Statement of

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Mr. Chairman, the Administration recently proposed a substantial reordering of responsibilities between the federal government and states and localities. That proposal--like others that have been made--arises out of a growing concern with the present system of federal grants-in-aid to other levels of government. My remarks today will cover two topics:

- First, how and why the present system evolved; and
- Second, how the Congress might now want to rethink the division of responsibilities among different levels of government.

THE EVOLUTION OF THE PRESENT SYSTEM

The present system of grants-in-aid grew up over many years in response to several widely held concerns regarding the delivery of state and local services:

- First, that different jurisdictions had seriously unequal resources with which to address their residents' needs;
- Second, that not all states and localities were equally responsive to the needs of their citizens--particularly the poor and minorities;
- Third, that many governments lacked the administrative capacity to assume full responsibility for providing certain types of services; and
- Finally, that individual jurisdictions lacked the incentive to address certain national policy objectives, such as developing a nationwide transportation network or dealing with interstate air and water pollution.

To address those problems, over the last two decades a large and complex system of grants has developed, including both programs that pay cash or in-kind benefits to individuals (such as Aid to Families with Dependent Children and Medicaid) and programs that finance other government services. Through 1978, spending for both types of grants increased substantially in real terms. Since then, however, spending for general service grants has declined in real terms and, since 1980, has fallen in nominal terms as well. Even so, total spending for all grants amounted to $95 billion in 1981--an increase of more than 300 percent in real terms from the 1960 level of $7 billion. As a consequence of this growth, states and localities have become increasingly dependent on the federal government, with federal grants-in-aid growing from 15 percent of all state and local government expenditures in 1960 to about one-quarter of all expenditures in 1981. The scope of federal involvement also expanded greatly during this time. In 1960, more than 80 percent of all grant funds went for transportation and income security. Today, federal grants touch heavily on virtually every state and local activity.

While some of the concerns that gave rise to this growth in grants remain, others--particularly regarding the administrative capabilities of states--have lessened. At the same time, the federal grant system itself is now increasingly perceived as presenting serious problems. Among these are the sheer number of often-overlapping programs; the amount of regulation attached to many of the programs; the potential conflict between federal and local priorities; and finally, the difficulty of designing a single national program flexible enough to address unique local circumstances.

This dissatisfaction with the present system has prompted a number of recent actions to reduce federal intervention into state and local affairs. Since the mid-1970s, for example, narrow-purpose categorical grants in several areas have been consolidated into less restrictive block grants. Similarly, a growing awareness that federal actions can impose substantial costs on states and localities led last year to legislation requiring the Congressional Budget Office to provide estimates of such costs for bills expected to have significant impacts.

RETHINKING THE CURRENT SYSTEM

Changing circumstances and perceptions have also led increasing numbers of persons to question the whole division of responsibilities between the federal government and states and localities.

From this point of view, the overriding question is: Is there a national interest in a given level or type of government activity? Where a national interest does exist, other questions include: At what level of government should standards for the delivery of the service or benefit be set? What government should administer the program? Who should bear the cost?

Realigning Responsiblities

In the case of programs that provide cash or in-kind benefits (such as medical services) to individuals, the question of the desirability of uniform benefit standards may be particularly important. For programs that finance other government services, variation in the ways different localities provide these services may be more generally accepted, and the principal question may be whether federal involvement is necessary to ensure that a service is provided at all or at a minimally acceptable level.

Benefit Payments for Individuals. More than two-fifths of all federal funds channeled through states and localities support benefit payments for individuals. Aid to Families with Dependent Children (AFDC) and Medicaid together are expected to account for more than half of all direct benefit grants in 1982. Under both of these programs, the federal government pays slightly more than half of all costs, while the states administer the programs and have wide latitude in determining benefit levels, especially for AFDC. This leads to widely varying benefit standards.

Moving full financial responsibility for the AFDC program to the federal government would permit uniform national standards to be established and would remove from states the burden of added program costs during economic downturns. On the other hand, fully federalizing AFDC with a uniform payment standard would either reduce benefit levels in some states or substantially increase total program costs, depending on the level at which the nationwide standard was set. Shifting full responsibility for AFDC to the states--as the Administration has proposed--might increase somewhat the incentives that states now have to reduce fraud and abuse, but could also increase disparities among states in benefit levels.

Fully federalizing Medicaid--as the Administration has proposed--could reduce benefit differentials but would also likely diminish the cost-control efforts many states have been pursuing. Shifting full responsibility to the states, by contrast, would increase cost-control incentives, but could also increase benefit differentials and might result in substantial benefit reductions in some areas.

Another approach would be for the federal government to assume the costs of both income assistance and medical care for the elderly and disabled, and for the states to bear the costs for the remaining portion of the low-income population. Such a division would protect states from the financial burden that might otherwise result from the projected increase in the number of elderly poor persons over the next several decades. On the other hand, granting states full responsibility for serving the non-elderly poor could increase benefit differentials that already exist.

Other Government Services. Two general criteria are likely to be used in determining what the federal role should be in the delivery of other public services: first, whether direct federal involvement is necessary to guarantee some minimally acceptable level of services (either for all citizens or for some designated subgroup) and, second, whether certain national policy objectives would otherwise not be addressed. How these criteria might be applied--and the difficult judgments required--can be seen through a few examples.

Transportation is one field in which the line between federal and state responsibilities has become increasingly blurred in recent years. Large federal capital and operating assistance programs have been created for mass transit, and almost half of all federal highway funds go to roads of primarily local importance. Allowing states and localities to assume responsibility for most mass transit and noninterstate highways--as proposed by the Administration--would free those governments from federal constraints on design standards and labor agreements, while placing responsibility for financing services with the jurisdictions that realize virtually all of the benefits. For many states and metropolitan areas, however, the additional financial burden would be great.

The federal government also helps finance elementary and secondary education--an area that almost everyone views as primarily a state and local responsibility. In this instance, most federal aid is intended to increase services for certain disadvantaged groups. Other programs, however--most notably the Chapter II block grant created last year--provide largely untargeted assistance that could probably be eliminated without seriously jeopardizing services for disadvantaged students.

Federal wastewater treatment grants are an example of aid designed to help localities address a problem that often crosses the boundaries of the jurisdiction in which it originates. Eliminating such federal grants might, therefore, make some states and localities slower to deal with certain of their pollution sources. The risk would be especially great if--as the Administration has also proposed--the power to enforce water cleanliness standards was also shifted away from the federal government with no provision for interstate coordination.

Fiscal Assistance Alternatives

While returning to states and localities the full responsibility for providing certain public services would reduce federal intervention in their affairs, it could also leave them with seriously diminished resources with which to meet those responsibilities. Thus, any broad realignment plan might also include some provision for enhancing the resources of other governments--either temporarily or permanently--in compensation for the loss of program-specific aid. Two general approaches are available: eliminating or reducing certain federal taxes, and providing revenue sharing.

Eliminating or Reducing Certain Federal Taxes. Eliminating or reducing certain federal taxes, so that other governments could pick them up if they chose to, would provide maximum flexibility for states and localities in determining what level of services they wished to offer and how to finance them. It would also ensure that the government at which the spending authority resided bore the political costs of raising the necessary revenues. On the other hand, this approach would do nothing to address differences in the fiscal capacities of states and localities. Indeed, given the uneven distribution of certain revenue sources among states, it could increase rather than diminish fiscal disparities, depending on what revenue sources the federal government vacated.

Such disparities would probably be especially severe in the case of the windfall profits tax on oil--one of those proposed by the Administration to help fund the turnback of programs. Because many states would not have the option of taxing energy, they would have to find alternative revenue sources. Moreover, as currently specified, the Administration's proposal would rely on the windfall profits tax for 60 percent of all revenues designated to fund the turnback of programs in 1984. If the proposed temporary trust fund was continued beyond 1991, the windfall profits tax might have to be extended past its scheduled expiration date, or some alternative revenue source found.

Providing Revenue Sharing. Alternatively, the federal government could continue to raise revenues and then distribute them among states and localities through an expanded program of general revenue sharing. In contrast to merely reducing federal taxes, revenue sharing could be used to help alleviate disparities in the fiscal capacities of states and localities by providing the largest allocations to those jurisdictions with the fewest resources of their own. Revenue sharing would also permit the federal government to maintain some leverage over the activities of other levels of government, even after a specific program had been terminated. On the other hand, this approach would weaken the link between taxing and spending responsibilities.

Net Fiscal Effect of the Administration's Proposal. The Administration's federalism proposal would realign numerous government responsibilites, while providing a temporary revenue sharing trust fund to assure that no state's total financial burden would either increase or decrease when the plan was implemented in 1984. The Administration's estimates assume, however, that further spending cuts will be made before programs are realigned. Using the Administration's estimates, the federal government would take on $19.1 billion in additional Medicaid costs in 1984, while states and localities together would take over an additional $46.7

billion in program costs--$16.5 billion for Food Stamps and AFDC plus $30.2 billion for the "turnback" programs. The net additional state and local expense would thus amount to $27.6 billion that would be made up through a $28 billion trust fund financed with revenues from selected excise taxes and a portion of the revenues from the windfall profits tax on oil.

The Congressional Budget Office has estimated the net fiscal impact on the states and localities, based on current policy projections that assume program funding will increase with inflation, except where capped by law (see Table 1). In this case, the states and localities would take on $62 billion in additional expenses--$20.6 billion for public assistance programs and $41.4 billion for the turnback programs. When balanced against the federal takeover of the state share of Medicaid, the net additional burden on the states and localities would be $42.9 billion. That amount is nearly $15 billion more than the Administration's trust fund estimate; it is $10.8 billion more than the $32.1 billion that CBO estimates would be available if all revenues from the windfall profits tax were included in the trust fund as well as revenues from the selected excise taxes.

TABLE 1. PROJECTED FUNDING FOR PROGRAMS INVOLVED IN THE ADMINISTRATION'S FEDERALISM INITIATIVE (In billions of dollars)

	1982 Funding Level	1984 Administration Baseline[a]	1984 CBO Current Policy Projection[b]
Shifted to Federal Level (Medicaid state share)	15.4	19.1[c]	19.1
Shifted to States and Localities			
Public assistance	18.6	16.5	20.6
Food Stamps	(10.5)	(9.6)	(12.1)
AFDC federal share	(8.1)	(6.7)	(8.6)
Turnback programs	35.8	30.2	41.4
Total	54.4	46.7	62.0
Net Cost of Programs Shifted to States and Localities		27.6	42.9

NOTES: Figures for Medicaid, Food Stamps, and AFDC are outlays. Figures for turnback programs are budget authority levels. Figures for Puerto Rico and the territories are excluded. Components may not sum to totals because of rounding.

a. Administration estimates, including effects of funding reductions proposed but not yet enacted. The Administration's treatment of administrative expenses may not be consistent with CBO's treatment.

b. Congressional Budget Office projections based on Congressional actions completed through the first session of the 97th Congress.

c. Figure does not include effects of Medicaid changes proposed by the Administration for 1983.

CONCLUSION

In summary, the present system of federal grants-in-aid grew up over many years in response to a set of serious concerns. As circumstances have changed, however, the focus of the federalism debate has changed as well. Interest first shifted from expanding the direct federal role in financing a wide range of public services to consolidating categorical programs. More recently, attention has turned to disengaging the federal government from the affairs of states and localities. The Congress faces numerous difficult tradeoffs as it considers how to lessen direct federal involvement without jeopardizing essential services or leaving other governments without sufficient resources to meet their expanded responsibilities.