

Consolidating Existing Programs. A great deal of program consolidation has already taken place within the last two years. In the area of health care, for example, more than 20 different programs were combined into four block grants under the Omnibus Budget Reconciliation Act of 1981. The addition of three smaller health care programs--family planning, migrant health services, and black lung clinics--to the Primary Care Block Grant has been proposed by the Administration but has not been enacted by the Congress. Combining these categorical programs with the existing block grant might reduce administrative costs somewhat and would give local agencies--in many cases, the same agencies that already receive funds under the Primary Care Block Grant--greater flexibility. On the other hand, if agencies used their increased discretion to reduce the funds available for the specific purposes of the existing categorical programs, significant spillover benefits might be lost--for example, the prevention of unwanted births to teenage mothers, which tend to increase federal welfare costs.

Consolidation might be beneficial in a number of other areas, such as vocational education, some social services, and child nutrition. In addition, some analysts have argued that a comprehensive restructuring and consolidation of the federal public assistance system could lead to both greater efficiency and better targeting of federal resources.

Making Federal Regulations More Flexible. Relaxing federal regulations could be beneficial in a number of areas, including wastewater treatment, mass transit, and highways. In most cases these changes would logically complement the withdrawal or reduction of federal funds by giving state and local governments more freedom in how they use their funds. For example, if federal highway dollars for local roads were withdrawn, state governments could be freed to apply their own road standards based on local traffic characteristics. In the area of wastewater treatment, current regulations embodied in the Clean Water Act could be interpreted more flexibly in cases where there is little economic justification for requiring the upgrading of wastewater treatment facilities. One example is coastal systems in which natural currents are sufficient to prevent environmental degradation from wastewater discharge. To handle such situations, site-specific coastal waivers might be issued to allow less intensive treatment of wastewater where warranted by local conditions.

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## CHAPTER I. INTRODUCTION

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The federal government shares with states and localities the responsibility for carrying out a wide range of public activities, primarily through grants-in-aid. In 1983, the Congress will channel about \$100 billion to nonfederal governments through nearly 300 grant programs. These federal grants touch virtually every state and local activity, including programs that provide cash or in-kind benefits for individuals (such as Aid to Families with Dependent Children and Medicaid) and programs that finance government services (such as education and road construction).

The extent of federal involvement in state and local affairs increased substantially over the last two decades, in response to expanding perceptions of the proper role of government and concerns about the capacity of nonfederal governments to meet perceived needs. At the beginning of 1981, the number of grant programs was four times what it had been in 1960, and grants spending (in constant dollars) was more than four times the 1960 level.<sup>1/</sup> During this time federal involvement also expanded greatly in scope; in 1960 it supported primarily income security and transportation programs, but by 1981 it included subsidies for environmental quality, education, training, social services, health care, and general government services as well.

As the ways in which the federal government interacts with state and local governments increased in number and complexity, so did public dissatisfaction with the intergovernmental system. Criticism of the system is now widespread, including complaints that it contributes to waste through programs that are ineffective, outdated, duplicative, and unnecessarily inflexible. The criticism gathers force from the fact that, in some instances, the rationale for federal involvement in any form is unclear, while in others the form of federal involvement seems poorly designed to address federal goals.

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1. According to estimates by the Advisory Commission on Intergovernmental Relations (ACIR), 539 grant programs were authorized in 1981. The Office of Management and Budget, which uses a different method of counting separate programs, estimates that 360 intergovernmental grants were funded in 1981. See ACIR, Significant Features of Fiscal Federalism, 1981-82 Edition, p. 66.

The Administration sparked renewed interest in identifying the considerations underlying federal involvement by its 1982 proposal for a massive realignment of responsibilities in current programs. If this proposal had been enacted, the federal government would have assumed greater responsibility for some health services for the poor, but lesser responsibility in a number of other areas including cash assistance, education, social services, and transportation. The proposal was not enacted, however, because of disagreements about what role the federal government should play in these areas.

### THE PROBLEM--HOW TO DEFINE AN APPROPRIATE FEDERAL ROLE

A major factor behind the development of the current wide-ranging grants system is the lack of generally accepted guidelines to identify activities for which some federal role is important. Without such guidelines, virtually any social problem left unattended by some state or local governments may lead to federal involvement, unless constrained by budgetary concerns.

The problems of determining whether federal involvement is appropriate in a given program area, and if so what form it should take, are perennial. The Congress makes such a determination, implicitly if not explicitly, each time it authorizes a new program or modifies or eliminates an existing program. The current grants system is the result of numerous decisions of this sort made piecemeal by various committees of the Congress as individual programs were considered. The fragmented nature of this legislative process makes it difficult to eliminate poor coordination and duplication among programs entirely, but the grants system might be considerably improved if guidelines for federal involvement were developed and used by the Congress.

### PLAN OF THE STUDY

This study suggests guidelines the Congress could use to isolate areas in which federal involvement is appropriate and to determine the form it should take. In later chapters, it applies these guidelines to specific programs.

The guidelines are developed in Chapter II as a framework for analysis. Following Chapter III, which gives an overview of the current grants system, the remainder of the study examines specific program areas more thoroughly. Infrastructure and development programs are analyzed in

Chapter IV. Chapter V covers education, employment, and social service programs. Chapter VI discusses income security and health programs, with an emphasis on public assistance. Finally, revenue-sharing and other means by which the resources of state and local governments might be increased for general purposes are considered in Chapter VII.



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## CHAPTER II. FRAMEWORK FOR ANALYSIS

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This chapter presents some general principles that could be used to determine where there is an appropriate federal role and what might better be left to nonfederal governments or to the private sector. It also describes the forms of federal involvement now in use, some problems with them, and general approaches for modifying current programs. This framework is the basis for analysis of specific programs in later chapters.

### REASONS FOR FEDERAL INVOLVEMENT

Concerns that might justify involvement by some level of government are described first in this section, followed by discussion of the considerations that could help to determine whether federal involvement was required or whether state or local government involvement would be sufficient.

A strong governmental role is most clearly justified by concern with one or more of the following:

- o Spillovers or external effects--costs or benefits from particular activities that cross jurisdictional borders;
- o The advantages of centralized coordination--efficiency or other gains from centralized planning to insure coordinated services; and
- o Poor distribution of resources--inequities or hardships that are unusually severe for certain groups or regions.

The relative importance of these concerns varies among programs. Spillovers and administrative efficiency are the dominant considerations underlying infrastructure programs, for example, while modifying the distribution of resources is the dominant concern in public assistance programs.

### Spillovers or External Effects

Some activities generate costs or benefits that spill over to other communities. As an example, improper wastewater disposal may have little

effect on the community creating the problem, but impose substantial costs on downriver communities because of the health, aesthetic, or cleanup costs they must bear. The residents of the community causing the pollution may lack the incentive to build sufficient wastewater treatment capacity unless they receive a subsidy to cover the costs of the necessary equipment, or are subject to pollution penalties more costly than the equipment. In general, government intervention--through penalties or subsidies that reflect the value of external effects--can result in the curtailment of activities with spillover costs and the expansion of activities with spillover benefits.

### Centralized Coordination

Government intervention is also appropriate when it makes possible substantial efficiency or other gains from centralized control or administration. The Social Security system provides an example of gains from federal administration, because it permits a uniform retirement plan based on detailed records of individual contributions over a working lifetime that may include employment with a number of employers in different states. Development of the Interstate Highway System is another example, in which federal coordination ensured that routes planned and standards used within each state were consistent nationwide.

### Distribution of Resources

The desire to relieve hardship or inequity has fostered numerous government programs--at both the federal and state levels--intended to redistribute resources among people or communities. The largest federal redistributive programs provide benefits for individuals, either cash assistance as in the Aid to Families with Dependent Children (AFDC) program, or in-kind assistance as in health care and nutrition programs. Other redistributive programs increase public services available to disadvantaged groups, such as compensatory education for the poor and special education for handicapped children. Finally, community development programs and revenue-sharing redistribute resources among political jurisdictions, in order to promote economic development or to assure some basic level of public services.

### Additional Considerations

In many instances the scope of the problem is limited enough so that intervention by state, or even local, governments would be sufficient if they were willing to undertake it. If the scope of the problem crosses state

boundaries, however, federal (or multi-state regional) intervention may be necessary. For example, spillover effects from municipal wastewater pollution may not be limited to downriver communities within a state, but may affect communities in neighboring states as well. Similarly, benefits from centralized coordination may be limited to a metropolitan region in the case of ground transportation, but be nationwide for national defense and the air traffic control system. Redistribution of resources among states requires federal intervention, although redistribution among regions within a state need not.

In some instances more than one consideration may be involved, and these sometimes conflict. Regulations to reduce spillover costs--pollution from industrial production in a depressed region, for example--might impose hardship on people in the region by raising production costs and thereby reducing employment and income. Or benefits from programs to deal with spillover effects might be swamped by their administrative costs, especially if the external effects are limited.

## FORMS OF FEDERAL INVOLVEMENT

Federal involvement can take a number of forms. In many instances, the federal government pursues its goals directly, with program funding, policy control, and administration independent of nonfederal governments--as in the air traffic control system and Social Security. In other areas, responsibilities are shared through grants-in-aid. In grant programs, administrative responsibilities are delegated to nonfederal governments, and some responsibility for funding and policy control may be delegated as well. 1/

### Policy Choices in Shared Programs

Program responsibilities are shared in a variety of ways, as the result of choices made about:

- o How to allocate federal funds;
- o Whether and how to require cost sharing by grant recipients; and

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1. The Supplemental Security Income program is one exception to the delegation of administration for intergovernmental programs. In this program, administration may be either state or federal, whether or not the federal minimum standard is supplemented by the state.

- o How much policy control to delegate to grant recipients--that is, how restrictive to make federal program rules.

Allocation of funds. Most programs providing benefits for individuals are entitlements--where the program rules determine eligibility for benefits, but spending is a consequence of the number of eligible individuals who apply. Federal funds for the major entitlements that are grants--AFDC and Medicaid--are allocated among the states in accordance with state spending under the programs. In nonentitlement programs--where the Congress sets spending totals--funds may be allocated to selected applicants on a project basis, or they may be allocated among states or localities according to formulas that assure some payment to all qualifying areas. These formulas generally include some measure of program need--such as road miles for highway programs, and population for social service programs--and they may include a measure of fiscal capacity as well. 2/

The method by which program funds are allocated has implications for the way program benefits are distributed among the population. For entitlements, all individuals who satisfy the program's eligibility conditions and who apply receive benefits. The federal government can control spending for entitlements only by altering the program rules. For non-entitlements, by contrast, the federal government controls spending by appropriation limits, but total spending is often inadequate to provide services to all who may qualify. When non-entitlement grants are allocated by project, the federal government plays a large part in determining how services will be distributed among all those who qualify for them, but it has no such discretion when non-entitlement grants are allocated by formula.

Cost Sharing. In current entitlement programs, cost sharing--if any--takes one of two forms. The federal government may pay 100 percent of a minimum benefit standard, as in the Supplemental Security Income (SSI) program, permitting states to provide supplemental benefits entirely at their own expense. Alternatively, as in the AFDC and Medicaid programs, the federal government may reimburse states for some share of total benefits paid. Cost-sharing provisions, if any, in non-entitlement programs generally require that recipients match federal grant dollars in some specified proportion as a condition of receiving the grant.

Cost sharing is typically justified on one of the following bases. For one, it is used to increase service levels when there are sufficient local benefits that nonfederal governments would undertake the activity without

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2. The fiscal capacity of a government is its ability to raise revenues of its own. It depends primarily on the value of the tax bases the government may assess.

federal funding, but at a level the Congress would consider inadequate because, for example, of spillover benefits. Cost sharing is also used to increase incentives for recipients to use program dollars efficiently, since they may be less tolerant of waste when their own dollars are involved. Finally, cost-sharing rates may be based on a concern with the unequal distribution of resources--the rates varying inversely with the fiscal capacity of the recipient so as to reduce differences in the tax effort that nonfederal governments must make to fund their share of program costs.

Policy Control. The extent of policy control delegated to grant recipients, by definition, varies inversely with the restrictiveness of federal program rules. In entitlement programs, eligibility and benefit levels may be determined entirely by the federal government--as in the Food Stamp program--or jointly by federal and recipient governments--as in the AFDC and Medicaid programs.<sup>3/</sup> Non-entitlements may specify a narrow set of allowable uses for federal funds--as in bilingual education--or may support a variety of services within a broad functional area--as with the Social Services Block Grant. Revenue sharing is a grant for which allowable local discretion is virtually unrestricted.

Very restrictive program rules are appropriate when the Congress wants to control exactly how grant funds are used, whether or not this would conflict with local interests. When, however, the Congressional interest is in encouraging more activity in a broad functional area, or in targeting more services on certain population groups, greater allowance for local interests and differences--through more flexible rules--might be made without jeopardizing federal goals. A portion of grants that support services already provided by recipient governments will likely be used to replace nonfederal funding rather than to further expand services, however, unless maintenance of effort requirements are imposed.

#### SOME PROBLEMS CITED IN CURRENT PROGRAMS

The need for federal involvement is in some cases unclear, while in others its form may be inappropriate. In either instance, programs might be modified to achieve a more effective use of federal dollars.

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3. In the AFDC program, categorical requirements for eligibility are determined by the federal government, but benefit levels--and hence income limits for eligibility--are set entirely at the states' discretion. In the Medicaid program, the federal government sets minimum requirements for groups covered and services provided, but states may cover certain additional groups and provide certain additional services, with the federal government sharing the additional costs.

Federal dollars may be poorly used in some water resource programs--for example, those that were originally intended to hasten the development of the West--because development has been largely completed. Federal support may not be necessary for some other programs because their benefits are primarily local, without significant spillovers. Critics cite federal grant programs for secondary highways and for rural roads as examples, as well as federal subsidies for general education programs.

In other areas, changes in the form of federal involvement might result in programs that could better address current concerns. For example, cost-sharing provisions are frequently criticized, for a variety of reasons. Critics suggest that the structure of matching rates in Interstate Highway programs might be altered to favor repair and maintenance over new construction, since the sections of the Interstate System that remain unbuilt are predominantly of local importance, while deterioration of the existing national network is of growing concern. Cost-sharing provisions for most education and social service grants that subsidize traditional state and local activities serve little purpose at present, although they may increase administrative costs, because the federal grants are so small relative to spending by recipient governments that the matching requirements are irrelevant. Finally, cost-sharing provisions in the AFDC program--requiring federal reimbursement to states for a portion of the benefits they pay--direct as much or more federal aid per capita to high-income states as to other states that the Congress might prefer to favor. <sup>4/</sup>

Other criticisms of current federal programs concern the way in which federal funds are allocated, the desirability of certain program rules, and the benefits of multiple programs that provide similar services. For example, federal programs that subsidize education and social services might more effectively address concerns for spillovers and hardship if federal funds were targeted more toward disadvantaged groups or poor jurisdictions. Even programs that are allocated by a formula that includes a measure of fiscal capacity might be more effectively targeted, since the measure of fiscal capacity typically used--per capita income--is not suffi-

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4. This occurs despite the use of matching rates that vary inversely with a state's per capita income. It is due, in part, to the minimum value set in current legislation that restricts variation in matching rates to a narrow range (between 50 and 78 percent). In addition, it reflects the fact that rich states tend to have more generous public assistance programs than poor states. See Albert Davis and Robert Lucke, "The Rich-State Poor-State Problem in a Federal System," National Tax Journal, vol. 35, no. 3 (September 1982), p. 351.

ciently comprehensive to serve this purpose well.<sup>5/</sup> In addition, some programs that are intended to induce localities to provide special services for disadvantaged groups may be too inflexible, while others may allow too much discretion to local agencies to accomplish the purposes the Congress intended. Finally, consolidation of related programs in some areas--such as infrastructure or social services--might benefit recipient governments by reducing administrative costs and increasing flexibility, while still adequately addressing problems of concern to the Congress.

## WAYS TO MODIFY CURRENT PROGRAMS

Specific options for modifying current federal programs discussed in later chapters are of three general types. The federal government could eliminate (or assume) program responsibility, change funding provisions, or change program rules.

### Eliminate or Assume Program Responsibility

Under this approach, the program would no longer be intergovernmental. Either it would be left to nonfederal governments to continue at their own expense, if they chose to do so; or it would be a federal program with federal funding, policy control, and administration. In either case, activities might be managed more effectively because a single government would be held fully accountable. Complete elimination of federal responsibility would be inappropriate for programs that address significant federal concerns about spillovers, administrative efficiency, or the distribution of resources, however, while assumption of full federal responsibility for such programs might be undesirable if the services provided depended on local conditions.

### Change Funding Provisions

This approach could include altering the process by which federal funds are allocated among recipient governments, changing the cost-sharing provisions, or both. The allocation process could be used to target federal funds more effectively by, for example, modifying the measures of program need or fiscal capacity used in the distribution formulas for some programs.

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5. A more comprehensive alternative often suggested is the fiscal capacity measure currently compiled by the Advisory Commission on Intergovernmental Relations, based on the Representative Tax System. See Chapter VII for further discussion of this measure.

Changing cost-sharing provisions by altering matching rates might mean that the federal share of costs would better reflect the extent of spillovers from program activities. Another way of changing cost-sharing provisions--relevant to some public assistance entitlements, for example--would be to fund a minimum federal benefit, rather than to reimburse states for part of total benefits they set. This approach might better ensure that federal aid for public assistance was distributed according to need, and could make public assistance benefits more uniform nationwide. Implementing it could increase federal costs substantially, however, depending on how high a minimum was chosen.

#### Change Program Rules

This approach could entail redefining the population to be served, changing the activities allowed or the benefits provided, or modifying administrative requirements. Recipient governments might be given either more or less discretion over the groups served and the kind of services provided with program funds. Relaxation of requirements or consolidation of related programs--ways in which more discretion could be allowed--might be appropriate in areas where federal restrictions distort local priorities but not in any way clearly related to federal goals. In other areas, where recipient governments seem not to be serving the groups the Congress wished to aid or to be using program funds for broader purposes than the Congress intended, requirements might more appropriately be strengthened.

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## CHAPTER III. THE CURRENT INTERGOVERNMENTAL STRUCTURE

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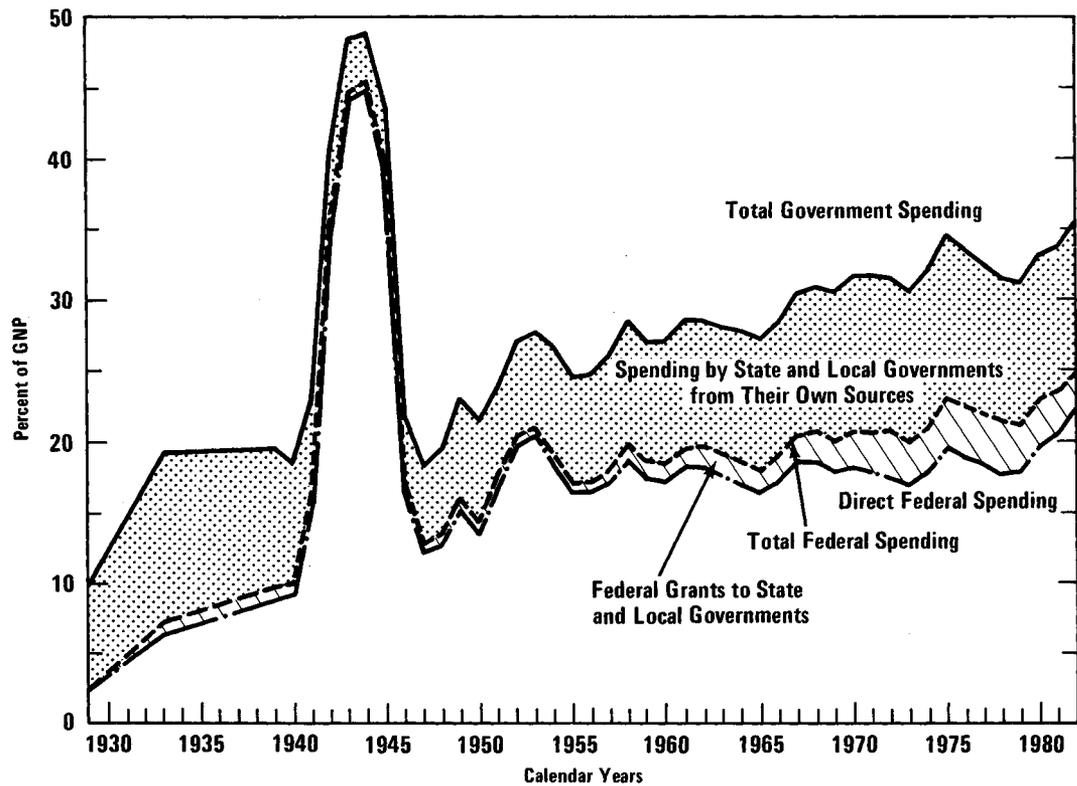
The size of the public sector relative to the economy has increased substantially over the last 50 years. In 1929, just before the Depression, spending by all levels of government was 10 percent of GNP, with spending by state and local governments about three times as large as federal expenditures (see Figure 1). By 1939, total government spending had almost doubled--to 19 percent of GNP--and the federal share had grown to equal the nonfederal share. Although government spending grew to nearly 50 percent of GNP during the war years, by 1950 it was not much larger relative to GNP than it had been in 1939. Between 1950 and 1982, spending by all levels of government increased from 21 percent to 35 percent of GNP. Direct spending by the federal government grew from 13 percent to 22 percent of GNP, and federal grants-in-aid to other governments rose from less than 1 percent to 3 percent of GNP. Spending by states and localities from their own sources rose from 7 percent of GNP in 1950 to 11.5 percent in 1975, before dropping to 10.5 percent in 1982.

In calendar year 1982, combined spending by governments at all levels in the United States was \$1.1 trillion--35 percent of the gross national product (GNP). 1/ Federal expenditures accounted for nearly \$800 billion (or 25 percent of GNP), including nearly \$700 billion spent directly by the federal government and about \$85 billion in grants channeled to nonfederal governments. States and localities spent more than \$300 billion from their own sources (or about 10 percent of GNP) to finance public services. 2/

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1. This rate is among the lowest among western industrialized nations. As of 1980, total government expenditures in the United States amounted to about one-third of the gross domestic product (GDP)--a concept that measures production within the borders of a country. As of the same year, total government expenditures as a percent of GDP were half a percentage point less in Japan and one percentage point more in Australia. In ten other industrialized nations, however, the public sector was far larger, ranging from 41 percent of GDP in Canada to nearly two-thirds of GDP in Sweden. See Organization for Economic Cooperation and Development, Economic Outlook, vol. 31 (July 1982), p. 149.
  2. Economic Report of the President, 1983, Appendix B. All figures for spending by different levels of government are for calendar years on a National Income and Product Accounts basis, and thus differ somewhat from those reported in most federal budget documents.

Figure 1.

## Government Spending as a Percent of Gross National Product, 1929-1982



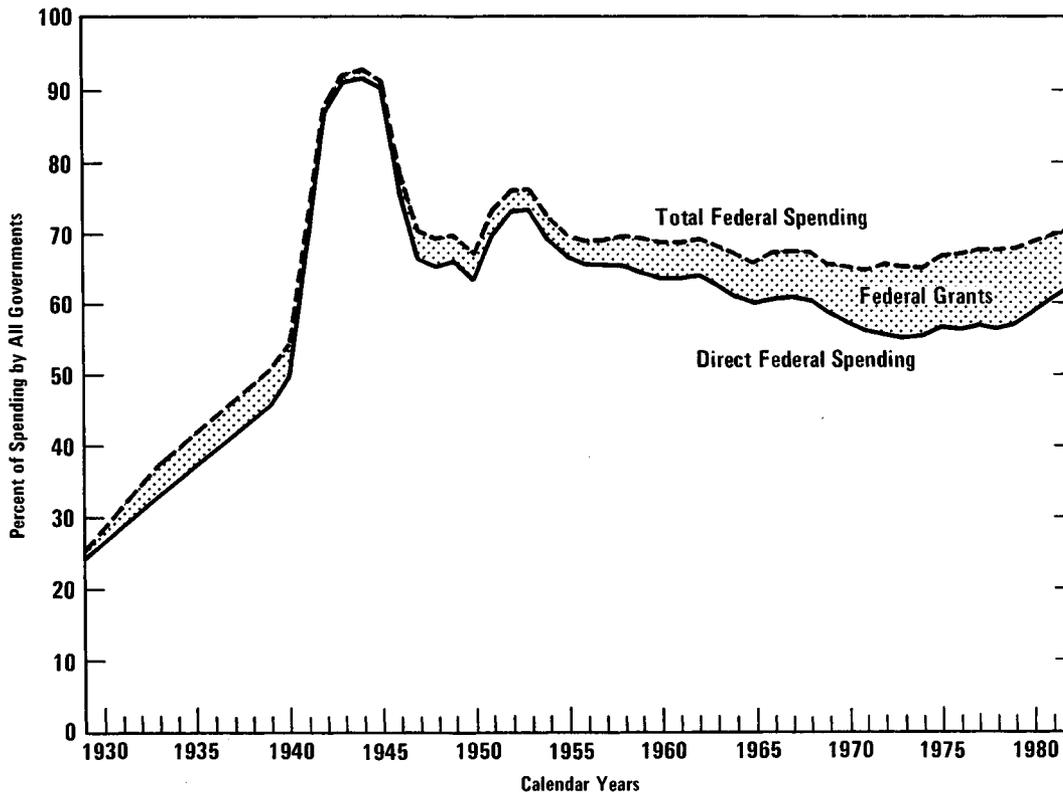
SOURCE: *Economic Report of the President* (1983).

### The Growth of Intergovernmental Grants

While the federal share of all government spending has remained fairly constant since 1950--between 65 and 70 percent, except for the Korean War period--an increasing proportion of federal spending has been through intergovernmental grants (see Figure 2). In 1950, federal grants to nonfederal governments were about 6 percent of all federal spending; by 1978, intergovernmental grants had risen to 17 percent of all federal spending, before declining to 11 percent in 1982.

Figure 2.

Total Federal Spending and Direct Federal Spending  
as a Percent of Spending by All Governments, 1929-1982



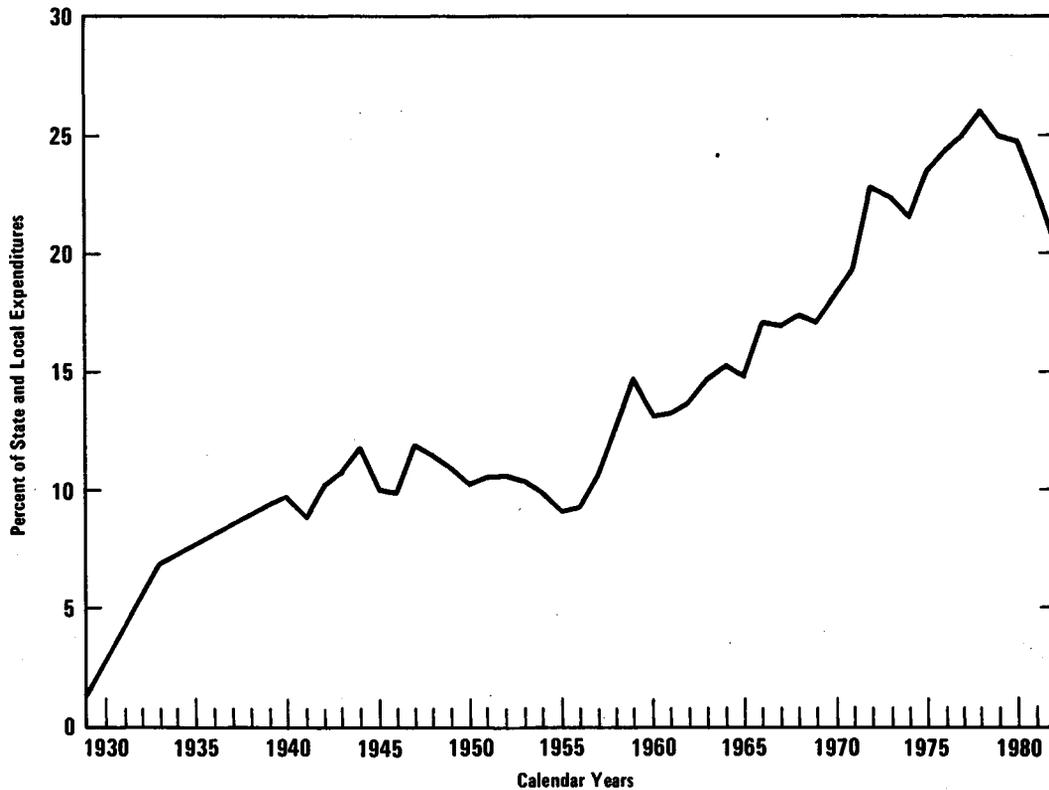
SOURCE: *Economic Report of the President* (1983).

As a result of the rapid growth in federal grants, coupled with the slower rise in spending by states and localities from their own sources, nonfederal governments rely much more on the federal government for financial support than previously. Federal grants as a percent of all state and local expenditures rose from 10 percent in 1950 to a peak of 26 percent in 1978, before dropping to 21 percent in 1982 (see Figure 3). It is estimated that 25 percent of federal aid goes directly to local governments, and that another 20 percent goes to local governments indirectly after passing through state governments first.<sup>3/</sup> To some extent, the growth in grants

3. See Advisory Commission on Intergovernmental Relations, Recent Trends in Federal and State Aid to Local Governments (July 1980), Table 5, p. 8.

Figure 3.

### Federal Grants as a Percent of State and Local Expenditures, 1929-1982



SOURCE: *Economic Report of the President* (1983).

has allowed the federal government to use nonfederal governments as administrative agents. This is reflected in government employment figures, which show that state and local government employment grew by 218 percent from 1950 to 1982, while federal employment grew by only 42 percent. <sup>4/</sup>

#### The Broadening Scope of Federal Aid

Along with the growth in grants has come a broadening in the scope of state and local activities supported by the federal government. In 1950, 80

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4. Economic Report of the President, 1983, Table B-37, p. 205.