

**THE FEDERAL GOVERNMENT IN A FEDERAL SYSTEM:
CURRENT INTERGOVERNMENTAL PROGRAMS AND
OPTIONS FOR CHANGE**

The Congress of the United States
Congressional Budget Office

All years are fiscal years unless otherwise indicated. Budget data for 1983 include all appropriations authorized up to August 15, 1983. In particular, they include supplemental appropriations under Public Law 98-8 and Public Law 98-63.

PREFACE

As federal involvement in the activities of state and local governments has grown, so has criticism of the intergovernmental system. Problems have developed, in part, because there are no generally accepted criteria to define and limit the federal role. This study, undertaken at the request of the Subcommittee on Intergovernmental Relations of the Senate Committee on Governmental Affairs, develops guidelines that could be used to identify activities for which some federal role is important, and applies them to current intergovernmental programs. In keeping with CBO's mandate to provide objective analysis, the study offers no recommendations.

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SUMMARY

The federal government currently funds almost 300 different programs that provide grants to state and local governments. These grants cover a wide variety of government activities, and will cost nearly \$100 billion in 1983--more than 10 percent of the total federal budget. In spite of this myriad of federal programs and the large federal financial commitment, no clear set of principles is used to determine the need for federal participation, nor are there any generally accepted rules for deciding the form that federal participation should take. As a result, the current grants system is often perceived as disorganized and wasteful. In addition, if the federal government intervenes in areas where there is no clear national purpose, it may inappropriately limit state and local choices, leading to a misallocation of resources and to unnecessary administrative costs.

In an attempt to deal with these perceived problems, in 1982 the Administration proposed a massive realignment of responsibilities between the federal government and the states. Under this proposal, the federal government would have turned over to the states primary responsibility for current programs in areas such as cash public assistance, education, social services, and transportation, while assuming greater responsibility for some health services for the poor. In order to help states fund their expanded responsibilities, some federal tax bases would have been relinquished to them. In large part, the rationale for this proposal was that state and local governments are generally closer to the groups served, and therefore would be able to design and run more efficient and responsive programs. The proposal met with opposition, however, both from members of Congress who felt that such a major realignment would leave important national interests unmet, and from state and local governments that doubted their ability, even with the additional revenue sources, to pay for the new responsibilities proposed for them.

Although the Administration's proposal was not enacted, it did help to focus attention on the need for some reorganization of the intergovernmental structure. Under the federal system, states and localities are primarily responsible for the provision of local public services--police protection, for example. The primary role of the federal government is to coordinate activities between states and to provide services with more-than-local benefits, such as national defense. In general, federal participation is necessary only if there is an important national purpose that would not be served without federal involvement. Identification of such

areas can be difficult and controversial, however. The aim of this paper is to propose some guidelines to aid in this identification, and then to apply them to options for modifying federal responsibilities in four major areas of the budget. 1/

HISTORY AND CURRENT STATUS OF THE GRANTS SYSTEM

Federal grants to states and localities grew very rapidly in the 1960s and 1970s, largely in response to changing perceptions of the appropriateness of government intervention in solving a wide variety of social and environmental problems. Funding through the intergovernmental grants system developed because, although states and localities had the administrative structure needed to address these problems, they often lacked the ability or the willingness to finance programs in these areas.

By the start of 1981 there were four times as many grant programs as there had been in 1960, and real spending levels--that is, spending adjusted for inflation--had increased more than four times (see Summary Table). The scope of areas in which grants were funded had also increased considerably--in 1960, the bulk of federal grant money went to programs for income security and transportation, while by 1981 there were also large programs for education, training, social services, health care, environmental management, and general government. In percentage terms, the largest growth was in health care programs (principally Medicaid) and energy spending; the health care area now has the second highest funding level overall, after income security.

In recent years, however, attention has turned from developing new programs toward improving existing ones. In part, this new focus has been a response to the haphazard growth of the previous years--a desire to step back and evaluate the results of that growth. It was also, in part, a response to economic and fiscal conditions that pressed the Congress to reduce federal spending in general. As a result, spending for grants has declined in real terms since 1978, and in 1982 outlays fell below the 1981 level in nominal terms. The number of grants has also dropped--from more than 400 in 1980 to under 300 in 1982--through consolidation into block grants in some areas and elimination of funding in others.

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1. Most programs discussed in this paper are grants, but some non-grant programs have also been included because they provide services similar to those available through grants or because they have other intergovernmental ramifications.

SUMMARY TABLE. GROWTH IN FEDERAL OUTLAYS FOR GRANTS, BY FUNCTION (In billions of current dollars)

Program Areas	Outlays			Percentage Growth in Real Terms 1960-1980	1982 Outlays	Percentage Change in Real Terms 1980-1982 a/
	1960	1970	1980			
Infrastructure and Development						
Energy	6	25	499	2,420	509	-7
National Resources and Environment	108	429	5,362	1,404	4,871	-17
Transportation	2,999	4,538	13,087	32	12,171	-15
Community and Regional Development	109	1,780	6,486	1,703	5,379	-24
Education, Training, and Social Services	526	6,390	21,862	1,101	16,589	-36
Income Security and Health						
Income Security	2,635	5,819	18,495	186	21,930	+2
Health	214	3,850	15,758	1,819	18,839	-3
General Purpose Fiscal Assistance	159	430	8,478	1,441	6,347	-37
Other a/	<u>264</u>	<u>753</u>	<u>1,445</u>	<u>58</u>	<u>1,559</u>	-9
Total Outlays for Grants	7,020	24,014	91,472	334	88,194	-17

SOURCE: Office of Management and Budget for outlays. Specialized deflators for each spending category were used.

a. Includes grants for national defense, agriculture, commerce, veterans' programs, administration of justice, and general government.

In a period of budget cutbacks, the effective use of federal funds--including the elimination of unnecessary or duplicative efforts--becomes especially important. Although the committee structure of the Congress makes it difficult to coordinate program changes in different areas, a consistent set of guiding principles to determine the need for federal involvement in each area could help to develop a better-organized grants system in the coming years.

REASSESSING THE FEDERAL ROLE

There are two basic questions to consider in evaluating federal involvement in particular state or local activities. First, is federal involvement necessary? Second, if it is, what form should that involvement take? These can be difficult and controversial questions, and there are few programs for which the answers are clear. Nevertheless, the aim of this paper is to set out some criteria to use as guidelines.

Before deciding if the federal government should intervene, it is necessary to decide if a response is needed from any level of government. Three major concerns that may justify government intervention are:

- o Spillovers or external effects--that is, costs or benefits from particular activities that cross jurisdictional borders;
- o Benefits from centralized coordination--efficiency or other gains from centralized planning and coordination of services; and
- o Poor distribution of resources--that is, inequities or hardships that are unusually severe for certain groups or regions in the country.

Once a need for some governmental role has been established, the justification for federal--rather than state or local--involvement depends on the extent to which the problem is non-local in nature; that is, the extent to which there are important national interests that would not be met without federal involvement. The existence of interstate spillovers, the need for administrative coordination between states, or the desire for redistribution among states, for example, would all constitute such national interests.

If federal involvement seems to be necessary, the form this involvement should take also depends to some extent on the reason for federal intervention. If the rationale for federal participation stems from the existence of spillovers, for example, federal subsidies designed to curtail

activities with external costs or to expand activities with external benefits are appropriate. Where the basis for federal activity is the need for centralized administration, direct federal provision may be most effective. When the federal interest involves the distribution of resources, direct federal provision or a narrowly focused categorical program would be necessary if the major consideration was the supply of particular public goods or services or the welfare of particular recipients within jurisdictions, while more broadly defined grants programs or general revenue sharing may be appropriate if the concern is instead the general level of resources available to states and localities for providing large classes of public services.

This paper applies these criteria for government involvement to programs in three major sectors of the budget: infrastructure and development; education, employment, and social services; and income security and health. In each of these areas, the current program structure is analyzed, and options for realignment are examined. In addition, a final chapter discusses general revenue sharing and the relinquishing of federal tax bases.

OPTIONS FOR MODIFYING GRANTS PROGRAMS

Some broad categories of options for modifying the federal role in current programs can be identified. The major approaches examined in this study are:

- o Eliminating federal funding;
- o Changing funding provisions; and
- o Changing program rules.

Eliminating Federal Funding

Eliminating federal funding might be appropriate for programs where there is not now a strong interjurisdictional basis for involvement--that is, where there are no interstate spillovers, efficiency gains, or distributional issues. In some cases, there may originally have been such a basis, which has now become outdated or unnecessary as circumstances have changed. In others, the basis for federal involvement may have been limited from the start.

An example of an area where the elimination of federal funding might be appropriate is the support provided for roads of predominantly local importance under Federal-Aid Highway programs. Such roads include

Secondary System (rural) and Urban System routes--roads that are probably not essential to a national, interconnected system of highways. Elimination of federal funding for them, on the other hand, would impose additional financial burdens on state governments, although these could be offset, if desired, by reducing the federal tax on motor fuels (which would allow higher state taxes) or by allocating part of the revenues from the federal fuel tax to the states.

Elimination of funding might also be appropriate in a number of other grant programs. Examples include operating subsidies for mass transit, general education grants, and some child nutrition programs. The advantages and drawbacks of eliminating these programs are discussed in the relevant chapters of this study.

Changing Funding Provisions

Changes in the funding provisions for federal grants could take several different forms. For example, in some programs it might be appropriate to change from a project-based allocation of funds to a formula-based approach. In others, an alteration in the allocation formula might improve the effectiveness of a program. Finally, in some cases it might be beneficial to alter the cost-sharing arrangements between recipient governments and the federal government. Such changes could help to redistribute federal resources toward groups with greater needs, take better account of spillover costs or benefits, or increase administrative efficiency.

Changing from project funding to formula funding in the bilingual education program might be desirable, for example, in order to compensate localities facing higher education costs as a result of federal immigration policy and civil rights laws, which require schools to provide special language services for non-English-speaking students. Currently, less than 20 percent of students requiring services are in federally funded programs. A formula-based federal program could distribute funds to all school districts based on the number of non-English-speaking students and the average additional costs of serving such children. This option would increase federal spending, however, and would change the current program's purpose from capacity-building to continuing support.

General revenue sharing is an example of a program where changing the allocation formulas might be appropriate. The formulas for allocating funds to local governments, both among and within states, are based on population, tax effort, and per capita income. Per capita income is included to measure fiscal capacity but does so poorly, because income is only one of several important components of state and local tax bases. In addition,

because severance taxes are included in the tax effort calculation, substantial GRS payments are allocated to local governments in energy-rich states. The interstate allocation would be better targeted if tax effort was eliminated from the formula altogether and a more comprehensive measure of fiscal capacity was used, such as the Representative Tax System (RTS) compiled by the Advisory Commission on Intergovernmental Relations. ^{2/} On the other hand, the data required for updating the RTS depend in part on nongovernment sources, so that new government data series might have to be developed to implement this option.

An area where changing the cost-sharing ratio might be desirable is capital grants for transit programs. The high federal share under current law means that in most urban areas the availability of federal funds strongly influences local transit priorities and encourages capital-intensive solutions to transit problems. While the federal share of costs for these programs will be reduced in 1984 from 80 to 75 percent, a further reduction to 60 percent would double the local share from what it has been, thereby encouraging localities to commit funds only to projects they really need and to focus on the most cost-effective ways of moving people. On the other hand, such a reduction could increase financial burdens for state and local governments, and might cause particular hardship for some urban areas with limited resources.

Changes in funding provisions might also be appropriate in a number of other areas, such as highway aid, vocational education, some social service programs, and some income security programs such as Aid to Families with Dependent Children (AFDC). These and other examples are discussed at greater length in the body of this study.

Changing Program Rules

Changes in program rules could be implemented in two major ways. They could be designed either to consolidate diverse and possibly overlapping programs in a given area, or to change the degree of discretion allowed to recipient governments in using funds. Where there is no overriding national interest that calls for close federal control over the allocation of program funds, greater state and local discretion can increase program efficiency without jeopardizing federal goals.

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2. Changes might also be beneficial in the intrastate allocation of GRS payments. These are discussed in Chapter VII.