Governor Richard Snelling contends that "federalism is not dead" because of a "fundamental yearning for 'doing your own thing,' though within the bounds of overriding morality and national purpose, which gave life to federalism 200 years ago and will again give it life today."

John Naisbitt considers the shift from centralization to decentralization one of his ten "megatrends," and he writes that, "Federalism and a new version of states' rights are reemerging in the daily newspaper." Columnist David Broder notes that, "More and more of the critical decisions in our domestic government are being made in state capitols." On all sides we find state and local leaders emerging as a new class of governmental entrepreneurs, taking the lead in spurring economic development, in containing health care costs, in rebuilding public facilities, and in improving education.

Abetting these broad movements is one specific force that is encouraging decentralization: stringency in the federal budget. Since the Great Depression, attention for addressing the nation's domestic ills increasingly focused on Washington. Now, few new domestic initiatives emanate from the national government, as demographic factors, defense buildups, deficits, and a recession all combine to reduce resources available for new or expanded domestic activities. Federal aid remained about static in 1983 when inflation is taken into account. Federal aid continued to decline as a percentage of state and local budgets and in relation to total federal spending. It fell to state and local governments to raise taxes, to cut services, or to do both so that revenues would match expenditures. As ACIR Assistant Director John Shannon has noted, the national government could no longer "be counted on to bail states out of the recessionary tides."

The deficit, and efforts to reduce it, are generating significant changes. The 1983 deficit of $195 billion exceeds by $24 billion all state tax collections combined for that same year. Having never been in this exact situation before, we cannot be sure as a nation what qualitative changes a quantitatively growing deficit may generate.

With mounting deficits have come a host of proposals for reducing federal expenditures. Cost-saving measures were proposed by the Grace Commission last year, and the administration and Congress will continue to grapple with these and other recommendations to cut federal spending.

At the same time, the deficit has spurred a host of revenue raising proposals, ranging from simple tax hikes, repealing or modifying indexation and closing "loopholes" to sweeping tax reforms or new federal taxes. The challenge lies in reconciling the national government's need for lower deficits with the necessity that all partners be strong to have a viable federalism. Almost every proposed change in the federal revenue system would affect, in varying degrees, the abilities of states and localities to raise revenues and finance public services. State and local governments are shouldering increased responsibilities, and their concerns for revenue adequacy, tax fairness and fiscal flexibility should not be ignored in deliberations over the deficit.

The ebb and flow continues as our federalism is shaped in new ways. A rebalancing is occurring, but it is being done without any formal "sorting out" of governmental roles and responsibilities. The national government's attention is increasingly riveted on matters that are indisputably national in scope. Meanwhile, state and local governments did what it took to survive the recession and have sharpened their own priorities, in the process sometimes restoring federal grant reductions they deemed most hurtful. These governments have emerged from this experience a little leaner and, surely, different. As the same wringing out occurs in the national government, American federalism "it is a-changing," whether reflected in theory and statutes or not.

Federalism in 1983: Mixed Results from Washington

SUMMARY AND HIGHLIGHTS

Perhaps federalism issues in 1983 can best be summarized by noting that there were no highlights. Because the President's New Federalism legislation had been shelved in Congress, intergovernmental debate was, for the most part, subordinated to the hand-to-hand combat over the entire budget. However, as this article relates, numerous decisions on the overall budget had significant intergovernmental import. Of particular note, a three-year reauthorization of General Revenue Sharing for local governments was passed—for the last time, as it turned out.

It must be kept in mind that, due to the 1982 recession, state and local governments entered 1983 in very bad fiscal shape. They were beginning to recover by year's end, but the full benefits of the economic expansion on state and local treasuries still lay ahead.

Indeed, the lingering effects of the recession had significant impact on public policy at all levels of government. An example related in this article was a $4.6 billion emergency jobs package passed by Congress, which was intended to create 400,000 public service and works jobs. Yet, in the ensuing months of the recovery, it was not uncommon for the economy to create 400,000 jobs a month. But while the national economy brightened considerably, Washington's financial situation did not—which is the subject of the next article in this volume.

This article, written by ACIR Assistant Director David B. Walker and Senior Analyst Cynthia Cates Colella, first appeared in the Winter 1984 issue of *Intergovernmental Perspective.*

*   *   *   *   *

In 1983, it became apparent that the Reagan administration's historic "Big Swap" proposal of 1982 had failed to achieve consensus. As promised, the President proposed legislation for a New Federalism early in the first session of the 98th Congress. Noticeably lacking, however, was the major trade-off of welfare and health care responsibilities contained in the original plan and much debated among governors, state legislators, local leaders, and administration officials the previous year.

"I think it was a strategic error to put the federalism initiative on the table at the same time we were trying to get cuts out of a budget that had already suffered," Richard Williamson, former assistant to the President for Intergovernmental Affairs, told the *Washington Post* last year. "It poisoned the well for the federalism discussion because the mayors and governors were so concerned they were going to be left holding the bag with a recession coming on."

The biggest federalism story, then, in 1983 was the nonstory of action on New Federalism initiatives. The President's proposal generated little enthusiasm on Capitol Hill where, in the words of one senator, it was viewed as an "idea whose time had not come."

Although the New Federalism was placed on the legislative back burner in 1983 and the spotlight on federalism dimmed considerably, significant national actions affecting intergovernmental relations did occur. In some cases they assumed the form of executive circulars and orders, often little heralded but nonetheless important in shaping the course of domestic governance. Moreover, Congress passed and the President signed legislation of critical importance to states and localities.

This article will probe major intergovernmental developments as they emanated from Washington during 1983. Together, they suggest that the national government's role in the federal system remains significant, but probably will not expand unless and until other overarching issues are resolved.

FEDERALISM INITIATIVES 1983

In his January 25, 1983, State of the Union Message, the President indicated he would be sending to Congress a comprehensive federalism proposal that would "continue [the administration's] efforts to restore to state and local governments their roles as dynamic laboratories of change in a creative society." The legislative proposal as transmitted would consolidate 34 programs into four mega-block grants, costing about $21 billion.

In his transmittal letter to Congress, President Reagan emphasized that controversial aspects of prior proposals had been dropped and that the new mega-block grants were not intended to be "a vehicle for budgetary savings."

The President's proposals were introduced as legislation and referred to three committees in the Senate and six in the House. The congressional response was limited to hearings conducted in March by the Joint Economic Committee. Gov. Richard Snelling (VT), the National Governors' Association's lead governor on federalism, summed up the NGA's view:

The President has kept federalism reform before us through his recent proposal for four new megagrants. Such grants must be carefully considered, but they do not in themselves, without vesting broad operational authority in the states, constitute federalism reform. In this connection, I am disappointed that the President has decided not to submit his landmark proposal for the federalization of Medicaid, though I do recognize the difficult issues involved.

Snelling reiterated NGA's call for a national income security policy, with a larger federal role, as the centerpiece for federalism reform. In testimony before the same JEC hearings, local officials also expressed their concerns. Mayor George Latimer of St. Paul, MN, said the proposals were "misdirected" and did not address "the needs of thousands of St. Paul's poor and near-poor."

Without strong state and local support, major restructuring through the mega-blocks was quietly dropped from the legislative agenda. Attention quickly shifted to pressing budgetary concerns and the need to authorize or reauthorize other pieces of intergovernmental legislation.

The Legislative Agenda

To those who viewed 1983 as a series of budget battles, political posturing, veto threats, and fragmentation, a picture of disarray emerges. To those who look carefully at legislative results, however, a surprising degree of consensus is apparent. At the same time, the picture remains unfinished, and the second session of this Congress has a full platter of pressing business to tackle.

Without a doubt, intergovernmental legislation and issues were a sideshow—albeit an important one—to larger budgetary and international concerns. In light of real and mounting pressures on the federal fisc, Congress failed to enact major new spending programs for education, infrastructure, and industrial revitalization. Yet, Congress also rejected most further cuts in domestic programs, maintaining its commitment to the majority and even modestly increasing funds for a few.

The Record

In sharp contrast to recent years, 10 of the regular 13 appropriations bills were enacted during 1983. In all, about $1.2 billion were appropriated over the President's initial budget request. Although a relatively modest difference, the gap between administration request and congressional response was significant in certain areas. The defense appropriations bill called for only a 4 percent real dollar increase compared to the 10 percent called for by the President. Moreover, aggregate dollar figures mask significant shifts that did occur among functional categories of aid.

However, Congress did honor fully or approximate closely the President's request for certain other programs, including unemployment insurance operations, the new *Job Training Partnership Act of 1982* (JTPA), and four block grants: preventive health; community development; special programs for the disadvantaged; and alcohol, drug abuse, and mental health (ADAMHA).

The aggregate fiscal effects of these various actions was to authorize intergovernmental grant outlays that are 4 percent higher than those for FY 1983 and 8 percent over FY 1982. Yet when inflation is factored in, the growth in federal aid over these three years turns out to be static, with the estimated FY 1984 figure ($98.7 billion) actually falling slightly below the level for FY 1982.

In terms of specific programs, supplemental assistance for the unemployed was extended 18 months, health planning funds were renewed, JTPA got advanced funding, the wastewater treatment plants program received continued budget authority, and the vocational rehabilitation program was extended. Even more significant was the passage of three major authorization measures: the emergency jobs package, General Revenue Sharing, and the omnibus housing bill.

Congress overwhelmingly approved a $4.6 billion emergency jobs package in March as part of a $15.6 billion supplemental appropriations bill for FY 1983. The compromise legislation was rushed through Congress as a response to the very high unemployment figures that prevailed during the winter months.

The emergency measure increased funds for a wide assortment of existing aid and loan programs, including 6 in the transportation area; 4 in housing and urban development; 7 in parks, recreation, and Indian affairs; 8 in rural development and conservation; 3 in energy and water development; and 18 in employment and human services. Some of the funds were allotted to direct federal undertakings such as repairing federal buildings, but most were channeled into intergovernmental grant and loan programs.

Two-thirds of the total was slated for public works jobs, with the remainder going to social services, health, and other humanitarian purposes. All told, three quarters of the $4.6 billion was expected to generate public service and works jobs. Backers of the measure claimed it would create 400,000 full-time jobs. By late fall, however, only a small proportion of the estimated jobs had been produced.

General Revenue Sharing was finally passed late in the session, reflecting significant differences between the House and Senate that required resolution. Under threat of a Presidential veto if funding were increased, a simple three-year extension of the current $4.6 billion program was finally adopted. Major program changes included modified audit requirements: local jurisdictions receiving less than $25,000 annually will be exempted; those receiving from $25,000 to $100,000 will be audited once every three years (as the earlier legislation required for all recipients); and those receiving more than $100,000 will be audited annually. A study was mandated of federal-state-local fiscal relationships, including alternative GRS allocation formulas and means of returning revenue sources. Finally, the states were formally dropped from the program.

During the final hours of the first session, Congress broke a five-month impasse and enacted a $15.6 billion omnibus housing and community development authorization, attaching it as a rider to the President's International Monetary Fund (IMF) bill. Although many provisions of the multi-faceted measure had been opposed by the administration, its forced marriage to the IMF bill obviated a veto.

Of major importance were the extensions of both the community development block grant (CDBG) and the urban development action grant (UDAG), the first at $3.468 billion annually through FY 1986 (slightly larger than the FY 1983 figure) and the second at $440 million annually. Fifty-one percent of CDBG funds were restricted to benefit low- and moderate-income persons, settling an earlier dispute on this matter between HUD and the authorizing House Committee. The same constraint applies to the now largely state-run small cities CDBG program. In addition, for the small cities program, beginning in FY 1984 the states must include in their "fiscal statements" a description of how the funds made available since FY 1982 were used and an evaluation of the relationship between such uses and the program's statutory goals.

Unfinished Business

Alongside this record of accomplishment stands a lengthy list of deadlocked, delayed, or "deep frozen" measures of intergovernmental interests. The President's urban enterprise zones and criminal justice assistance programs were among these, as well as revisions in the *Clean Air* and *Clean Water Acts*, a new authorization for the health planning program, extension of the *Resource Conservation and Recovery Act* (Hazardous Wastes), natural gas pricing, immigration reform, disaster relief, reauthorization of the marine sanctuaries legislation, cable TV deregulation, and municipal antitrust liability. This listing does not include pending proposals for upgrading public education; repairing, replacing, or expanding public capital facilities; repairing, replacing, or expanding public capital facilities; new health care cost containment measures; industrial policy alternatives; and a host of other items in the legislative hopper.

THE DEREGULATORY DRIVE

Vice President Bush's Task Force on Regulatory Relief went out of business in 1983, but the Reagan administration continued its deregulatory drive through other means. Chief among these other approaches were a firm federal "hands off" when administering block grants (within the latitude permitted by law); delegation to the states of certain watchdog functions, also when allowed by statute; and decentralizing responsibilities through executive orders and administrative circulars.

To date, the administration's deregulatory thrusts have been partially successful in devolving authority back to the states and in cutting administrative burdens. What is still lacking is a comprehensive approach to intergovernmental regulatory reform. Omnibus reform legislation—including measures that were intergovernmental in nature—received scant attention in Congress last year. To paraphrase Sherlock Holmes, regulatory relief legislation was "the dog that did not bark in the night," a clue that meaningful reassessment of the regulatory process is difficult to accomplish, especially when popular social and environmental programs are involved. Congress may choose to revisit the regulatory reform issue in 1984, and may begin to tackle the complicated and controversial problem of simplifying national standards without sacrificing national goals. In 1983, regulatory reform remained part of Congress' unfinished agenda, and the major stories emanated from the executive branch.

The Block Grants

The administration continued, to the extent permitted by law, a "hands off" federal position in administering the nine block grants enacted in 1981. As a result, some federal, and even state, officials expressed frustration in trying to maintain oversight over the block grant monies. Representative Ted Weiss (NY), chairman of the House Subcommittee on Intergovernmental Relations and Human Resources, stated during congressional oversight hearings, "Congress never really passed intelligent judgment on block grants" approved in 1981. Because congressional intent remains unclear, some uneasiness in administering the consolidated programs prevailed in 1983—a sense of unease that probably will continue until the first audits of state programs pass muster and states become convinced that the federal government will not intervene in determining program activities and goals.

In the case of the newest block grant, the *Job Training Partnership Act of 1982*, which became operational in October 1983, signs of tension have emerged already. Most controversy to date has revolved around designating service delivery areas, funds for administering the new program, and the composition of private industry councils. In New Hampshire, for example, counties appealed to the Secretary of Labor when the state failed to recognize certain counties as service delivery areas qualified to administer the job training program. When the Secretary rejected their appeal, the counties petitioned the First Circuit Court of Appeals in Boston.

In spite of certain problems in a few states, overall administration of existing block grants and implementation of the new block grant appeared to be proceeding smoothly. In some areas, as noted, Congress has begun to tighten up requirements and to express frustration due to incomplete reporting requirements. The ultimate arbiters may well turn out to be auditors, with recourse to the courts if funds are deemed misspent.

Regulatory Delegation to the States

Another administration effort in the devolution area is to turn over more responsibility for regulatory administration to states. Delegation of this kind is possible under what are sometimes termed "partial preemption" statutes, which are especially common in the environmental areas. Such laws allow states to carry out administrative tasks if they establish programs that meet federal specifications. Otherwise, regulations are enforced by a federal agency.

Formal delegations of this sort accelerated at an unprecedented pace during the first 24 months of the Reagan administration, according to an Urban Institute analysis. For example, the study found that 27 of the 37 delegations for managing hazardous waste control efforts were completed during this period. This pattern of rapid activity continued throughout 1983, with an additional eight states receiving interim authorizations. Twenty-five states also have "achieved primacy" for operating strip mining control programs, nearly all of them during the Reagan years. Most of the states that have surface mining within their borders were participating a year ago, hence no additional states were added to the list during 1983.

At the same time, there has been little or no change in some of the older regulatory programs. No new states have assumed responsibility for Occupational Safety and Health Administration operations since 1978. Thirty-six states now issue permits for discharging effluents into a waterway under the *Federal Water Pollution Control Act*, but only one additional state was added during 1983.

PORTENTS AND PROSPECTS

The national government dealt with some intergovernmental initiatives in 1983, delayed others, and may have defeated permanently still others.

In 1983 as in other years, both the Congress and the Presidency engaged in posturing, politics, and polemics. Yet, significant enactments did occur. The record of achievement generally suggests a return to an incremental approach to intergovernmental relations. Major federalism reform initiatives were rejected. And federal aid will flow at about the same rate that it has for the past several years. The proportion of aid dollars channeled through General Revenue Sharing and block grant conduits will be about the same (approximately 20 percent) as it was in 1980. There is less "bypassing" of state governments than in 1980, but the renewal of GRS, UDAG, and the entitlement portion of CDBG, plus the passage of the new housing assistance program, all assure continuance of a strong direct federal-to-local linkage. Congress, not unexpectedly, began to impose added conditions on a few of the new block grants, even as the administration sought to devolve greater discretion to recipient governments. Neither branch came to grips with amending the statutory bases of regulatory federalism.

This summary might suggest that few nationally initiated changes have occurred in the federal system. But this is not the case. The changing nature of the national debate was significant. Mounting interest payments on the national debt, the fiscal crisis confronting Medicare, the long-term solvency of Social Security, the condition of the federal pension system, increased expenditures for defense, and international tensions overshadowed other issues. Moreover, all these matters are fully federal responsibilities, and all will require national, not intergovernmental, action.

In short, a real, but unplanned, "sorting out" of government functions appears to be taking place. This rearrangement is being done largely because of fiscal duress on the federal side, without serious consideration being given to what level of government is best suited to conduct which functions. The Reagan administration's New Federalism was a bold attempt to raise this consideration, but it, too, quickly became enmeshed in a debate over dollars. Charles Kurfess, former Speaker and Minority Leader of the Ohio House of Representatives, stated at an ACIR hearing held in September 1983:

> Proposals for realignments of government functions have usually been based upon the cost of those functions and where the money should be coming from. . . . I would suggest that we look at not just what level is best equipped to raise the funds but also at what level is best equipped to effectively administer the function in question.

It is now nearly 200 years since the federal system was constitutionally created and our bicentennial celebration could—and should—include a serious national debate on the shape of the system of shared but separate powers created among the three levels of government. Even Madison might smile at the thought.

1984—
Not a Good Fiscal Year for Big Brother

SUMMARY AND HIGHLIGHTS

By 1984, the realization had arrived that the days of a fiscally omnipotent federal government, proliferating elaborate new grant-in-aid programs which could effectively establish priorities for state and local governments, were over.

In hindsight, this occurrence was almost predictable. But considering the commentary and prognostications of just a few years earlier, this development was startling. From the New Deal on, and particularly after World War II, a growing dominance of the federal government over the states had seemed to become the natural order. The fact that by the 1980s states and localities were the centers of creativity and innovation was "a world turned upside down."

This article relates the changes in assumptions and conditions within the body politic that caused this reversal. It also discusses the flaws in the federal income tax which, to a significant extent, led to a major income tax reform package two years later.

The article was written by former ACIR Executive Director John Shannon, and first appeared in the Winter 1985 issue of *Intergovernmental Perspective*.

* * * * *

Shortly after the end of World War II, George Orwell painted a bleak future for modern democracy: he warned that by 1984 the central government ("Big Brother") could become all powerful and individual freedom a thing of the past.

In far less gloomy terms, students of American federalism also made their predictions after World War II. Many agreed with the assessment that the states were the "fallen arches" of our federal structure; they also viewed the centralization of power in Washington as inevitable if not desirable.

When attempting to ascertain where we are going, looking back over the shoulder often proves more instructive than simply speculating about the shape of things to come. In this article, therefore, Orwell's year 1984 becomes the high vantage ground from which to look back over the great changes of the last three decades so as better to judge both the course of fiscal federalism and the prescience of yesterday's forecasters.

FEDERAL AID: THE SLOW RETREAT

1984 marked Year Six for De Facto New Federalism: a fiscal decentralization process slowly nudged along by growing fiscal stringency at the federal level and given added impetus by the strong public support for the Reagan administration's conservative and decentralist philosophy. Because federal aid continued to grow more slowly in 1984 than did state and local own-source revenue, aid from Washington dropped for the sixth straight year as a percentage of state-local expenditures.

This new brand of austere federalism (creeping fiscal decentralization) can best be understood by comparing it to the old brand of affluent federalism which began at the end of the Korean War and ended in 1978, the year of the Russian invasion of Afghanistan and the California taxpayer revolt.

—Old federalism was characterized by steadily growing state-local dependence on federal aid as the nation increasingly looked to Washington to set the domestic agenda. New federalism is marked by steadily decreasing state-local reliance on federal aid dollars as the country expects localities and the states to finance from their own funds an increasing share of their expenditure needs.

—Old federalism was intrusive in character: a steadily growing number of federal aid "strings" and conditions were designed to alter state and local budgetary priorities and to race state and local fiscal engines. New federalism is becoming partially extrusive in character: the federal government is pulling aid funds and tax resources from state and local governments to strengthen the financing of its own national programs without a commensurate rollback in federal court orders and congressional mandates.

—Old federalism represented a steady advance of the national government into areas that had heretofore been the exclusive province of state and local governments. New federalism represents a slow retreat from national government positions staked out during the Great Society era.

—Old federalism called on Washington to provide extra aid to stabilize state and local finances during periods of economic recession. New federalism calls on the states to help themselves by setting up "rainy day" funds to cushion their finances from the shock of economic downturns.

—Old federalism flourished in a political environment that resolved the doubts in favor of social equity concerns, national defense containment, and domestic public sector growth. New federalism operates in a political environment that emphasizes economic efficiency concerns, national defense expansion, and domestic public sector containment.

This gradual decentralization process is not the orderly and swift sorting-out process for which reformers yearn. Nor does it resemble the program swap and tax turnback proposals the Reagan administration advanced in 1982 for achieving a more orderly and decentralized allocation of responsibilities between the national government and the 50 state-local systems.

Nevertheless, De Facto New Fiscal Federalism is slowly effecting a "sorting out" of sorts. Federal policymakers are being forced by fiscal and political realities to allocate an increasing share of their resources for strictly national government programs: defense, Social Security, Medicare, and interest on a $1.5 trillion debt.

The decisive 1984 reelection victory of President Reagan—a candidate pledged to cutting budget deficits by cutting expenditures, not raising taxes—holds promise of both speeding up this sorting-out process and hurrying fiscal decentralization along.

FEDERAL FISCAL CRISIS

Events in 1984 sharply underscored the fact that the national government is afflicted with two serious fiscal ailments: growing budget deficits and a badly flawed income tax.

Massive Budget Deficits

There is an iron law that governs the federal budget process: it takes a searing crisis to generate the consensus needed for federal policymakers to take unpopular actions such as making cuts in programs with strong constituencies or enacting major tax hikes. Absent a full-blown crisis, federal officials avoid making these hard budget choices by papering over the budget gap with deficit financing when receipts fall short of steadily rising expenditure demands. Unlike their state and local counterparts, federal officials are not disciplined by a balanced budget mandate.

In a semi-crisis situation, federal authorities can enact modest "revenue enhancements" and slow down the growth of those programs with relatively weak political constituencies. Many of the federal aid programs to states and localities fall into this weak political constituency classification. As a result, federal aid is the first major component of the budget to feel the fiscal squeeze—an early warning signal to the constituencies of more popular federal expenditure programs that there may be budget trouble ahead.

From a budgetary standpoint, 1984 was another very bad year for the national government. For the fiscal year ending September 30, 1984, the budget deficit totaled $175 billion. Moreover, in December 1984, the Director of OMB, David Stockman, revealed that the estimate for the 1985 budget deficit had been revised upward to $200 billion—an amount slightly larger than total 1984 tax collections for all 50 state governments combined.

The national government has spent more than it has raised in taxes in 23 of the last 24 years, but the size of the annual deficit has become progressively greater over the last three decades. In the late 1950s, annual federal budget deficits averaged about 3 percent of total federal expenditures; by the 1980s, the average had climbed to 17 percent of total federal outlays.

When it comes to deficits, quantitative changes can have qualitative effects. For years, growing federal budget deficits have attracted remarkably little public attention; but now they have reached such massive proportions that they can no longer be ignored. In fact, the size of the federal budget deficit has become the nation's number one economic problem—if not for the immediate present, then for its threat to our future. The menacing character of this budget deficit was clearly acknowledged in President Reagan's January 1984 budget message:

All signs point to continued economic growth, vigorous investment and rising productivity without renewed inflation—all but one. Only the threat of indefinitely prolonged high budget deficits threatens the continuation of sustained noninflationary growth and prosperity; it raises the specter of sharply higher interest rates, choked-off investment, renewed recession and rising unemployment.

In December 1984, the Reagan administration unveiled a deficit reduction package designed to cut back the growth in federal spending by $237 billion during the 1986 through 1988 period. If enacted, this deficit reduction plan—consisting of spending freezes, cutbacks, and program wipe-outs—would adversely affect virtually every major beneficiary of federal domestic spending, including state and local governments.

Prior to this proposed deficit reduction package, federal grants to states and localities were projected to rise from $104 billion in 1985 to $117 billion by 1987. According to a preliminary estimate by the National Association of State Budget Officers, the adoption of the December proposals would cause federal grants to fall to $95 billion by 1987. Thus, the pattern of slow federal aid growth would be replaced by slow actual decline. The most drastic proposal in this package called for eliminating the $4.5 billion annual federal Revenue Sharing program for local governments in 1987.

Flawed Federal Income Tax

The year 1984 provided powerful new support for the proposition that the national government's primary revenue instrument, the income tax, was deeply flawed and in need of a major overhaul. In November, the Treasury Department report to the President succinctly set forth the indictment against the income tax:

> The present U.S. tax system desperately needs simplification and reform. It is too complicated, it is unfair, and it retards savings, investment, and economic growth. Under the current progressive tax system, all taxpayers face higher marginal tax rates in order to make up the revenue lost by numerous special preferences, exceptions, and tax shelters used by a relatively small number of taxpayers. As a result, the tax system is complex and inequitable. It reduces economic incentives, hampers economic growth, and is perceived to be so unfair that taxpayer morale and voluntary compliance have been seriously undermined.

The findings of ACIR's 1984 annual public opinion poll corroborated this Treasury indictment of the federal income tax. For the sixth straight year, the federal income tax again received more votes than any other major tax when respondents were asked to select the worst tax.

The Treasury Department report went beyond indicting the present tax system to present a sweeping reform package to promote tax fairness, simplicity, and economic growth. The two most important recommendations on the individual income tax front were:

—Replacing 14 brackets of tax rates ranging from 11 to 50 percent with a simple three-bracket system with tax rates set at 15 percent, 25 percent, and 35 percent.

—Raising the personal exemption for all taxpayers and their dependents from $1,000 to $2,000.

To pay for this tax rate rollback and personal exemption increase, the Treasury proposed to decrease or repeal a large number of itemized deductions, exclusions, and special tax credits. Of special concern to state and local governments were the Treasury proposals that called for eliminating the itemized deduction for all state and local taxes and making taxable the interest on all new state and local bonds issued for "private purposes."

It is too early to assess with accuracy the legislative prospects for these tax reform proposals. On Capitol Hill they must contend with a harsh reality: the ease with which Washington lobbyists can throw sand into the gears of tax reform machinery.

STATE-LOCAL RESILIENCY

Events in 1984 also obscured a badly underrated virtue of contemporary federalism: the remarkable resiliency of state and local governments. Over the last decade, these jurisdictions absorbed in rapid order a series of powerful jolts: double-digit inflation, a taxpayers' revolt, two severe recessions, and a sustained slowdown in federal aid flows. Yet, as the 1984 fiscal year ended, most states and many localities were enjoying surplus funds, thereby giving them a measure of fiscal discretion that few observers would have predicted two years earlier. They could replenish badly depleted working balances, build "rainy day" funds, strengthen the financing of local schools and infrastructure projects, or grant tax relief.

The rapid 1983-84 economic recovery—a rising tide that carried up most revenue ships—stands out as one of the most obvious causes for the general strengthening of the state-local sector. The road to state-local fiscal recovery was paved, however, by the tough decisions necessary to balance budgets during the 1982 recession, the most severe economic downturn since the Great Depression. These unpopular actions called for expenditure belt-tightening; they also required numerous tax hikes that came hard on the heels of the tax revolt.

Public acceptance of repeated state-local tax increases is especially revealing. It proves that even in the post-Proposition 13 era, the public still accepts tax hikes when there is convincing evidence that expenditure programs have been pruned and that tax increases are necessary to maintain program standards. Public acceptance of tax increases can also be attributed to the fact that states and localities must operate in the disciplined environment of balanced budgets.

SUMMARY: A WORLD TURNED UPSIDE DOWN

If a student of American federalism had fallen into a deep sleep in late 1964 and reawakened—like Rip Van Winkle—in late 1984, he would quickly conclude that his world of fiscal federalism had turned upside down.

—In 1964, economists feared that large federal budget surpluses would soon create a major "fiscal drag" that would jeopardize the ongoing economic recovery. In 1984, economists feared that massive federal deficits would not only jeopardize the ongoing economic recovery but would soon plunge the nation into another major recession.

—In 1964, the Johnson administration's economists argued that the state and local governments lacked the revenue sources needed to meet their rapidly growing expenditure requirements. In 1984, Treasury economists (using a highly controversial current services approach) projected substantial state-local surpluses for the foreseeable future.

—In 1964, a federal task force (Heller-Pechman) urged the Congress to enact a federal revenue sharing program with the states, in part because the national government would soon have surplus funds to share. In 1984, the Reagan administration urged the Congress to put an end to the federal Revenue Sharing program because the national government now had only budget deficits to share.

—In 1964, the federal individual income tax was viewed as the revenue instrument of choice. In 1984, the federal income tax received more votes than any other major levy when the American public was asked, "Which is the worst tax, that is, the least fair?"

—In 1964, the federal government was held in high esteem. In 1984, the federal government placed third when respondents were asked, "From which level of government do you feel you get the most for your money—federal, state, or local?"

The modern day Rip Van Winkle will quickly discover that the year 1984 did not represent an abnormal blip on federalism's big trend screen. The fiscal decentralization process that started in 1978 should continue to move along at a fairly good clip for several more years. It is a trend powered by growing fiscal austerity at the national government level and strong public support for President Reagan's conservative policies.

Fortunately for our intergovernmental system, state and local officials have demonstrated an outstanding ability to adjust quickly to great changes—cyclical changes in the economy, fiscal changes in Washington, and preference changes in the body politic.

Historical Postscript

The English historian Thomas Carlyle described the unitary government of France on the eve of the Revolution as a regime suffering from apoplexy at the center and paralysis at the extremities. A future historian of American federalism might well conclude that on the eve of the great federal budget battle our intergovernmental system was marked by growing fiscal distress at the center and remarkable fiscal resiliency at the extremities.

This verdict serves as a most telling argument in favor of a federal system. To put the issue more bluntly, this verdict vindicates the wisdom of the American experience—that of not placing all of our policy eggs in Big Brother's fiscal basket.

Whatever Happened to Federalism? Intergovernmental Issues Upstaged in 1984

SUMMARY AND HIGHLIGHTS

Unlike the presidential election of 1980, federalism received little attention during the 1984 election, which was perhaps a precursor to the fading of federalism concerns during the second Reagan administration. To be sure, important intergovernmental issues were addressed (e.g., welfare reform), and the Domestic Policy Council issued important thematic reports, but the 1984 election did not engender momentum for new broad-based federalism reform proposals.

Indeed, federalism inertia had set in well before election day. One striking example described in this article was the passage and signing of the 21-year-old drinking age bill, whereby federal highway funds would be withheld from those states which did not raise their drinking age to 21. This method of coercing the states into action—withholding programmatic funds in one issue area to influence state policy in another only marginally related area—was the exact device employed a decade earlier to force states to lower their speed limit to 55 MPH for fuel conservation purposes. That earlier action had been widely unpopular in many states, and the 1980 Republican platform had proposed repealing the law. Yet, President Reagan, after first maintaining that he would veto any national drinking age bill, then announced that he would sign one, and the Congress enacted legislation with amazing swiftness.

The episode was a prime illustration of federalism being subordinated in the heat of immediate concerns. In this case, the problem of drunk driving superseded the principle of state autonomy—and on a bipartisan basis. Furthermore, although public interest groups representing the states officially protested the action, many elected state officials quietly approved because the national legislation relieved them of a very thorny, no-win decision in their states.

Whether it was a cause for lament in some quarters, or rejoicing in other quarters, the title of this article accurately portrays the intergovernmental situation in 1984: "Whatever Happened to Federalism?" The article was written by former ACIR Research Fellow Susan Golonka, and first appeared in the Winter 1985 issue of *Intergovernmental Perspective.*

*　　*　　*　　*　　*

If the spotlight on federalism was dim in 1983, federalism lay in the shadows in 1984, upstaged by election year politics. Deficit reduction and the budget were the main issues that drove the agenda in 1984, leading Sen. Dave Durenberger (R-MN) to complain, "All we do is play the money game. We're not dealing with peace in the world, with feeding the hungry. We just sit around and play the numbers."

The Republican platform called for the return of "nonessential federal functions" to the states, but neither it nor the Democratic platform proposed comprehensive schemes to define or alter roles and responsibilities among national, state, and local governments. Despite this, a federalism agenda, although not recognized, was implicit. Democratic proposals to address a menu of domestic issues generally involved state and local governments. While President Reagan's New Federalism initiative was mentioned only once, the Republican platform advocated block grants and a reduced national role in welfare and education, and its position on federal courts carried important implications for federalism. The issue of federalism reform may galvanize few voters, but recommendations for budget cuts, tax reform, deregulation, private partnerships, and likely judicial appointments all portend changes in the federal system.

Although attention to federalism issues paled in comparison to the previous years of the Reagan administration, a scattering of events significant to the federal system did occur at the national level. With support from the President, Congress passed a municipal antitrust bill, relieving cities and counties of the threat of treble damages under federal antitrust laws. At the same time, both Congress and the President supported measures which would constrict state and local authority in a wide range of areas and in some cases impose new costs. For example, legislation enacted in 1984 set new restrictions on state and local issuance of industrial development bonds, established penalties for states that fail to set a minimum drinking age of 21, preempted local regulation of cable TV, and mandated expanded state Medicaid coverage. One would be hard pressed, however, to find a pattern linking these decisions.

In short, intergovernmental developments in 1984 lacked a coherent or unifying theme. Talk of states' rights and a reduced federal role was juxtaposed with preemptory and regulatory activities. The hotly contested debates in previous years over swaps, turnbacks, and broad intergovernmental reform were narrowly focused in 1984 on discrete, usually unrelated, issues. This article explores major intergovernmental events in Washington during the past year, and considers the issues and opportunities ahead.

EXECUTIVE BRANCH DEVELOPMENTS

Initiatives from the White House

Noticeably missing from President Reagan's 1984 State of the Union Address was any mention of New Federalism, sorting out functions, or block grants. After failing to gain significant support for his New Federalism initiative in 1982 and the four megablock grants he proposed in 1983, the President appeared reluctant to advance major new intergovernmental changes. Nevertheless, the President's FY 1985 budget message included several modest proposals to "improve the management of intergovernmental assistance through new block grants, the consolidation of restrictive categorical programs, and the elimination of unnecessary regulatory constraints." The President proposed a new science and mathematics education "block grant" to train teachers, consolidating programs for older Americans, consolidating child nutrition programs, and expanding the existing primary health care block grant to include black lung clinics, migrant health, and family planning programs. In response, Congress passed a science and mathematics education bill but gave scant consideration to the remaining recommendations.

On the tax side, the President proposed new restrictions on tax-exempt private purpose bonds and continued to press for enterprise zone legislation that would provide tax incentives for investment in economically distressed areas. The Senate approved enterprise zones as part of the deficit reduction package, but the plan was dropped during the House-Senate conference. State and local public interest groups, fearful that enterprise zones would be substituted for existing economic development programs, gave only limited support. The President's proposals to place state-by-state volume caps on industrial development bonds and to limit the volume of bonds issued for any one user were adopted by Congress in the *Deficit Reduction Act of 1984*.

Federalism Draws the Short Straw

Two instances in 1984 showed the President opting for national authority at the expense of states: a nationwide minimum drinking age and proposed federal preemption of product liability. Additionally, the President, discounting strong objection from some states, opposed amendments to the *Coastal Zone Management Act* relating to federal off-shore oil and gas leasing policies and procedures.

Drinking age: Last year, the President reversed his earlier position and endorsed legislation aimed at compelling states to raise the minimum drinking age to 21. The legislation utilizes a "crossover sanction" to accomplish its objective: Any state that does not adopt a minimum drinking age of 21 within two years would face a 5 percent reduction in its federal highway construction money in 1986 and a 10 percent reduction in 1987. Initially, the President had been reluctant to support such an approach, preferring to continue an existing program of incentives to induce the remaining 27 states to raise their drinking age. Moreover, legislative authority in this area seemed firmly fixed within the sphere of state responsibilities—a tradition reaffirmed by the wording of the 21st Amendment (repeal of prohibition). However, under pressure from members of Congress, Transportation Secretary Elizabeth Dole, and strong grassroots lobbying efforts led by Mothers Against Drunk Driving, the President endorsed the legislation, which was then quickly passed. "The problem is bigger than the states," he proclaimed at the signing ceremony. "With the problem so clear-cut and the proven solution at hand, we have no misgivings about this judicious use of federal power." State officials are not quite so sanguine, resenting use of the crossover sanction and intrusion into an area they had previously regulated. South Dakota, challenging the measure, has filed a lawsuit against Secretary Dole.

Product liability: Despite some opposition from within the administration, the President continued to support national product liability legislation. The bill, S. 44, introduced by Sen. Robert Kasten (R-WI), would preempt state product liability laws but require state courts to try liability cases and interpret the federal law. State officials opposed the bill intensely:

The healthy diversity of state products liability law would be eliminated by S. 44. The capacity for common law growth necessary to adapt to changing local conditions would be cut off. State legislative experimentation would be precluded. No truly compelling national objective would be achieved. The sweeping preemption of state tort law in both versions of S. 44 can only be characterized as radical and unjustified.[1]

Despite these objections, the President concluded: "As for product liability reform, my administration's support is based on the fact that product liability law as it has developed today has become a significant burden on the free flow of goods in interstate commerce." Although the bill did not reach the Senate floor, the measure is expected to receive a big push in 1985.

Offshore leasing: Last year, the conflict between the expansion of domestic energy sources and states' environmental and economic interests was heightened by the Supreme Court's ruling in *Secretary of Interior v. California*. The federal-state conflict arose in 1981 when former Interior Secretary James Watt proposed leasing the outer continental shelf (OCS) for oil and gas exploration and recovery over a five-year period. In response, several states attempted to hold up OCS development by bringing lawsuits against the national government. In the California case, the court ruled that the Coastal Zone Management Act (CZMA) did not require the national government's offshore oil and gas leasing activities to be consistent with the coastal zone management plans of affected states. The court decision limited the consistency requirement of the CZMA to the actual drilling and production and not the leasing. Although some studies have concluded that state economic interests are often met under existing law, states with active coastal recreation and fishing industries which are particularly concerned about the court decision and the environmental consequences of the administration's leasing policies, sought changes to the act.

LEGISLATIVE EVENTS

Intergovernmental Funding

Congress authorized and funded several new grant programs last year, and, overall, federal aid continued to increase modestly. In FY 1984, federal grant-in-aid outlays to state and local governments were $97.6 billion, compared to $93 billion in FY 1983, an increase of 5 percent. With inflation running at 4 percent in FY 1984, this "real" growth amounted to 1 percent. As a result of the appropriations and budget activity last year, budget outlays in FY 1985 for grants-in-aid are estimated to be $107 billion, an increase of 10 percent from FY 1984. If inflation is maintained at 4 percent, as projected throughout FY 1985, a real increase of 5 to 6 percent would occur. So, in spite of deficit worries, Congress has yet to repeat its actions of 1981 when it actually reduced aid to state and local governments.

In FY 1985, health and income security programs, which receive the largest portion of federal grant-in-aid dollars, are expected to increase by 13 percent and 3 percent, respectively. Sizable increases of about 20 percent are expected in the functional categories of agriculture and transportation.

Specific intergovernmental programs that received increased appropriations for FY 1985 included the hazardous waste Superfund, the Maternal and Child Health block grant, compensatory education, impact aid, the state education block grant, and comprehensive emergency planning. General Revenue Sharing and most employment training programs received funding at their 1984 levels. Contract authority for highway programs remained fairly constant. However, because Congress failed to enact the interstate cost estimate for the second year in a row, states will be unable to use the more than $7 billion in funds authorized for FY 1984 and FY 1985 for interstate construction and interstate highway transfers.

Housing programs: In the Department of Housing and Urban Development (HUD) appropriations bill, Congress provided funding for the first new housing initiatives in four years. Congress appropriated $615 million for the FY 1984 and FY 1985 Housing Development Grants (HoDAGs) and the Rental Rehabilitation Program, which were authorized in the *Housing and Urban-Rural Recovery Act of 1983*. In October, HUD made the first HoDAG awards totaling more than $288 million for 141 projects which will result in an estimated 14,500 new or rehabilitated rental housing units in areas of substantial need. Cities and counties receiving the awards can use them for grants, loans, interest reduction payments, or other forms of assistance to private developers. In return, developers must reserve at least 20 percent of the units for lower income families.

The rental rehabilitation program provides grants on a formula basis to cities with populations over 50,000 and urban counties and states to assist in financing moderate rehabilitation of privately owned housing and commercial rental property. Last year, after HUD received the appropriation, it disbursed

[1]Testimony of State Rep. Jeffrey Teitz (RI) on behalf of the National Conference of State Legislatures. U.S. Congress, Senate, Committee on Commerce, Product Liability Act, Hearing Before the Subcommittee on the Consumer, 98th Cong. 2nd Session, March 5, 1984, pp. 419-20.

funds to nearly 400 cities and counties. Despite a few exceptions, such as the new housing appropriations, states and localities must necessarily and increasingly rely on their own revenue sources for any new spending initiatives.

Even if federal officials for domestic programs did attempt to reverse course and return to the "good old days," the federal deficits would cut them off at the pocketbook. Unless federal taxes are raised well above the level necessary to close the budget gap, which seems unlikely, the federal government does not have the fiscal flexibility to reverse the flow of influence and responsibility to the states. Moreover, the deficit reduction package enacted last year demonstrated that indirect forms of federal aid, such as the tax exemption on private purpose industrial development bonds, will receive increasing congressional scrutiny.

Deficit Reduction Act (DEFRA)

In mid-1984, Congress responded to public outcry over the growing deficit by approving a package of tax increases and spending cuts which is expected to result in a $63 billion "down payment" on the deficit by FY 1988. DEFRA makes numerous changes in current laws to achieve a $50 billion increase in federal revenues and a $13 billion cut in spending. Increased revenues will result from closing and postponing a wide range of tax shelters and loopholes; retaining or increasing some consumer taxes; and cutting back deductions for real estate depreciation. The Medicare program, bearing the brunt of the spending cuts, will experience a $7.6 billion reduction between FY 1985 and FY 1988.

Spurred by strong state lobbying, House conferees on DEFRA refused to accept a Senate provision that would have reduced federal contributions to Medicaid by 3 percent annually over the next three years. The defeat of this cut, which would have increased state Medicaid costs by $1.3 billion, was considered a major victory by interest groups. The bill does impose restriction on tax-exempt private purpose bonds and changes the tax treatment of municipal sale-leasebacks and contracts. The act also imposes additional state and local costs through mandated changes in AFDC and Medicaid.

Controversy boiled throughout 1984 over the tax exempt status of private-purpose industrial development bonds (IDBs). Congress looks askance at the revenues lost due to the exemption, and at bonds issued in small amounts for private enterprises that do not serve a public purpose. In the *Tax Equity and Responsibility Act of 1982* (TEFRA), Congress enacted a number of reforms designed to increase public accountability and limit the commercial use of IDBs. The TEFRA reforms, however, did little to reduce the total volume of IDBs issued; federal revenue losses from all tax-exempt private-purpose bonds were estimated at more than $10 billion in 1984. In DEFRA, Congress enacted additional IDB reforms. To check the growth of IDBs, prohibit their use for some purposes, and increase federal revenues by $400 million, Congress took major steps. The act sets a $150 per capita or $200 million per state annual volume cap (whichever is greater) on issuing tax exempt industrial development bonds. This restriction applies to bonds for student loans, pollution control, private health care facilities, and agriculture, and small-issue IDBs, including those for projects in economically distressed areas. It exempts IDBs used to finance multifamily housing, publicly owned convention and transportation facilities, and public and nonprofit health facilities.

Although Congress sought to restrict the use of IDBs, it permitted state and local governments to issue tax exempt low- and moderate-income housing. In 1983, 14 states' new issues of IDBs exceeded $150 per capita (excluding new issues for convention and transportation facilities) although some of these states would meet the total volume limit.

The new restrictions were strongly opposed by cities and counties, which claimed IDBs are an important economic development tool for stimulating and attracting investment to distressed areas. Analyses by the Treasury Department, however, conclude that IDBs are an inefficient tool for economic development, providing financing for projects that would occur without IDB financing, and that IDBs only subsidize the relocation of businesses rather than create new firms and jobs.

Local officials remain wary that the changes will result in unwanted interference by states into local development decisions. The National League of Cities, encouraging opposition to the IDB provisions, stated: "Congress should let cities determine how to apply restrictions in their own communities, rather than imposing another level of government's priorities upon them." The bill establishes a formula to allocate the cap, although in the first year, the allocation may be made at the governors' discretion. After that, the state legislature has the authority to make allocations. The new legislation may foster intense competition as local governments scramble to get their "fair share" of the ceiling.

Federal Preemption

The sleeper issue of the 1980s may be the growing proclivity of all three federal branches to preempt state laws. Federal preemption of product liability laws has already been mentioned. Other legislative proposals that would supersede state policies and regulations were considered in a number of areas in 1984: cable TV, public employee pensions, banking regulation, unitary taxation, telephone access charges, and truck regulation. Taken singly, national assumption of policy in each of these areas may not appear ominous. Viewed in totality, however, and combined with numerous prior preemption actions, they are seen by many as an imposing threat to the states as viable partners in the federal system.

No one expects Congress to obliterate the states in one fell swoop. If there is any danger, it lies in the tyranny of small decisions—in the prospect that Congress will nibble away at state sovereignty, bit by bit, until someday essentially nothing remains but a gutted shell.[2]

THE FORECAST

In 1985, Congress will have the task of reauthorizing a number of programs that expire before October, including the *Coastal Zone Management Act*, assisted housing programs, low-income weatherization, and the *Higher Education Act*. Items that Congress failed to complete in 1984 will also be on the 1985 agenda. Immigration reform, reauthorization of the *Clean Air* and *Clean Water Acts*, hazardous waste superfund, banking deregulation, and highway construction are among those issues that will face even greater difficulties in the 99th Congress as election year jitters are replaced by deficit tremors. All of these issues, however, will take a back seat to tax reform and deficit reduction.

Programs that aid and subsidize state and local governments are prime candidates for spending reductions in 1985. Indeed, the President's FY 1986 budget recommended the elimination of General Revenue Sharing (GRS), Urban Development Action Grants (UDAG), and mass transit funding. In addition, large reductions were proposed in public housing subsidies and modest reductions in welfare expenditures. Overall, the President has requested reductions in federal aid to state and local governments amounting to more than $6 billion.

The Treasury's tax reform and simplification proposal is also of great interest to state and local governments. Like several tax reform plans introduced in Congress (Bradley-Gephardt and Kemp Kasten, for example), the Treasury plan proposes to reduce marginal tax rates by removing and modifying most of the existing deductions (including the deductibility of state and local taxes), credits, and exemptions.

The administration proposals have left many fearful that the budget will be balanced on the backs of state and local governments. Some observers of the federal scene wonder if 1985 will the year of "whiplash federalism." However, the administration's proposals have elicited strong reaction from many corners, indicating that they are far from being faits accomplis. Congress is already grappling with its own budget and deficit reduction plans and may choose to adopt one quite different from the President's budget. One thing is certain: Congress and the administration face a rigorous agenda of tough decisions in 1985, one that could lead to strikingly new approaches or to resumption of stalemate.

CONCLUSION

Intergovernmental activity at the national level was not inconsequential in 1984; neither was it extraordinary. Fiscal pressure and election year politics effectively eclipsed interest in major federalism reforms. Changes that occurred were incremental. In many instances, changes were byproducts of activity driven by other purposes, such as reduction of the deficit and deregulation of the private sector.

As the political debate over taxes, budget cuts, and the deficit intensified, state and local officials turned their attention from service delivery and balancing their own budgets to participating in the national policy arena. A resolution passed by the National League of Cities (NLC) in November declared that "resolving the deficit problem is the most urgent priority confronting the nation as well as the cities," and NLC President George Latimer called for the cities to become the "watchdog" of the Treasury and the tax code.

Yet within the widely accepted notion that these are desperate budgetary times requiring drastic measures, there lies an opportunity for states and localities, and the public interest groups which represent them. Intergovernmental aid cuts, which are certain to occur, can be made with a budget hatchet or they can be accomplished through policy reform. State and local governments have begun to weigh the risks and decide between strategies: they can take a defensive posture and man the barricades to minimize cuts, or they can agree upon a level of cuts and present them in a positive package of policy reform. The fundamental issues confronting the nation present an opportunity for states and localities to demonstrate that federal spending reductions can be the byproduct of genuine federalism reform. In this way, the federal deficit crisis could prove to be the mechanism that is needed to rebalance our federal system.

---

[2]Laurence Tribe, American Constitutional Law (Mineola, NY: The Foundation Press, 1978), p. 302.

The Return to Fend-for-Yourself Federalism: The Reagan Mark

SUMMARY AND HIGHLIGHTS

Since Alexis de Tocqueville in the 1830s, students of government and policymakers world wide have had a fascination with American federalism. If anything, this fascination has intensified in recent years.

Yet, the uniqueness of American federalism—indeed, the uniqueness of the American experience—probably makes our exact system of government inapplicable elsewhere. Unlike subnational units of government in most major federations, American states and localities raise most of their revenues on their own, with very little mitigation of taxpayer burden by the national government (although itemizing taxpayers can deduct state and local income and property taxes from federal income taxes). Furthermore, with only minor exceptions, our national government does not engage in direct fiscal equalization among states and regions. While Washington does redistribute income among individuals—and this has the residual effect of revenue collection and expenditure disparities among the states—direct income redistribution from richer to poorer regions is not ingrained in the U.S. political culture. Fiscal equalization is the norm not only in most of the world's unitary systems of government, but in the other major federal systems as well.

This article, written by former ACIR Executive Director John Shannon, describes the American brand of "fend-for-yourself" federalism, and measures the Reagan impact on it.

This article first appeared in the Summer/Fall 1987 issue of *Intergovernmental Perspective.*

*　*　*　*　*

When compared with the states of other major democratic federations—Australia, Canada, and West Germany—American state governments operate in a fairly harsh and politically risky fend-for-yourself fiscal environment. While the long road to stronger state revenue systems in the United States has been paved with the political bones of former governors, state officials in the other major federations have been more successful in enlisting the help of their central governments in raising revenue.

—The Australian states derive most of their revenue from unconditional federal grants negotiated periodically by federal and state policymakers.

—Most of the revenue that flows into the coffers of the German states is the product of tax sharing arrangements worked out with the central government in Bonn.

—In the not-so-distant past, the Canadian provinces also received powerful revenue raising assistance from Ottawa in the form of full tax credits (political heat shields) that permitted the provinces to reenter the income tax field after World War II at virtually no political risk to their elected leaders—an innovative federal-state tax sharing program.

The distinctive "fend-for-yourself" brand of American fiscal federalism is also underscored by the fact that not even the poorest states in our Union receive special help from Washington. This hands-off policy with respect to interstate equalization stands out in sharpest contrast to the Australian, Canadian, and West German policies that provide special (equalizing) aid to their poorer states.

THREE DISTINCTIVE FEATURES

The American brand of federalism is marked by diversity, competitiveness, and resiliency, and the Reagan administration's contribution boils down to this: it has helped give our pre-Great Society brand of fend-for-yourself federalism a new lease on life.

Diversity—
Providing Choices within the System

Because all states raise most of their revenue, there are great variations in state and local tax and expenditure policies in the United States. These fiscal differences—which provide real choices for citizens and business firms—are found in all regions of the country.

In New England: New Hampshire has neither a broad-based personal income tax nor a general sales tax, and leans heavily, therefore, on the local property tax. The neighboring states make use of all three of these revenue producers.

In the mid-Atlantic region: State and local expenditures (per capita) for New York are far above average, while Pennsylvania's expenditures are definitely below the national average.

In the Great Lakes region: There is a real difference between the progressive tax policies of Minnesota and Wisconsin and those of the more conservative states of Illinois and Indiana.

In the far west: An interesting choice exists between Washington State, where voters have repeatedly voted down an income tax, and Oregon, where voters are strongly opposed to a sales tax.

A Striking Interregional Difference: New England states make above average use of the property tax and place heavy emphasis on local control. In contrast, southern states make rather anemic use of the property tax and favor more centralized state financing.

These great differences can be traced largely to three factors: (a) widespread variations in fiscal capacity, (b) substantial differences in voters' tastes for both public services and taxes to support them, and (c) a federal hands-off tradition with respect to equalizing intergovernmental fiscal disparities.

These great state and local fiscal variations are viewed quite differently by liberals and conservatives. Liberals often view these fiscal differences as disparities, and call for equalizing federal and state actions. Most conservatives tend to view these variations as diversities that should not be wiped out by redistributive federal and state actions. For the supporters of decentralized government, one of the toughest policy issues is this: When does a "good diversity" become a "bad disparity" that necessitates corrective federal and/or state action?

However one views these variations, one thing is clear: state and local boundaries do make a difference in the American federal system. In the United States, "You pays your money and you takes your choice."

Competitiveness—
Stabilizing the System

If diversity is one of the hallmarks of American fiscal federalism, what prevents our 50 state-local systems from becoming too diverse? Again, the quick answer: Competition for jobs and economic development appears to be an important factor in preventing our states from drifting too far apart.

The 50 state-local systems behave much like ships in a naval convoy. Because they are spread out over a great area, there is considerable room for each state to maneuver within the convoy. Two considerations prevent a state from moving out too far ahead or lagging too far behind.

1 If a state moves out too far ahead of the convoy on the tax side, it becomes increasingly vulnerable to tax evasion, taxpayer revolts and, *most importantly, to tax competition* for jobs and investments from other states.

2 If a state-local system lags too far behind the convoy on the public service side, it becomes increasingly vulnerable to quality of life and economic development concerns—poor schools, poor roads and inadequate support for high-tech operations.

It should be noted that this competition issue is given different spins. Conservatives are more apt to focus on the price (tax) side of the competition coin and warn that high tax levels in general and highly progressive tax policies in particular can drive footloose upper-income taxpayers and businesses to jurisdictions with more salubrious tax climates. There is no doubt that this message is now causing many of the northern liberal states to scale down sharply their progressive tax rates. In the last two years, New York, Wisconsin, Minnesota, Delaware, and West Virginia have pulled their top personal income tax rates down from the double-digit category into the single-digit range.

Liberals, on the other hand, are more inclined to play down the importance of state and local taxes in business location decisions, and focus instead on the public service side of the competition coin. They contend that good schools, well-financed physical infrastructure and quality of life amenities figure importantly in the value systems of high-tech policymakers. There also is no doubt that these concerns are causing some lagging states to upgrade their educational systems.

This competitiveness factor points up another distinctive feature of American fiscal federalism. The other major federations provide special assistance to the poorer states to keep interstate tax and spending differentials from becoming too great. In the United States, however, we rely on interjurisdictional competition for economic development to perform this stabilizing role—simultaneously forcing high-tax states to slow down, while prompting low-spending states to accelerate on the public service side of the ledger, especially for education and physical infrastructure.

This federal hands-off policy with respect to interstate fiscal equalization will come under increasing criticism now that the poorer regions of the nation are no longer slowly closing the rich state-poor state gap, as they did between 1929 and 1979. In fact, since 1979, that gap has slowly widened because the wealthier states located in New England and the mid-Atlantic regions are once again growing at a faster rate than most states in the other regions, especially the south. Without outside help, can the poorest states and localities be competitive? This issue poses another tough equity question for fend-for-yourself federalists.

No matter how the equity question is resolved, one thing appears fairly certain: the competition issue is not going to go away. In fact, competition for jobs and investment dollars is likely to become increasingly fierce because: (a) the U.S. economy is becoming more and more open to global competition and (b) the recent and sharp cuts in federal income tax rates have substantially reduced the value of state and local tax deductions on the federal 1040. This development, in turn, is bound to increase the sensitivity of upper-income taxpayers and business firms to interstate and interlocal tax differentials.

The memory of the taxpayers' revolt and the squeeze on the federal budget also put a keener edge on interjurisdictional competition for jobs and economic development. In the post-Proposition 13 era, major tax hikes are still quite risky and the prospects for more aid from Washington are almost nil. Thus, the growth in the tax base generated by economic development stands out as a most attractive method for revenue enhancement. It should also be emphasized that bringing in new jobs and retaining existing jobs are becoming two of the most important tests of a successful state or local administration. In view of these political realities, it is highly unlikely that many governors or mayors would be willing to sign nonaggression pacts with their counterparts in neighboring jurisdictions.

Resiliency— Keeping the System Going

Now for the third distinctive feature of American federalism—the resiliency of state and local governments. In my judgment, the most underrated feature of our federal system is clearly the demonstrated ability of our 50 states and thousands of localities to absorb and then to rebound from regional and national shocks.

The fiscal resiliency of the 50 state systems can be easily documented. Since 1978, the 50 state-local systems have absorbed the shock of the three Rs:

Revolt of the taxpayers—Proposition 13, et al.

Recession—the 1981-82 economic downturn, which was the sharpest since the Great Depression.

Reduction in federal aid flows.

More recently, many of the states have been hit hard by regional downturns. The farm states have been pinched severely by the agricultural recession, and the energy states of the southwest have taken hard hits from the sharp drop in oil prices. Yet despite all these shocks the states as a collectivity are doing far better than most students of state and local finance would have predicted a few years ago.

The resiliency of our 50 state-local systems also comes through clearly when the fiscal fortunes of the federal government and the states are compared over time. If a modern Rip van Winkle had fallen into a deep sleep at the end of the Korean War and awakened recently, he would not believe the changes that have transformed our intergovernmental system. By the 1950s, the federal government towered over the states and localities, its revenue system massively strengthened first to combat the Great Depression and then to finance World War II and the Korean War. While Washington appeared all powerful, the states were being described as the "fallen arches" of the American federal system.

Now, the states and localities are both playing the activist roles in education and welfare reform, and collecting well over one-half trillion dollars from their own resources. Even more surprising to the modern Rip van Winkle, however, would be the spectacle of the federal government mired down deeply in massive budget deficits because the Congress and President Reagan cannot agree on a budget balancing strategy.

Although the diversity and competitiveness features raise equity questions, the resilience of states and localities poses no such problem. The ability of states and localities to bounce back is both an unqualified virtue and the most significant feature of American fiscal federalism.

THE REAGAN MARK

The creation of a fiscal environment that forces state and local officials to become more self-reliant stands out as the primary impact the Reagan administration has had on our federal system. Three developments support this verdict.

—Federal aid as a percentage of total state-local outlays has dropped from 25 percent in 1981 to an estimated 19 percent for FY 1987. More significantly, this downward trend (which actually started in the latter half of the Carter administration) reverses the long 1955-78 Affluent/Great Society trend in which federal grants grew at a consistently faster clip than did state-local own source revenue. As noted earlier, in 1987 state and local governments will collect from their own sources well over one-half trillion dollars—about five times the amount that they will receive from Washington.

—The federal government did not provide countercyclical aid when states and localities were buffeted in 1981-82 by the sharpest economic downturn since the Great Depression, nor has the federal government provided special aid to the state and local governments in the farm states severely pinched by the agricultural recession or to the state governments to the southwest hard hit by the dramatic drop in oil prices. This hands-off Reagan policy not only stands out in sharp contrast to the countercyclical action taken by previous administrations, it also sends up a powerful fend-for-yourself message to the states. Over half of the states have now created their own "rainy day" funds to help cushion the shock of an economic downturn.

—The Reagan administration has also maintained the traditional federal policy with respect to the poorest states—no special (equalizing) aid. Moreover, citing the federal budget squeeze, the current Reagan administration pushed successfully for the elimination of the General Revenue Sharing Program for localities—an unconditional assistance program with some equalizing power.

The determination of the Reagan administration to shift more financing responsibility back to the states and localities received powerful support from the three Ds: deficits, defense and demographics (social security and medicare). These three federal budgetary realities of the 1980s would have made it difficult for even a President Lyndon Johnson to maintain—let alone expand—the federal fiscal presence on the state-local front.

This gradual decentralization process is not the neat, orderly and swift sorting-out process for which reformers yearn. Nor does it resemble the program swap and tax turnback proposals the Reagan administration advanced in 1982 for achieving a more orderly and decentralized allocation of responsibilities between the national government and the 50 state-local systems.

Nevertheless, fend-for-yourself federalism is slowly effecting a "sorting out" of sorts. Federal policymakers are being forced by fiscal and political realities to allocate an increasing share of their resources for strictly national government programs: defense, social security, Medicare, and interest on a $2.4 trillion debt.

To sum up, three significant changes have emerged from the interaction of the federal budget crisis and the Reagan decentralist philosophy.

—A sea change has occurred in the expectations of state and local officials. When forced to search for "new money," they once again look to their own resources.

—The recent burst in state activism and the remarkable demonstration of state-local fiscal resiliency can be attributed in no small part to this return to fend-for-yourself federalism.

—Federalists no longer worry that states and localities will become "federal aid junkies."

The Near Future. What is the prognosis for this tough brand of fend-for-yourself federalism after Ronald Reagan leaves the Presidency? This inquiry takes on added significance because most of the federal aid programs (over 400) are still intact, albeit in a semi-frozen condition. In my estimation, the future of Reagan-type federalism will be shaped more by the financial condition of the federal Treasury than by the political philosophy of the next President. Because deep slashes in federal spending appear highly unlikely, the condition of the federal Treasury will be largely determined by whether or not Washington policymakers gain access to a major new tax—a national sales tax or value added levy.

The prospects for finance-it-yourself federalism remain fairly bright if Washington fails to strengthen its revenue system in a very major way. In that case, the federal budget squeeze will continue for some time to come and state and local officials will have no alternative but to keep on tapping their own sources when confronted with the need for additional revenue to finance their own new initiatives.

On the other hand, if Washington gains access to a major new source of revenue, then the prospects for the continuation of fend-for-yourself federalism become cloudy. In that case, the squeeze on the federal budget will be relaxed and Washington should once again be in a fairly good position to push more funds into the state-local arena—with more federal expenditure strings attached. Why? Because there no longer exist real political and judicial restraints on federal entry into areas once considered the exclusive domain of the states. With the withering of all but the fiscal constraint, more than ever federalism is finance.

Federalism 1986-87: Signals of a New Era

SUMMARY AND HIGHLIGHTS

> It is my intention to curb the size and influence of the federal establishment, and to demand recognition of the distinction between the powers granted to the federal government, and those reserved to the states or to the people. All of us need to be reminded that the federal government did not create the states; the states created the federal government.
>
> Ronald Reagan
> Inaugural Address
> January 20, 1981

Historians may never be able to agree on the extent of Ronald Reagan's federalism accomplishments, but few would refute that the Reagan administration wrought dramatic changes in expectations about government—not only about the role of the public sector in general, but also about which unit of government is best equipped to deal with any given program. Still, no exact moment can be pinpointed when this change took place. Certainly it did not occur merely by the President's declaration in his first Inaugural Address, for the rhetoric attendant on legislative battles during the early Reagan years was replete with the traditional arguments about the states being unable to cope with the nation's pressing domestic problems.

This article, written by ACIR Director of Communications Robert Gleason, takes note of the evolutionary process that occurred in intergovernmental relations during the Reagan years, but points to two events during the middle of the second term—the termination of General Revenue Sharing and federal income tax reform—as both symbolic and substantive culminations. Because it was written when a full year remained on Ronald Reagan's second term, the article was obviously not intended to be a final summary of the administration's federalism record. For example, another major grant-in-aid program for local governments, Urban Development Action Grants, was terminated in the FY 1989 budget, and, as of this writing, welfare reform continues to be a major issue. Nevertheless, the budget battles of 1988 were much less contentious than the previous seven years, and much of the public policy discourse focused on nonintergovernmental issues—e.g., international trade, and the Moscow Summit. Finally, of course, attention shifted to the presidential elections.

This article first appeared in the Winter 1988 issue of *Intergovernmental Perspective.*

* * * * *

Although federalism developments during the early Reagan years—the block grants and regulatory relief of 1981, and the 1982 New Federalism initiative—received far more media coverage, future historians may well view the 1986-87 biennium as the culmination of this administration's legacy to intergovernmental relations.

Both substantively and symbolically, two events in 1986 and responses to them in 1987 signaled a new era in federal-state-local fiscal arrangements: the *Tax Reform Act* altered the environment in which state tax systems operate by intensifying interstate competition; and the termination of General Revenue Sharing (GRS) ended the direct fiscal relationship that the majority of localities had with Washington.

Yet, 1986-87 also offered a constancy. It was a time frame in which a full measure could be taken of the evolution in intergovernmental relations over the past decade. As ACIR Research Director John Kincaid has noted: "If fiscal affluence helped drive Lyndon Johnson's Creative Federalism and Richard Nixon's New Federalism, fiscal conflict and rising debt have helped to drive Ronald Reagan's New Federalism."

Beginning in 1978, and accelerating in the 1980s, federal budget priorities underwent a double shift. A macro shift occurred in overall budget priorities, with a general slowdown in discretionary (nonentitlement) domestic spending, and a micro shift occurred within domestic spending priorities. Both produced a substantially restructured intergovernmental grant system.

CHASING THE ALMIGHTY DOLLAR

Even when adjusted for inflation, both federal receipts and outlays have grown sharply during this decade. Real revenues in FY 1987 were 17 percent higher than in FY 1980, and expenditures were 23 percent higher. However, of the increased expenditures, 35 percent was consumed by national defense, 34 percent by federal payments for older Americans (social security, medicare, and other retirement), and 20 percent by interest on the national debt—for a combined 89 percent "consumption" of all the increase in expenditures. These are the federal government's "big ticket" items, which ACIR Executive Director John Shannon refers to as the three Ds: defense, deficits (interest payments), and demographics (an aging population). Indeed, in FY 1987 these three expenditure items accounted for almost three-quarters of the budget—up roughly 10 percent from 1980.

With some domestic programs, such as farm subsidies, also growing, other discretionary spending was squeezed, and aid to state and local governments took the first and hardest hit. Whereas grants had amounted to $105.9 billion (1982 constant dollars) in FY 1980, in FY 1987 they amounted to $90.2 billion—a 15 percent decline. Of more importance was the change in the percentage of grants earmarked for payments to individuals (primarily AFDC and Medicaid). In 1980 they accounted for 35 percent; in 1987 they accounted for almost 50 percent. Thus, beyond an overall decline in grants, those that are spent directly by state and local governments—as opposed to being passed through to individuals—declined even further. Calculated in this manner, federal dollars spent on grants-in-aid for "governing" functions declined by 34 percent in real terms between 1980 and 1987.

The inevitable result of this federal retrenchment was that state and local governments became more self-reliant during the Reagan years. Whereas in 1980 federal grants in aid accounted for 26.5 percent of spending by state and localities, in 1987 it was 19.1 percent. State-local expenditure from their own sources rose from $266.9 billion to $505.9 billion during this time, and in constant (1982) dollars, their per capita own-source spending grew by approximately 26 percent. In contrast, federal per capita spending grew by approximately 15 percent during the 1980s, and in FY 1987 recorded the first post-Great Society one-year decline (from $3,744 to an estimated $3,709).

Of conspicuous note is the imbalance of the federal government's revenue-expenditure ratio in comparison to states and localities. While in FY 1987 the federal government spent about $1.20 for every dollar of receipts, the 50 state-local systems had about $1.10 in receipts for every dollar spent. In the aggregate, state and local revenues exceeded expenditures by approximately $60 billion. Although these revenues cannot properly be considered surpluses (the vast majority went into public employee pension funds), the contrast is striking. At the same time that the federal government is obligating future interest payments, state and local governments are covering future obligations.

BORN AGAIN STATES AND STILLBORN PROPOSALS

In light of this glaring disparity, the emergence of states and localities as more prominent actors in the federal system was inevitable. Fred C. Doolittle of Princeton University has observed that with many states in relatively good financial health at the same time that Washington is deficit ridden, "many lobbyists are finding their way back to the state capitol." In areas like economic development, individual rights, and education, states have launched bold initiatives and enacted legislative remedies. These developments have likewise attracted the notice of interest groups.

However, equally noteworthy during 1986-87 was what didn't happen. A central concept of the Reagan New Federalism—the idea of federal-state "swaps" of programs and fiscal responsibilities-seemed to lose political momentum after having spawned several alternative proposals. In some cases, states and localities had always resisted the idea. What continued to maintain a foothold in fiscal debates, though, was the concept of fiscal neutrality, namely, the idea that new domestic commitments should not result in a net increase in federal expenditures. In addition, states and localities intensified their call for federal reimbursements when federal mandates necessitate expenditures.

In another intergovernmental domain, judicial decisions and federal preemption of state laws continued to frustrate state and local policymakers. Some raised the possibility that in the aftermath of the Supreme Court's decision in *Garcia* v. *San Antonio Metropolitan Transit Authority* constitutional reform might be necessary to correct a breakdown in restraint by the national government. Others disagreed that the states have been emasculated. Both sides were debated at a roundtable discussion convened by ACIR in September 1987. On one side, for example, Stuart Eizenstat, former Domestic Policy Advisor to

President Jimmy Carter, said: "It seems to me that it is somewhat ironic for dramatic notions of constitutional amendments to surface at a time when states are, more clearly than at any point in the last 50 years, the centers of innovation and creativity, while policymaking in Washington is an utter shambles."

Conversely, New Hampshire Governor John Sununu, ACIR vice chairman and National Governors' Association chairman, said: "Right now, post-*Garcia*, it is clear that there is nothing that the federal government cannot do willy nilly that would—in any case, in any way, shape or form—be deemed by the federal courts to be an intrusion on the rights of the states. It is that swing of the pendulum, well past the extreme, that must be corrected."

So it is against this backdrop that federal tax reform and the termination of General Revenue Sharing transformed federalism. Surely, though, it is fair to ask why these two actions—the former not even an intergovernmental action per se, the latter just one of 400+ intergovernmental programs—together became a culmination after so much that had gone before. Why can turning on just one more appliance cause a circuit breaker to trip? The cumulative effects of budget retrenchment set the stage for the realization that the course of intergovernmental relations had been permanently altered.

TAXING THE FEDERAL SYSTEM

Though the federalism aspects of tax reform were well debated in the 1986 package, the saga really commenced with the income tax revisions of 1981. For in that act the top marginal rate was reduced from 70 percent to 50 percent, thus beginning the process of diminishing the value of deductibility of state and local taxes from federal income taxes, particularly for high-income taxpayers. Then, in the 1986 act, the top marginal rate was reduced to 28 percent, further reducing the value of deductibility and intensifying interstate tax competition. In essence, over a five-year period, deductibility lost 60 percent of its value to the highest income, itemizing taxpayers—from 70 cents on the dollar to 28 cents. While this is true of all deductions (e.g., home mortgages), it is the ability of high-income taxpayers to move to lower-tax jurisdictions that gives tax reform intergovernmental import.

Still, the tax competition aspect of deductibility was intertwined with two other important ramifications of the 1986 *Tax Reform Act*: the "windfall" issue and the outright elimination of deductibility of sales taxes.

For 33 of the 43 states and the District of Columbia which have an income tax,[1] federal tax reform legislation had the potential of producing larger revenues if states did not alter their own tax codes. Since many states conform or "couple" in some way to the federal income tax structure, the base broadening in the 1986 legislation meant that states would be applying their marginal rates to higher adjusted gross incomes. According to ACIR staff estimates, the additional income tax revenues would have ranged from less than 1 percent in Massachusetts and Idaho to a high of 27.9 percent in Louisiana, and would have averaged 11.9 percent in the 33 states. In the aggregate, the potential additional revenue was estimated to be $5.2 billion. In the state legislatures, therefore, a major issue became what to do with the windfall.

Perhaps prompted by the memory of the taxpayers' revolt, and perhaps more keenly aware of heightened interstate tax competition, or both, approximately 80 percent of the windfall revenues were returned to the taxpayers under a wide variety of turnback strategies. As might be expected, the states hardest hit by the agricultural slump and/or the drop in energy revenues were most likely to keep all or some of the personal income tax windfall.

Of more lasting significance, however, is the fact that ten states took the occasion of federal tax reform to fashion major restructuring of their own individual income tax codes.[2]

In varying combinations, they cut top rates, reduced the number of brackets, and removed low-income filers from the tax rolls. Not surprisingly, the majority of the states cutting rates and curtailing progressivity were those sharing borders with lower income tax jurisdictions and/or situated in highly competitive regions. New York, for example, cut its top rate almost in half, from 13% to 7%, and reduced the number of brackets from 13 to two over four years. In the upper-midwest, both Minnesota and Wisconsin cut top rates and reduced brackets. Yet, even California—a state somewhat protected from interstate tax competition because of geography—cut its top rate and reduced brackets. Interestingly, most of these states took a leaf from the federal tax reform book at the other end of the income spectrum by removing low-income taxpayers from the base.

While innumerable local considerations contributed to tax revisions in the various states, five primary national trends stand out: (1) the "windfall" revenues from federal tax reform provided financial maneuverability; (2) because of ease of administration and taxpayer convenience, state lawmakers feel compelled to conform the major provisions of their tax code to federal provisions; (3) because of competition for high-income taxpayers and their investment dol-

[1]Connecticut, New Hampshire, and Tennessee tax income only from interest and dividends.

[2]States with major income tax rate reductions were California, Colorado, Delaware, Washington, DC, Iowa, Minnesota, New York, Oregon, West Virginia, and Wisconsin.

lars, it is becoming increasingly risky for states to use a highly graduated rate structure to accomplish income redistribution; (4) considerations of tax fairness are forcing states to grant more generous personal exemptions and standard deductions; and (5) a coalition of conservatives and liberals is changing state income tax policy, with less emphasis being placed on soak the rich and more on protecting the poor.

Nevertheless, in another response to federal tax reform, conventional wisdom did not prevail. It had been argued that total elimination of the deductibility of sales taxes would cause states to reduce their reliance on sales taxes and rely more heavily on income or other taxes. Not only have many states receded from income taxation, in 1987 alone six states increased sales taxes—either through rate increases, extending temporary rate increases, or base broadening. Indeed, since 1982, 23 states have increased sales tax rates, and the national median rate has climbed a full percentage point, from 4% to 5%. In retrospect, the deductibility thesis may have long ago been discounted by political practitioners. As ACIR Commissioner State Senator Ross Doyen has said: "In my 28 years in the Kansas legislature, never once have I heard someone get up on the floor and say it was OK to raise taxes because they're deductible."

REVENUE SHARING: BROTHER CAN YOU SPARE $4.6 BILLION?

During its 14-year life span, General Revenue Sharing disbursed over $83.5 billion to state and local governments, reaching a high of $6.8 billion in 1978, 1979 and 1980. The centerpiece of Richard Nixon's New Federalism, GRS was terminated for state governments in 1980, and the annual appropriation for local governments was $4.6 billion when authorization expired in 1986. Though always controversial, as long as fiscal affluence prevailed in Washington, GRS was able to maintain a majority coalition for support. With the rise of the deficits, however, the balance gradually tipped. A dominant coalition emerged of conservatives in Congress who had long objected to GRS "handouts" and liberals who had long disliked the idea of giving highly discretionary funding to states and localities because of concern that the money would not be used to help the poor. Perhaps more importantly, the very thing that made GRS so popular with state and local officials made it one of the easiest (as distinct from easy) programs to terminate: because they were discretionary dollars to be spent by other units of government, Congress had difficulty taking credit for what the money was spent on.

At its inception, GRS was an uneasy mix of economics and ideology, and a marriage of convenience for liberals and conservatives. In the early and mid-1960s, some economists were predicting that the federal income tax would soon be generating revenues at such capacity that the federal treasury would have huge surpluses, and that this would be a drag on the economy. Thus, it was argued, an effective mechanism was needed to dispose of money.

Politically, in the late 1960s and early 1970s, Revenue Sharing was a means of giving both liberals and conservatives something they wanted. For liberals, the money would not be spent by Washington to achieve centralization, but at least it would be raised by the progressive income tax, and kept in the public sector; for conservatives, the anticipated surpluses would not be used for tax cuts as they might have preferred, but at least GRS would engender more decentralized spending decisions, and perhaps state and local tax reductions.

Obviously, the ensuing years were to prove that the national government was never in danger of being unable to spend its revenues. In some quarters, Revenue Sharing gained a new moniker: Deficit Sharing. A particularly salient criticism, however, arose from the very design of the program to be universal—that GRS provided funds not just for poor communities, but for rich ones as well. Some critics argued that a fiscally strapped federal government redistributing wealth to affluent communities was perverse.

Given that GRS payments to states were stopped in 1980, the full expiration of GRS has had its greatest effects on the nearly 39,000 local governments that received it, especially the governments of many small and/or poor localities. Although, on average nationwide, GRS funds constituted less than 3% of local government expenditures, GRS accounted for as much as one-fourth to nearly two-thirds of total tax revenues for some small and poor local governments. Furthermore, GRS was the only direct federal aid received by many small localities. The National Association of Towns and Townships estimated that about 78% of the 36,000 communities having a population of less than 25,000 would no longer receive any direct federal aid with the expiration of GRS.

While various interest groups and members of Congress have proposed revising Revenue Sharing in some form, mainly as a more targeted program for fiscally strapped communities, whether Congress can enact a program that will benefit only some communities is questionable. Drawing a line between localities that are marginally affected and severely affected by the loss of GRS funds is politically difficult. Probably less than 30% of local governments can be considered severely affected, and they constitute a small portion of the population.

Meanwhile, other major programs for local governments, such as Urban Development Action Grants and the Community Development Block Grants, continue to be targets of proposed elimination. Indeed, of the 435 grants-in-aid funded in 1987, only 16 were strictly for local governments, while 177 were strictly for state governments. Forty-five flowed to both state and local governments, while the remainder were channeled to some combination of governmental and other organizations.

Hence, a dramatic change has occurred from the thrust of the Great Society years and Nixon's New Federalism. Whereas the direct fiscal relationship between the national government and localities had been growing, it has now contracted—to none at all for the majority of the nation's localities which previously had received only General Revenue Sharing.

FREE DEMONSTRATIONS AND NEGATIVE PORK BARREL

In terms of precedent, the 1987 highway reauthorization bill may be the most significant event of the past two years. Included in the bill were 120 "demonstration" projects for specific undertakings. This had the effect of dictating priorities for certain roads and bridges, and superseded the discretion of state highway administrators. In essence, this is a new way for members of Congress to get credit for their spending. In any given congressional district, the project becomes not the state's or Governor Smith's road, but Congressman Jones' road—a subtle distinction of particular importance when it's time to cut the ribbon. To some degree, Congress is looking for a replacement for the old Rivers and Harbors program in which well-placed individual members could bring home dollars for their district. And, using the highway precedent, project-specific funding can be extended to many other areas such as housing and economic development.

Yet another device that cropped up in 1987 was that of "negative pork barrel"—the withholding of federal funds to settle local disputes. For example, specific amendments were adopted prohibiting the use of federal funds for demolishing certain public housing projects in Dallas and Houston; a hold was put on federal funds until Burbank, CA, airport authorities adopted new noise-reduction takeoff and landing patterns; and federal funds were halted for the construction of an expanded Atlantic City, New Jersey, airport in an effort to force competing local interests to reach compromises.

From an intergovernmental perspective, these developments are a dramatic departure from the decentralizing thrust of the 1981 block grants, and certainly from General Revenue Sharing. They go beyond even the restrictive categorical grant approach, because these federal grant policies are project specific. In cumulative fashion, they could become an even more powerful way for Congress to micromanage state-local priorities.

FEDERALISM FUTURES

In an effort to put an end to state-local micromanagement by executive officials, President Reagan issued Executive Order 12612 on Federalism on October 26, 1987. In general, the provisions call for federal action to permit maximum state discretion in developing policies and administering federal programs within the scope of clear constitutional authority; refraining from establishing uniform national standards for programs; preempting state law only when provided or implied in statute; and directing executive departments and agencies to refrain from submitting legislation that would interfere with the independence of the states, or to attach conditions to grants that are not directly related to the purpose of the grant.

Each federal department and agency was also directed to designate an official to be responsible for ensuring the implementation of the order. Among their responsibilities are to prepare a "federalism assessment" for policy recommendations and proposals submitted to the Office of Management and Budget, including an estimation of the extent to which the policy imposes additional costs or burdens on the states. This assessment would include the likely source of funding for the states and their ability to fulfill the purposes of the policy.

FEDERALISM BECOMES FINANCE

Whatever one thinks of President Reagan's federalism record heading into the final year of his administration, it must be noted that of all the post-war presidents he arguably got the most of what he wanted. In his first Inaugural Address he said it was his intention "to curb the size and growth of the federal establishment, and to demand recognition of the distinction between the powers granted to the federal government and those reserved to the states or to the people." He did not accomplish all he wanted, and especially not the way he wanted. Nevertheless, from a financial standpoint, the division of responsibilities among the levels of government has been more clearly defined.

Like other post-war Presidents, Reagan's successes had philosophical underpinnings, but were fiscally driven. As John Shannon has noted: "The federal budgetary realities of the 1980s would have made it difficult for even a President Lyndon Johnson to maintain—let alone expand—the federal fiscal presence on the state-local front."[3] Yet, as also noted by Shannon, "The American brand of federalism is marked by diversity, competitiveness, and resiliency, and the Reagan administration's contribution boils

[3] Address to the American Political Science Association, Chicago, Illinois, September 5, 1987.

down to this—it has helped give our pre-Great Society brand of fend-for-yourself federalism a new lease on life."[4]

Accordingly, many observers looking to the future predict more of the same. In the absence of a major new revenue source, such as a value added tax or a general sales tax, Washington will not be able to reverse the recent devolution of domestic policymaking to states and localities.

What, then, might intergovernmental grant-in-aid funding look like if the trends of the past decade continue for another ten years? Since 1978 (the "high water mark" for grant funding), federal grants have declined by approximately one-third, from 27% of state and local spending to an estimated 17.1% in 1988. While it is conjecture, should that decline continue over the next decade, federal grants would amount to about 11% of state-local spending in 1998—roughly the same as during the second Eisenhower administration.

In 1957, President Dwight D. Eisenhower noted the federal government's fiscal dominance over the states, and told the Governors' Conference that, "if present trends continue, the states are sure to degenerate into powerless satellites of the national government in Washington."

If present trends continue. . . .

[4]Ibid.

☆ U.S. GOVERNMENT PRINTING OFFICE: 1989— 622-545 10078

Recent Publications of the
Advisory Commission on Intergovernmental Relations

Disability Rights Mandates: Federal and State Compliance with Employment Protections and Architectural Barrier Removal, A-111, 4/89, 136 pp.	$10.00
1986 State Fiscal Capacity and Effort, M-165, 3/89, 128 pp.	$15.00
Hearings on Constitutional Reform of Federalism: Statements by State and Local Government Association Representatives, M-164, 1/89, 60 pp.	$5.00
Significant Features of Fiscal Federalism, 1989 Edition, Vol. I, M-163, 1/89, 160 pp.	$15.00
State and Federal Regulation of Banking: A Roundtable Discussion, M-162, 11/88, 36 pp.	$5.00
Assisting the Homeless: State and Local Responses in an Era of Limited Resources, M-161, 11/88, 160 pp.	$10.00
Devolution of Federal Aid Highway Programs: Cases in State-Local Relations and Issues in State Law, M-160, 10/88, 60 pp.	$5.00
State Regulations of Banks in an Era of Deregulation, A-110, 9/88, 36 pp.	$10.00
State Constitutional Law: Cases and Materials, M-159, 9/88, 480 pp.	$25.00
Changing Public Attitudes on Governments and Taxes: 1988, S-17, 9/88, 88 pp.	$10.00
Local Revenue Diversification: Local Income Taxes, SR-10, 8/88, 52 pp.	$5.00
Metropolitan Organization: The St. Louis Case, M-158, 9/88, 176 pp.	$10.00
Significant Features of Fiscal Federalism, 1988 Edition	
Vol I, M-155, 12/87, 128 pp.	$10.00
Vol II, M-155 II, 9/88, 152 pp.	$10.00
Both Volumes Purchased Together	$15.00
Interjurisdictional Competition in the Federal System: A Roundtable Discussion, M-157, 8/88, 32 pp.	$5.00
State-Local Highway Consultation and Cooperation: The Perspective of State Legislators, SR-9, 5/88, 54 pp.	$5.00
The 1986 Federal Tax Reform Act: Its Effect on Both Federal and State Personal Income Tax Liabilities, SR-8, 1/88, 38 pp.	$5.00
Governments at Risk: Liability Insurance and Tort Reform, SR-7, 12/87, 42 pp.	$5.00
The Organization of Local Public Economies, A-109, 12/87, 64 pp.	$5.00
Measuring State Fiscal Capacity, 1987 Edition, M-156, 12/87, 152 pp.	$10.00
Is Constitutional Reform Necessary to Reinvigorate Federalism? A Roundtable Discussion, M-154, 11/87, 39 pp.	$5.00
Local Revenue Diversification: User Charges, SR-6, 10/87, 64 pp.	$5.00
The Transformation in American Politics: Implications for Federalism, B-9R, 10/87, 88 pp.	$5.00
Devolving Selected Federal-Aid Highway Programs and Revenue Bases: A Critical Appraisal, A-108, 9/87, 56 pp.	$10.00
Estimates of Revenue Potential from State Taxation of Out-of-State Mail Order Sales, SR–5, 9/87, 10 pp.	$3.00
A Catalog of Federal Grant-in-Aid Programs to State and Local Governments: Grants Funded FY 1987, M–153, 8/87, 36 pp.	$10.00
Fiscal Discipline in the Federal System: National Reform and the Experience of the States, A-107, 8/87, 58 pp .	$10.00
Federalism and the Constitution: A Symposium on *Garcia*, M-152, 7/87, 88 pp.	$10.00

The reports of the Advisory Commission on Intergovernmental Relations are released in five series: the "A" series denotes reports containing Commission recommendations; the "M" series contains Commission information reports ; the "S" series identifies reports based on public opinion surveys; the "B" series reports are abbreviated summaries of full reports; and the "SR" series are staff information reports. Reports may be obtained from ACIR, 1111-20th Street, NW, Washington, DC 20575.

What is ACIR?

The Advisory Commission on Intergovernmental Relations (ACIR) was created by the Congress in 1959 to monitor the operation of the American federal system and to recommend improvements. ACIR is a permanent national bipartisan body representing the executive and legislative branches of Federal, state, and local government and the public.

The Commission is composed of 26 members—nine representing the federal government, 14 representing state and local government, and three representing the public. The President appoints 20—three private citizens and three federal executive officials directly, and four governors, three state legislators, four mayors, and three elected county officials from slates nominated by the National Governors' Association, the National Conference of State Legislatures, the National League of Cities, U.S. Conference of Mayors, and the National Association of Counties. The three Senators are chosen by the President of the Senate and the three Representatives by the Speaker of the House of Representatives.

Each Commission member serves a two-year term and may be reappointed.

As a continuing body, the Commission addresses specific issues and problems, the resolution of which would produce improved cooperation among the levels of government and more effective functioning of the federal system. In addition to dealing with important functional and policy relationships among the various governments, the Commission extensively studies critical governmental finance issues. One of the long-range efforts of the Commission has been to seek ways to improve federal, state, and local governmental practices and policies to achieve equitable allocation of resources and increased efficiency and equity.

In selecting items for the research program, the Commission considers the relative importance and urgency of the problem, its manageability from the point of view of finances and staff available to ACIR, and the extent to which the Commission can make a fruitful contribution toward the solution of the problem.

After selecting specific intergovernmental issues for investigation, ACIR follows a multistep procedure that assures review and comment by representatives of all points of view, all affected levels of government, technical experts, and interested groups. The Commission then debates each issue and formulates its policy position. Commission findings and recommendations are published and draft bills and executive orders developed to assist in implementing ACIR policy recommendations.

acir