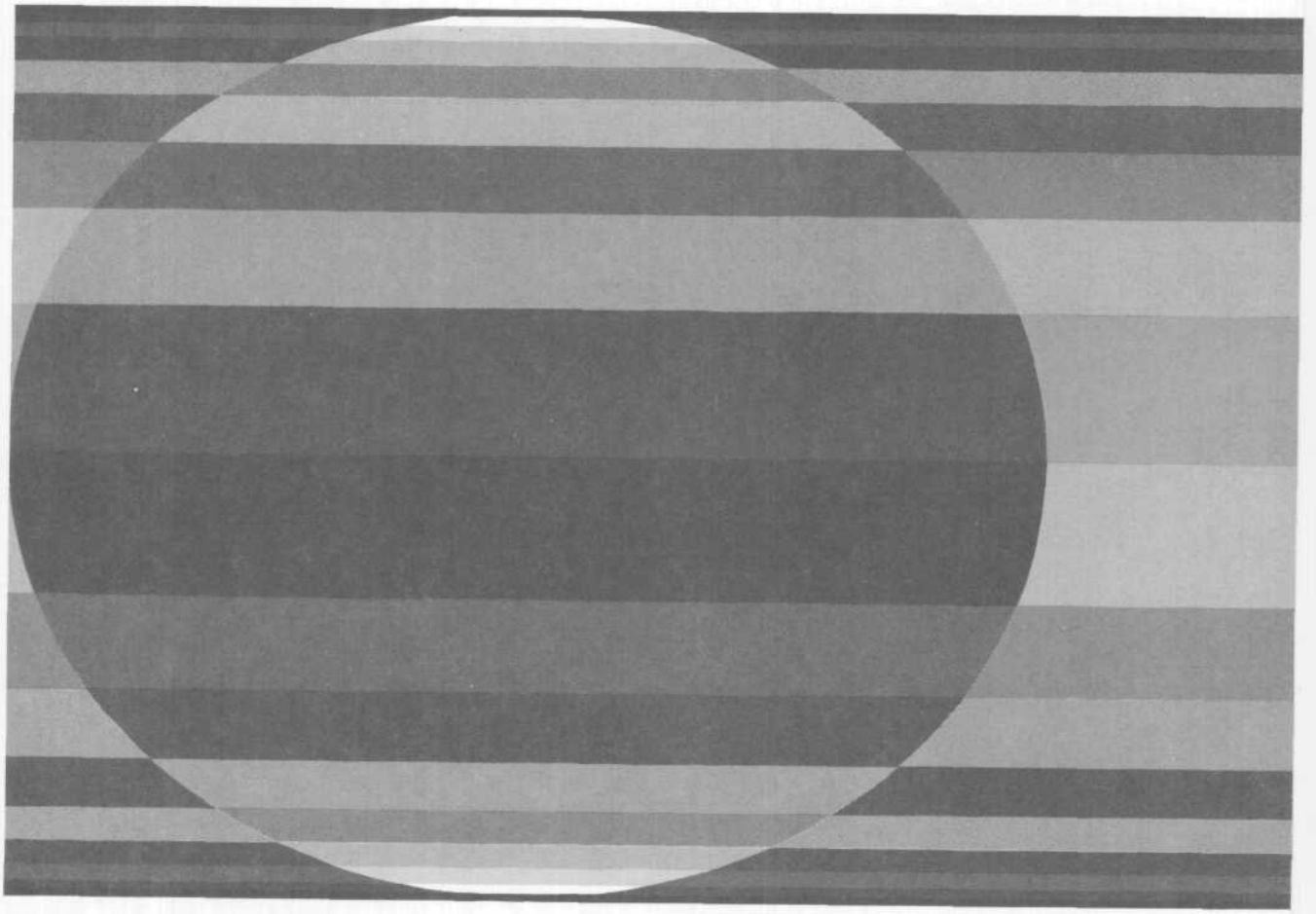
BACKGROUND PAPER

Federal Constraints on State and Local Government Actions:

April 1979



Congress of the United States
Congressional Budget Office

FEDERAL CONSTRAINTS ON STATE AND LOCAL GOVERNMENT ACTIONS

The Congress of the United States

Congressional Budget Office

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PREFACE

In recent years, state and local government officials have expressed concern over the extent to which federal laws and regulations constrain their actions and impose costs on their jurisdictions. To assist the House Budget Committee Task Force on State and Local Governments in evaluating these concerns, Representatives Elizabeth Holtzman and Norman Y. Mineta requested the Congressional Budget Office to prepare this study. The paper discusses different types of constraints and assesses what might be involved in measuring their costs and benefits. It also outlines some policy options that the Congress might consider if there is a consensus that intergovernmental constraints do pose a problem. In keeping with CBO's mandate to provide objective analysis, this paper makes no recommendations.

Federal Constraints on State and Local Governments was written by Peggy L. Cuciti of CBO's Human Resources and Community Development Division under the supervision of Robert D. Reischauer and David S. Mundel. Several other people, both at CBO and elsewhere, contributed to this report. In particular, the author wishes to thank Catherine Lovell and her associates at the University of California-Riverside who are doing research on the effects of federal and state mandates on local governments. They generously shared their work in progress and helped clarify many issues. Other people who provided valuable criticism include Stan Collender, Alfred Fitt, Richard Gabler, Sophie Korczyk, Martin Levine, Robert Levine, Dave O'Neill, and Charles Seagrave. The paper was typed by Jill Bury and edited by Johanna Zacharias.

Alice M. Rivlin
Director

March 1979

CONTENTS

FEDERAL CONSTRAINTS AS AN ISSUE

The constraints that federal laws and regulations impose on state and local government actions are a subject of concern to both state and local officials and to Members of Congress. As federal financial support of state and local functions has increased, and as federal regulatory policy has expanded, so too has the number of federal constraints. Critics contend that certain constraints impose excessive costs and require actions that are counterproductive to the achievement of federal programs' goals. They also argue that the extensive use of constraints compromises the principles of local self-governance and political accountability.

The counter argument is that constraints are necessary to further important national social and economic goals. While contending that most regulations are appropriate given the expansion in federal responsibilities, some constraints might nevertheless be criticized for being ineffective in furthering federal goals.

TYPES OF CONSTRAINTS

There are two general types of federal constraints on state and local action--mandates and contractual obligations:

- Mandates, the more coercive of the two types, are direct federal orders that state and local governments must follow. Most mandates are the result of court decisions interpreting the Constitution; for example, directives to provide legal counsel to the indigent, or orders to desegregate schools. Some, but not many, mandates derive directly from federal law. Examples include the various laws prohibiting discrimination in employment, and the Safe Drinking Water Act of 1974, requiring that drinking water be tested for impurities and that corrective steps be taken whenever necessary.

- Contractual obligations include constraints imposed as a result of agreements between the federal government and state and local governments. Such agreements are generally prompted by the availability of federal grants in aid. Conditions are specified as prerequisites for program participation. Some conditions are "program specific"; that is, they specify when and how money for a certain program is to be spent to insure consistency with stated objectives. Other conditions are generally applicable to grant programs; their purpose is to insure that all federally funded activities are consistent with broad national goals, such as nondiscrimination and environmental protection. Not all contractual obligations stem from grant-in-aid programs. Some, for example, arise as a result of federal regulatory programs. For example, under the Occupational Safety and Health program, states have the option of assuming administrative responsibility, provided they agree to abide by certain federal standards and guidelines.

ANALYSIS OF COSTS AND BENEFITS

Federal constraints involve costs, some of which fall on state and local governments. At present, little is known about the magnitude or distribution of these costs, although interest in developing an aggregate cost figure is great. Such an estimate would be very difficult to produce, since it would involve compiling a full inventory of constraints, as well as developing acceptable methodologies for estimating costs. Furthermore, the usefulness of such an aggregate figure would be limited, since decisions are made with respect to specific laws and regulations. Moreover, a judgment about whether or not these costs are excessive could not be made without a corresponding analysis of benefits and a review of possible alternatives.

Estimating the state and local costs and benefits resulting from specific laws or regulations is difficult. Many different types of effects--some of which are not readily measured--have to be considered. For example, analyses ought to take into account private as well as public, indirect as well as direct, intangible as well as tangible, and continuing as well as one-time costs and benefits.

Furthermore, incremental costs should be distinguished from total costs. Only those costs and benefits associated with actions that would not have occurred were there no federal intervention should be attributed to a mandate or to a condition of aid. Since there is overlap in the constituencies of policymakers at the federal, state, and local levels, it is not surprising that many constraints require actions that at least some state and local governments would have taken anyway.

Total and incremental costs may also differ, because of a redundancy in federal requirements. For example, as a condition for receiving federal aid, a state or locality may be required to prove compliance with an already existing federal law. Only those costs and benefits associated with a change in compliance can be attributed to the newer program.

The distribution of effects among jurisdictions is another consideration in the analysis of costs and benefits stemming from intergovernmental constraints. Analyses based on data aggregated at the national level may prove insufficient to the federal policymaker who wants to know not only whether a given course of action makes sense overall, but also whether it imposes unacceptably heavy burdens on specific jurisdictions.

POLICY OPTIONS

Critics who contend that intergovernmental constraints pose a problem want the Congress and the Executive Branch to consider changes in decisionmaking procedures and policies that would lower the number of constraints, increase their efficacy, and lighten the financial burdens they impose. There are several approaches the Congress might consider in response to this issue.

The first alternative is to take no explicit action, relying instead on the political process to prevent or change laws or regulations that impose excessive burdens on state and local governments.

A second course that the Congress might consider is to alter decisionmaking processes so that concerns about constraints on state and local governments are more likely to be addressed. Possible changes include:

43-127 0 - 79 - 2

- Requiring that analyses of state and local impact be undertaken before the Executive or Legislative Branch makes major decisions. Such a stipulation would complement recent executive orders requiring agencies to prepare urban and community impact analyses for major program changes and analysis of economic consequences--including effects on state and local governments--for all proposed regulations. State and local impact analyses would also supplement the information on the federal costs of most bills that the Congressional Budget Office now regularly gives to the Congress.

- Increasing Congressional oversight over agency rule making. Since many constraints are imposed as part of regulation, careful scrutiny of agency rule making could result in fewer problematic constraints.

A third approach would be for the Congress to attempt to lower the number of constraints by changing the structure and substance of federal policy. Specifically, it might consider the following:

- Reforming the administration of grant programs. Although steps have been taken to improve the management of grant programs, the number and complexity of requirements could still be reduced by -better coordination and by more standardization of procedures among different programs and agencies.

- Consolidating existing grant programs or relying more on block grants as opposed to categorical grants. At present, there are more than 440 categorical grant programs, many of which are very narrow in scope. Administration would be smoother if grants with similar purposes were consolidated. If this were done, however, the federal government's ability to set priorities would be weakened.

- Establishing a policy of fiscal reimbursement for some or all of the costs that federal constraints impose on state and local governments. Proponents of this approach argue that if Congress were required to appropriate funds, it might limit the number of requirements to those of most importance and proven effectiveness.

CHAPTER I. INTRODUCTION

In recent years, state and local officials have been troubled by the degree to which their actions are dictated or constrained by decisions made at the federal level. They see the system of regulation that has developed as costly, inefficient, and inflationary. Their concerns parallel many of those of private businessmen.

In addition, there is the fear that two important principles--local self-governance and political accountability--are both being undermined by federal actions. Local resources and energy are finite. When resources are allocated to follow dictates from higher authorities, they are diverted from locally identified needs and priorities. The principle of political accountability may be compromised inasmuch as state and local officials are identified with--and held responsible at the polls for--actions over which they have little control. Federal officials, meanwhile, may escape the political onus of the unpopular actions they order.

THE FEDERAL PERSPECTIVE

Most federal officials would agree that some regulations are ineffective or too costly. At the same time, however, they would argue that most regulations are necessary for implementing federal programs and for achieving national policy objectives.

Many of the regulations imposed on state and local governments are part of federal grant programs that have been enacted over the years in response to proven problems or needs. Because federal lawmakers are accountable to their own constituents, they must take steps to insure that federal funds are spent for the purposes intended. When state and local governments choose to participate in a grant program, they do so with the knowledge that their actions will be subject to federal review and regulation. Continued participation by state and local governments suggests that, regardless of regulation, they perceive that the programs' benefits outweigh their costs.

Some intergovernmental constraints stem from federal regulatory policies designed to end practices determined to have high social costs. Most such regulations are directed toward the private sector: private businesses are prevented by federal law from engaging in unfair labor practices; they must meet safety standards for work places, adopt pollution control technology, and so forth. Occasionally, regulatory policies also dictate or constrain state and local government actions. Some people argue that, to the extent that state and local governments engage in practices similar to those of businesses, their exclusion from federal regulation raises questions of equity and prevents the full achievement of national policy objectives.

Other constraints have been imposed because state and local governments have failed to fulfill their responsibilities under the Constitution. Both the federal courts and the Congress have acted to ensure that individuals' Constitutional protections are honored when state and local governments serve as employers, law protectors, and providers of services.

FEDERAL CONSTRAINTS AS AN ISSUE

The major reasons why intergovernmental constraints have emerged as an issue is that, over time, federal regulations have increased in number and complexity. As the federal government has expanded its role as social and economic problem solver, it has established numerous new programs and a concomitant number of regulations. Since many of the problems new programs address are inherently technical and complex (for example, environmental pollution), so too must be the accompanying regulations. Furthermore, as programs mature and administrators face diverse and unforseen circumstances, regulations tend to multiply.

Contributing to the concern over federal constraints is the increasing number of governments affected. Many of the newer grant programs involve local governments that had never before participated in the federal grant system. The burden of compliance with regulations may be greater in these smaller jurisdictions, which have less specialized staffs and less experience in dealing with federal officials.

Judicial actions have also contributed to the emergence of the issue. Besides handing down some controversial rulings based on the Constitution, the courts have assumed an important

role as enforcers of statutory and administrative law. This has occurred because citizen and other interest groups have increasingly resorted to litigation as a way to change government behavior. For example, the discretion of welfare program administrators has been reduced and the welfare rolls expanded as a result of successful litigation by welfare rights organizations. Public works projects have been halted or delayed by court orders following the discovery that procedures for environmental review had not been carried out.

As concern over inflation has mounted, attention has been drawn to all possible causes, including federal regulation. Although the regulation of private sector activity is more often cited, federal constraints on state and local governments also can be inflationary. If the federal government requires actions that are inefficient methods of achieving goals, inflation is a certain outcome. Regulations resulting in different or better state and local services could also cause the cost of services to increase, but these changes would not necessarily be inflationary.

The salience of the issue of intergovernmental constraints goes beyond these developments, however. To state and local officials, certain constraints seem more onerous in times of budgetary stringency than they do in periods of budgetary expansion. Inflation, recession, taxpayer revolts, and tax and expenditure limitation laws have all combined to force state and local officials to reexamine their budgets. As a result of these reexaminations, they realize the degree to which their options are constrained and their costs increased by requirements imposed by higher levels of government.

While intergovernmental constraints are often discussed by public officials and have been the subject of resolutions by their organizations, there is little common understanding of the range of federal actions being disputed or of the cost burden. This paper is a preliminary step in sorting out the issues. It is purely conceptual, and it provides neither an inventory of intergovernmental constraints nor *an* estimate of associated costs. The study has four objectives: to categorize the types of constraints (Chapter II); to discuss types of costs and benefits that should be considered in deciding whether constraints should be adopted or continued (Chapter III); and to examine various approaches the Congress might take in dealing with the issue of intergovernmental constraints (Chapter IV).

CHAPTER II. TYPES OF CONSTRAINTS

The different types of federal requirements that directly affect state and local governments and that involve some degree of coercion are examined in this chapter. These requirements fall into two categories--mandates and contractual obligations:

- Mandates are formal orders issued by the federal government, which is legally the higher government and is thus entitled to give orders under certain circumstances. State and local governments have little option but to comply with federal orders.

- Contractual obligations are conditional; they come about when state and local governments enter into binding agreements with the federal government. Most contractual obligations are associated with federal grant programs.

According to the Constitution, there are limitations on the right of the federal government to mandate the actions of state and local governments. Thus most federal requirements stem from contractual agreements. Compared to the federal government, states are much less restricted in their behavior toward local governments. As a result, state laws include many more direct orders.[1] It should be noted, however, that numerous state mandates have their origin in federal constraints imposed on the states by way of the grant-in-aid system.

1. For a full discussion of state mandates, see the Advisory Commission on Intergovernmental Relations, State Mandating of Local Expenditures, (A-67, July 1978). See also, State Limitations on Local Taxes and Expenditures, (Rept. A-64, February 1977).

MANDATES

Direct orders, in the form of mandates, may come from any of the three branches of the federal government. They may be based either on federal statutes or directly on the Constitution. Most mandates affect only the private sector, so they are outside the purview of this discussion. Some, however, are directed exclusively toward state and local governments, and others apply to the public and private sectors simultaneously.

Mandates Based on Court Orders

Most federal mandates that apply only to state and local governments stem from judicial interpretation of the Constitution, in particular, the Bill of Rights and the 14th Amendment. A wide range of state and local activities have been affected by such rulings. For example, the Supreme Court has ordered that electoral districts be redrawn, schools be desegregated, free counsel be provided for indigents, juvenile court procedures be reformed, and prisons and mental institutions be upgraded.

While direct court orders are issued to certain specific jurisdictions named in adjudicated cases, the principles articulated in court opinions often have general applicability. Jurisdictions not named in the cases are in effect mandated to change their behavior, too, since not to do so would expose them to court challenge. For example, as a result of Brown v. Board of Education, the court ordered Topeka, Kansas, to desegregate its schools. The impact of the Brown decision, however, was very far reaching: school systems across the country were signaled that the time had come to end de jure segregation of schools.

Mandates Based on Federal Statute

The Congress often attempts to achieve social and economic objectives by using its regulatory powers. Laws are passed and administrative regulations are promulgated proscribing certain actions and prescribing others. Mostly, these mandates have been directed toward the private sector. The scope of some social and economic regulatory policy, however, includes state and local government actions.

Most mandates affecting state and local governments are found in laws concerning either the environment or civil rights. A number of examples follow:

- The Clean Air Amendments of 1970 (Public Law 91-604) require states to develop plans acceptable to the Environmental Protection Administration (EPA) to attain federal air-quality standards. The EPA can require states to plan changes in state transportation policies (for example, by giving additional support to mass transit) as well as to regulate the pollution-creating activities of private persons (by establishing, for example, emission-control requirements and inspection programs for private cars).

- The Federal Water Pollution Control Act of 1972 (Public Law 92-500) requires state and local governments to adopt better methods of treating sewage in order to curb the discharge of pollutants.

- The Safe Drinking Water Act of 1974 (Public Law 93-523) requires all suppliers of drinking water (including, but not limited to, publicly owned systems) to test their water regularly for impurities. If "maximum contaminant levels" are exceeded, acceptable treatment processes must be introduced or another source of potable water used.

- The Equal Employment Opportunity Act of 1972 (Public Law 92-261) prohibits state and local governments from discriminating in their employment practices on the basis of race, color, religion, sex, or national origin.

- The Age Discrimination in Employment Act of 1967 (Public Law 90-202) prohibits discrimination in employment practices on the basis of age.

The constitutionality of efforts to regulate state and local actions has recently been called into question. Authority to regulate both the private and public sectors stems from the Commerce Clause, the Necessary and Proper Clause, and the 14th

43-127 O - 79 - 3

Amendment of the Constitution.[2] Since the 1930s, the Supreme Court has consistently upheld Congressional regulation of private business, including, for example, laws prohibiting discrimination in employment, housing, and public facilities; statutes establishing minimum wages and other fair labor practices, and so forth. While for political reasons, the Congress has rarely passed laws mandating state and local government activities, until recently, it was widely assumed to have the legal authority to do so. In 1976, however, the Supreme Court ruled in National League of Cities v. Usery that the 10th Amendment guarantee of state sovereignty implies certain restrictions on Commerce Clause powers as applied to state and local governments. Specifically, the Court invalidated the 1974 amendments to the Fair Labor Standards Act (Public Law 93-259) that extended minimum wage and overtime pay protection--rights that had long been enjoyed by employees in the private sector--to non-supervisory state and local government employees. The Court ruled that the extension of these provisions impermissably interfered with the integral functions of state and local governments and threatened their "separate and independent existence."[3]

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2. The "Commerce Clause" and "Necessary and Proper Clause" are both part of Article I, Section 8 of the Constitution. It reads, "The Congress shall have the power . . . [3] to regulate commerce with foreign nations, and among the several states and with the Indian tribes . . . [18] to make all laws which shall be necessary and proper for carrying into execution the foregoing powers and all powers vested by this Constitution. . . ." Additional authority is granted in the 14th Amendment. Section 1 reads: ". . . No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty or property without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws." Section 5 reads: ". . . the Congress shall have power to enforce, by appropriate legislation, the provisions of this article."

3. National League of Cities v. Usery, 426 U.S. 833 (1976).

How broadly the legal reasoning articulated in the National League of Cities decision will be applied is as yet unclear. Clarification is required on two major issues. First, what is the range of activities that are crucial to the states' "independent existence" and that must be protected from Congressional action? And second, is the protection offered absolute or only partial--subject to a balancing of the federal interest in the objective to be achieved by the regulation and the state's interest in freedom of action?[4]

Although the National League of Cities decision suggests limits on the Congress' authority to issue direct orders to state and local governments, the decision does not preclude the use of other, less coercive means to achieve similar ends. As discussed in the next section, the Congress can offer inducements of various sorts to get state and local governments to change their behavior.

CONTRACTUAL OBLIGATIONS

Numerous intergovernmental constraints have their bases in contractual relationships. When the Congress determines that a national policy objective can be furthered by some change in state or local behavior, it may seek voluntary cooperation. In effect, the federal government proposes to enter into a contractual arrangement: it offers some benefit (generally, but

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4. Major questions regarding the scope and implications of this decision remain for several reasons. First, while five Justices were in agreement on the outcome in the National League of Cities case, there did not appear to be a consensus regarding the legal standard; only four Justices signed the Court opinion with a fifth filing a separate concurring opinion. Second, the decision is a clear departure from past reasoning by the Court (for example, Maryland v. Wirtz 392US183 [1968]), so there are few precedents to draw on for clarification. And finally, the court has not had occasion since the National League of Cities decision to decide whether the principles enunciated in that case affect statutory mandates other than those for minimum wage and overtime pay. The lower courts have tended to decide related cases on narrower grounds and have not extended the reach of the case to other areas.

not exclusively, in the form of financial assistance), in return for state and local government agreement to act in a given way subject to federal regulation. For numerous historical and political reasons, intergovernmental constraints stemming from voluntary agreements are more common than are federal mandates.

Federal grant programs are the source of most contractual obligations. Occasionally, however, other circumstances will prompt such agreements imposing requirements on both parties. These are discussed briefly following the section on conditions of aid.

CONDITIONS OF AID

Federal grants are made available to state or local governments contingent on the potential grantees' willingness to implement certain programs and/or to meet conditions specified in federal law or in administrative regulations.

Voluntary or Mandatory?

Although constraints that are imposed as conditions of aid technically are incurred voluntarily, they may, for a variety of reasons, seem mandatory from the perspective of state or local officials. This is the case for the following three reasons:

- The choice to participate in the federal program may be made by state officials, but the burden of administering the program in accordance with federal regulations falls on local governments. For example, Aid to Families with Dependent Children (AFDC) is a grant program available to states. Yet in 18 states, local government agencies are responsible for administering the program. The regulations guiding local administrators come from their state governments, but many have their source in federal regulations.

- Conditions of aid may have changed since the decision to participate was originally made. While participation remains voluntary, state and local officials may believe that, despite the change in regulations, they have no option but to continue participation, since constituents rely on the service provided. Since it is not

feasible for states to assume the federal share of program costs, regulations imposed after a program is underway are perceived as tantamount to mandates. The 1976 amendments to the Unemployment Insurance (UI) law offer an example. In order for states to continue to qualify for grants for administration and for employers within the state to continue to receive a federal tax credit for UI taxes paid to the state, coverage must be extended to all public employees. The costs of noncompliance are perceived as being so high as to make the change in regulation seem coercive.

- Current constraints may stem from decisions made several years earlier. For example, in order to receive federal aid for the construction of a highway, a state must agree to keep the road up to federal highway safety standards. Decisions made as long ago as 20 years thus constrain the budgetary choices available to present day state and local officials.

Program-Specific Versus Generally Applicable Grant Requirements

Certain grant program regulations are described as "program-specific," meaning that they apply to a single program and are intended to guide program administration in ways that federal officials deem best for achieving that program's goals. Other regulations are general in that they apply to many grant programs and are designed to further national policy goals more or less independent of specific program goals. The two types of requirements described--program-specific or general--represent polar opposites, and many program requirements fall somewhere along the continuum between the two. For the sake of discussion, however, various program requirements are classified here as either program-specific or general.

Most aid requirements are program-specific, and these are of two sorts: programmatic and procedural. Programmatic requirements specify the scope, quality, or quantity of the service to be provided with the program money. For example, medicaid regulations specify and describe a certain eligible population (all AFDC and Supplemental Security Income recipients) and kinds of services to be provided, (for example, inpatient hospital care, physician services, laboratory and X-ray charges, and so forth). Procedural requirements dictate some aspects of

how the programs are to be administered. The most common procedural requirements relate to planning, reporting, and fiscal management. For example, General Revenue Sharing (GRS) recipients are required to report annually to the Department of the Treasury on how they use their GRS funds. They must also have an outside audit done according to generally acceptable auditing standards once every three years.

Program-specific regulations are often objected to on grounds that they are cumbersome, costly, and inefficent. State and local officials argue that conditions are so diverse that no single set of regulations can be appropriate everywhere. On the other hand, if an effort is made to write regulations applicable to every set of circumstances, the system becomes so complex as to be unworkable. State and local officials also argue that the problem is exacerbated by lack of coordination among federal agencies and by a tendency to write regulations that are more concerned with how a program is to be run rather than with what is accomplished.[5]

Sometimes federal regulations draw complaints on grounds that they amount to inappropriate extensions of federal authority. Most people would agree that the federal government has a legitimate interest in how federal funds are spent and that regulations directed toward that end are acceptable. But when regulations are written to further federal goals by directing state or local actions that may be related in function but that are otherwise independent of the grant-aided activity, state and local officials object. The following are some examples:

- The Land and Water Conservation Act includes a provision that no land purchased by the state with federal funds can be used for anything other than recreation without the consent of the Secretary of the Interior. This provision has been interpreted as meaning that if federal funds are used to purchase a 10-acre parcel of land to be added to a several-hundred-acre state forest, then

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5. See National Governors Conference, Federal Roadblocks to Efficient State Government, Vol. 1, February 1977, pp. 1-8 and pp. 13-19.

the whole state forest comes under the rules of the Bureau of Outdoor Recreation.[6]

- The 1976 amendments to the Unemployment Insurance Compensation Act make the federal tax credit for private employees' contributions to state unemployment insurance funds and the state governments' participation in grants for administration contingent upon the extension of unemployment insurance to state and local employees.

- The National Health Planning and Resources Development Act of 1974 makes receipt of federal health grants contingent on the establishment of health planning agencies that administer "certificate of need" programs, regulating decisions by hospitals and nursing homes to expand facilities or to purchase major new equipment.

Some conditions of aid have little to do with the specific purposes or objectives of the programs to which they are attached. On the contrary, in an effort to further broad national policy objectives, such as environmental protection or nondiscrimination, generally applicable grant requirements are put in place. The objectives are deemed sufficiently important to disallow federal support of any project that would interfere with their achievement. Generally applicable requirements are an important means of insuring consistency with federal policy. For example, the general environmental review requirement prevents the federal government from doing more harm to the environment with a local public works grant than it does to help it through a conservation program.

Generally applicable grant requirements are put into effect in two ways. Separate laws may be passed making a requirement applicable to all grant programs across the board. Title VI of the Civil Rights Act of 1964 (Public Law 88-352), which prohibits discrimination in any program or activity receiving federal financial assistance, is an example. Alternatively, the requirement may be appended to each statute authorizing a grant program. For example, most statutes authorizing grant programs for construction contain a clause invoking the

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6. See National Governors Conference, Federal Roadblocks to Efficient State Government, Vol. 1, February 1977, p. 11.

Davis-Bacon Act, which requires that all laborers employed on a federally funded project be paid at rates not lower than those being paid on private construction in the same locality.

In a major study of the federal grant system, the Advisory Commission on Intergovernmental Relations (ACIR) identified several groups of general policy requirements.[7] Several of these categories are described in the following paragraphs:

- o Nondiscrimination. Mandated prohibitions against discrimination in employment are supported by grant-in-aid regulations prohibiting the use of federal funds for discriminatory practices. Title VI of the Civil Rights Act of 1964 offers the most general protection against racial bias. It states that "no person in the U.S. shall on the ground of race, color or national origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving federal financial assistance." Similar protection has been accorded to the handicapped and to the aged.[8] The provisions regarding handicapped persons are particularly controversial, since compliance can involve considerable outlays of money to modify existing structures in order to accommodate handicapped persons. Although sex discrimination has not been prohibited in federal aid programs on an across-the-board basis, provisions have been appended to a number of the statutes authorizing specific programs.

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7. See Chapter 7, in ACIR "Generally Applicable National Policy Requirements," Categorical Grants; Their Role and Design, (Report A-52, 1978).

8. Section 504 of the Rehabilitation Services Act of 1973 (Public Law 93-112) states that "No otherwise qualified handicapped individual in the U.S. shall, soley by reason of his handicap, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal financial assistance." The Age Discrimination Act of 1975 (Public Law 94-135), using similar language, prohibits discrimination based on age.

- Environmental Protection. The National Environmental Policy Act of 1969 (Public Law 91-190) requires that all financial assistance programs, including both loans and grants, be reviewed to determine whether they will have a "significant impact" on the environment. A statement of the anticipated environmental impact must be prepared before the proposal can be funded. Specific things to be considered in the review process are stated in several laws and executive orders. These include the effects on air and water quality, on fish, wildlife, and endangered species, on "wild and scenic" rivers, on historic and archeological sites, and so forth.

- Relocation and Property Acquisition. The Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 requires that anyone displaced as a result of a federally funded activity be compensated fairly. The law and its regulations set standards governing the acquisition of property and the benefits and services to be provided to displaced residents.

- Labor and Property Procurement Standards. Two laws with general applicability regarding the use of grant funds are the Davis-Bacon Act of 1931 and the Work Hours Act of 1962. As written, the Davis-Bacon law required that workers on federal construction projects be paid at locally prevailing wage rates. Its provisions have now been extended to state and local government construction projects that are funded by the federal government under any of 60 different grant programs. The Work Hours Act specifies that employees carrying out federally funded activities must be paid overtime rates for hours worked in excess of eight-hour days and 40-hour work weeks. The Federal Procurement Policy Act of 1974 allows federal regulation of the procurement of services and goods other than real property using federal grant funds, but to date no generally applicable regulations have been issued. "Buy America" provisions, however, which currently constrain federal government purchases to domestically produced raw and manufactured materials, have been extended to four large federal grant programs during the past two years.

43-127 O - 79 - 4

- o Citizen Participation. Requirements for citizen participation in the implementation of grant-aided programs are increasingly common, though the exact stipulations vary from program to program.

Conditions of aid designed to further broad national policy goals have been objected to on several grounds. The major complaint is that they divert resources away from--and thereby hinder the achievement of--the primary goals of grant programs. General policy requirements are often imposed without any increases in program funding. To the extent that these requirements are costly to implement, resources are either diverted from program operations or an additional commitment of state/local revenues is required. For example, the requirement for environmental review is likely to increase the costs of any project to which it is applied. It costs something to perform environmental impact analyses. Furthermore, if a project is delayed or modified to meet environmental objections, its costs are likely to increase. So long as appropriations are fixed, added costs may mean fewer projects can be undertaken and that specific program goals (for example, improved transportation) would be sacrificed in favor of environmental considerations.

Another criticism lodged against generally applicable regulations is that they may not be cost-effective. State and local officials dispute whether the means set forth by the federal government for the achievement of national policy objectives are the most efficient ones available. For example, some critics have argued that public transportation is better made available to the handicapped by means of taxi vouchers or some other form of personalized service than by adapting existing buses and subways, as is now proposed by the Department of Transportaton.[9]

Some generally applicable regulations are disputed on grounds that they further goals that the grant recipients care little about achieving. For example, the Davis-Bacon Act requirement that prevailing wage rates be paid to workers on grant-funded projects is perceived by many state and local

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9. Department of Transportation, "Nondiscrimination on the Basis of Handicap, Federally Assisted Programs and Activities; Notice of Proposed Rulemaking," Federal Register, June 8, 1978, Part V.

officials as doing little more than increasing the power of unions in the construction trades. Some officials object to incurring costs that further this goal.

OTHER CONTRACTUAL OBLIGATIONS

State and local governments sometimes enter into agreements with the federal government for reasons other than the availability of financial aid. These agreements vary in terms of the benefits derived and the requirements imposed. Some examples are discussed below:

- Social Security coverage. Participation in the Social Security system is mandatory for private employers, but it is optional for public employers. At present, nearly 9.5 million, or 75 percent, of state and local employees have Social Security coverage under 50 state agreements. Wherever there are agreements, state and local governments and their employees are subject to requirements governing taxation and benefits.

- Occupational Safety and Health. In 1970, to help curtail work-related injuries and illnesses, the Congress authorized the establishment of safety standards in private places of business. In general, enforcement of these standards is a federal responsibility. The law provides for intergovernmental agreements, however, whereby states would assume responsibility for the administration of health and safety standards. A condition of any such agreement is the willingness of states to extend equivalent protection to public employees within the state. At present, 21 states have chosen the state-enforcement option.[10]

10. When states assume responsibility for administering Occupational Safety and Health Administration (OSHA) standards, they receive small grants covering part of the costs. One state in addition to the 21 cited above administers an OSHA program for public employees but leaves administration of the private sector program to the federal government.

CONCLUSIONS

Of the two types of federal constraints discussed in this chapter--mandates and contractual obligations--the former are the more coercive. They are less of an issue, however, since not so many of them exist, and of those that do, many are beyond the control of the Congress. Of greater concern are constraints originating in contractual obligations, particularly those that are conditions of receiving federal financial aid.

CHAPTER III. ASSESSING COSTS AND BENEFITS

The total costs associated with federal constraints--particularly that portion of costs not borne by the federal government--are matters of widespread interest. At present, no estimate of total costs exists, and it is not clear that one could be produced. The difficulties of compiling an inventory of constraints and of estimating the costs of compliance for all state and local governments are formidable.[1]

Even if an estimate of total costs were available, its usefulness to federal policymakers is uncertain. This is the case for several reasons:

- Costs considered without regard to benefits offer little basis for evaluation. If federal constraints are a problem, it is not because they are costly per se but rather because they are costly relative to the benefits they yield or relative to the benefits that other uses of the same money could yield.

- Aggregate costs give little guidance to policymakers who must make decisions on specific laws or regulations. Even if the total costs imposed by federal constraints were found to be too high, more information would be needed to know what policy changes would correct the problem. In other words, an estimate of total costs would only be useful if it were backed up by an estimate of costs for each federal mandate or condition of aid.

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1. A major research effort funded by the National Science Foundation is currently underway in the School of Administration, University of California-Riverside. The study's aims are to inventory federal and state constraints affecting local governments and to develop a methodology for estimating the costs associated with these constraints. The completed study will also contain preliminary cost estimates.

- o Aggregate costs provide little information regarding the burden imposed on specific types or levels of government. Costs are not distributed evenly among state and local governments. A situation that seems satisfactory or beneficial for state and local governments in general may nevertheless be problematic for certain specific governments. Focusing on aggregate costs would reveal nothing about particular jurisdictions' problems.

Although the utility of an estimate of total costs is uncertain, knowing the effects of specific laws or regulations on state and local governments would be useful to federal policymakers. Judgments regarding equity and efficiency would be facilitated if decisionmakers knew the magnitude of the costs and benefits inposed, how the costs and benefits are distributed among states and different types of local governments (for example, cities and counties), and whether they compare favorably with what could be achieved by alternative actions.

This chapter discusses the various types of costs and benefits that ought to be considered when any government action is evaluated. In addition, it examines the particular conceptual and measurement difficulties that arise when intergovernmental constraints are at issue.[2]

TYPES OF COSTS AND BENEFITS

Public and Private Costs and Benefits. Intergovernmental constraints, by definition, have as their primary goal a change in state and local government behavior. Government actions involve costs (personnel, equipment, and so forth), which are generally referred to as public, even though they are ultimately borne by tax-paying private citizens. But government actions may result in direct private costs as well, that is, costs apart from taxes. Such costs occur when a mandate or condition of aid causes changes in private as well as public actions.

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2. See Julius Allen, Estimating the Costs of Federal Regulation; Review of Problems and Accomplishments to Date, Congressional Research Service, Report No. 78-205E, for a related discussion focusing on federal regulation of the private sector.

As an example of these costs, consider a mandated state plan to improve air quality standards. Such a plan is likely to involve auto emission control standards and inspection. The state would incur costs in the development and administration of the state plan. Owners of older cars would bear the costs of the additional equipment and maintenance needed to keep cars operating up to standard. These costs would be in addition to those borne at the time of car purchase as a result of the direct federal regulation of car manufacturers regarding the installation of air pollution control equipment.

Benefits arising from state or local governments' response to a federal directive may accrue to particular client groups, to the public at large, or to the government itself. For example, a reduction in air pollution achieved by state implementation of federal air quality standards should result in several benefits. If the air is cleaner, health problems should be decreased; the populace as a whole may profit from this improvement, but the benefit would be greatest for the elderly and anybody with respiratory problems. The benefit should also be felt by state and local governments to the extent that they finance or directly provide health-care services. Clean air should also result in lower maintenance costs (less cleaning, less frequent painting, and so forth) and a longer useful life for physical objects such as cars, buildings, and bridges.

Direct Versus Indirect Costs and Benefits. Some costs and benefits follow directly from the action specified by a federal constraint. Direct costs include those incurred by state or local governments, or by private parties, as they comply with the mandate or condition of aid. Direct benefits are generally those that were intended and that justified the imposition of the constraint in the first place; however, other direct benefits may also be realized. Indirect costs or benefits are those that follow, generally with some lag, as economic and social adjustments to the change in government policy are made.

These distinctions are best illustrated by an example. Consider the requirement that states adopt a 55 miles-per-hour speed limit, which in 1974 was made a pre-condition for the receipt of federal highway aid.[3] Direct, one-time costs were imposed on governments because speed limit signs had to be

3. Federal Aid Highway Amendments of 1974 (Public Law 93-643).

altered or replaced. Continuing costs could include additional police patrol and court costs because more people would be inclined to violate the limit. Another continuing cost would be reduced revenues from gasoline taxes if compliance led to better fuel efficiency and fewer gas purchases. Of course, private businesses and individuals also bear costs. At lower speeds, it takes longer to get from one place to another. Ultimately, reflecting the higher costs of transportation from production through marketing, the consumers must pay higher prices. Direct benefits include energy conservation and accident reductions attributable to slower driving speeds.

Indirect costs are borne as production and consumption patterns change in response to price changes. Some companies may find their markets contracted, and others may go out of business when added transportation costs make their product noncompetitive. Interstate trucking firms may lose business to railroads; firms and places with access to rail transportation may benefit, while those that rely exclusively on trucking may lose.

From the perspective of any given individual, business, or place, these second-order effects can be very real and very important. From a national perspective, indirect gains and losses may balance out, and as a result, they are often omitted from analyses seeking to determine the efficiency of a given action. The pattern of gain and loss may be an important consideration, however, in evaluating whether an action is fair and equitable.

Tangible Versus Intangible Costs and Benefits. While dollar values can be assigned to many costs and benefits expected from a government action, certain effects are less tangible and more difficult to quantify. Indeed, a number of services—pollution control or police services, for example--are provided publicly rather than privately precisely because of the difficulties in pricing the benefits.

Costs, too, can be intangible. Consider the requirement that there be "maximum feasible" participation by affected citizens in planning and operating a Community Action Program in the 1960s.[4] That requirement gave rise to relatively few

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4. Title II of the Economic Opportunity Act of 1964 (Public Law 88-452).

tangible costs. In some instances, however, intangible costs in the form of city-wide tension and conflict were very high. Likewise many of the benefits from the citizen participation requirement were also intangible--for example, the development of leadership skills in impoverished communities.

More common is the case in which costs are quantifiable but benefits are not, leading to an imbalance in analysis and possibly to misleading conclusions. Requirements of the National Environmental Protection Act of 1969 (NEPA) provide a good illustration. Cost considerations include: staff time to research and prepare environmental impact statements; price increases attributable to the combination of inflation and the lengthened time between project conception and actual construction; and project changes necessary to minimize adverse environmental effects (for example, rerouting a highway in a way that adds to its length). Calculating the benefits is more difficult. How do you quantify the value of preserving marshes or coastal wetlands so that birds can maintain their migration patterns or that an endangered species can survive? Yet it is precisely because such things are valued that there was at least an initial willingness to require environmental review despite the costs it was known to entail.

One-Time Versus Continuing Costs and Benefits. Some costs and benefits occur only once, while others continue. Regulations under Section 504 of the Rehabilitation Services Act, requiring program accessibility to the handicapped, impose both kinds of costs. The prohibition of architectural barriers in new buildings results in one-time costs. Proposed Urban Mass Transit Authority regulations, however, could impose both one-time and continuing costs, since buses accessible to the handicapped--so-called "kneeling buses"--are more costly both to purchase and to operate than are ordinary buses. Operating costs are expected to increase because mechanical equipment that allows accessibility requires additional maintenance. Also, since buses usable by the handicapped carry fewer passengers, a city transit system may need more of them to maintain an adequate level of service.

Total Versus Incremental Costs and Benefits. Analyses of government regulations must take account of the distinction between total and incremental costs. Total costs and benefits are usually calculated assuming that all actions consistent with a federal regulation are in fact attributable to that

regulation. This approach results in an overstatement, because the federal government rarely requires something to be done that some state or local governments would not do of their own volition. In other words, some actions would have taken place anyway. Only the costs and benefits of actions that would not have occurred were there no federal intervention should be attributed to a federal mandate or condition of aid.

Consider, for example, the costs and benefits associated with the mandate that all sewage be treated using the "best practicable" technology before the sewage is discharged into any waterway.[5] Presumably, by 1983 all municipalities will be in compliance, and the nation's waterways will be substantially cleaner than in 1972 when the mandate was imposed. But what proportion of the total costs and benefits will be directly attributable to the federal mandate?

One alternative is to consider the mandate responsible for all costs incurred in the treatment of sewage and for all the associated benefits. This seems unreasonable since many municipalities had sewage treatment programs before 1972. No mandate should be credited with costs or benefits accrued prior to its adoption.

A second alternative is to count the full cost and all of the associated benefits of adopting or upgrading technology to meet standards specified by the mandate. The resulting estimate assumes implicitly that no municipality would have changed its sewage treatment procedures after 1972 had the federal law not been passed. This assumption seems unrealistic, however, since at least some state and local decisionmakers would probably have been influenced by the same environmental movement that brought about federal action.

A third alternative for assessing the costs and benefits of the federal mandate, then, is to compare the level of activity in sewage treatment specified by the mandate with a projection of what the level would have been if there were no mandate. This approach seems reasonable, but it is extremely difficult to carry out because it requires a causal model of state and local behavior.

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5. Federal Water Pollution Control Act of 1972.

Redundancy of regulation may also result in incremental costs and benefits being less than total costs and benefits. Sometimes state or local governments will be subject to some prior law or regulation mandating the same action. The requirement may be repeated to reiterate federal commitment to the policy and to increase the speed or level of compliance on the part of state and local governments. When a regulation is redundant, it is not clear how costs and benefits should be counted. For example, nondiscrimination in employment is a condition for receiving most federal grants; at the same time, state and local governments are prohibited by federal law from engaging in discriminatory employment practices. Does nondiscrimination as a condition of federal aid result in additional costs or benefits? The answer would depend to a large extent on the degree to which there was or would have been compliance with the previously enacted federal law.

Compliance. In general, a maximum level of costs and benefits would be calculated by assuming full compliance with federal requirements by state and local governments. In reality, compliance will be less than 100 percent; a lower estimate of costs and benefits taking this into account might provide a more realistic basis for making decisions.

Variations Among Jurisdictions. An intergovernmental constraint will have different effects in different jurisdictions. This is due both to place-to-place variations in policy and to differences in objective circumstances. Consider again the case of the sewage treatment mandate. The cost of the federal mandate can, of course, be relatively large for communities with no prior treatment capability. Little if any additional costs will result for municipalities that were already using the best available treatment technologies when the new mandate went into effect. For some jurisdictions, however, substantial benefits may accrue if the mandate forces municipalities upstream to reduce the discharge of pollutants.

Because costs and benefits are likely to vary so much from jurisdiction to jurisdiction, analyses conducted using data aggregated at the national level may provide insufficient information to the decisionmaker. While the ratio of costs to benefits may be satisfactory for the nation as a whole, unacceptably large burdens may nevertheless be imposed in some jurisdictions. Clearly, it would not be feasible to consider the effect

of proposed mandates and requirements on each and every jurisdiction. But because of the variation among jurisdictions, it would be desirable to consider the consequences of decisions for a sample of jurisdictions representing diverse situations.

EXAMPLE OF A COST/BENEFIT ANALYSIS

To illustrate the problems discussed above, and to demonstrate the complexity of the analytic task, the costs and benefits of a specific set of regulations are discussed here. The regulations proposed by the U.S. Department of Health, Education, and Welfare (HEW) in 1976 to implement Section 504 of the Rehabilitation Services Act will serve as the illustration. This example was chosen because the economic impact analysis accompanying those regulations is one of the most comprehensive ones ever undertaken.[6]

The Requirements. HEW's regulations prohibited recipients of federal aid (including educational institutions, health-care providers, and social service agencies) from discriminating against handicapped persons. The discusion here is restricted to those regulations that deal with the exclusion of handicapped persons because of physical barriers in buildings and other structures.[7]

Two standards were established, one governing new construction, and the other, existing facilities. New facilities must meet standards set by the American National Standards Institute

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6. See Dave O'Neill, Discrimination Against Handicapped Persons; The Costs, Benefits, and Economic Impact of Implementing Section 504 of the Rehabilitation Act of 1973 Covering Recipients of HEW Financial Assistance (revised version of an impact statement published in the Federal Register, May 17, 1976, Office of Civil Rights, HEW, May 4, 1977). This analysis is cited as an example of the type of analytic effort expected for a regulatory analysis under Executive Order 12044 by the Council on Wage and Price Stability.

7. See Subpart C of the regulations. The Section 84.22 sets standards for existing facilities; Section 84.23 deals with new construction.

by having no barriers. For programs operated in existing facilities, a standard of "program accessibility" was established. The proposed regulations stated that the recipient must ". . . through the elimination of physical obstacles or through other methods, operate each program or activity . . . so that . . . when viewed in its entirety is readily accessible to handicapped persons." The HEW economic impact analysis interpreted this as meaning that if modifications to facilities were too difficult to achieve, then other types of program adjustments would be acceptable. For example, in a university library that is inaccessible to students in wheelchairs because of narrow stack aisles and no elevators, establishing a stack search service for handicapped students might be sufficient accommodation.

Analyzing the Costs. The major costs for most recipients were expected to be the direct cost of achieving compliance by modifying existing or proposed structures. The analysis led to the following conclusions:

- The standard for new construction was estimated to entail relatively low costs. Based on previous studies done by HEW and the General Accounting Office (GAO), the regulatory analysis indicated that meeting the barrier-free standard could increase the costs of buildings by one-half of one percent or less. Much new construction already meets the standard. This might be the case because owners and architects have been made aware of handicapped persons' needs or because buildings are already subject to state laws or the federal Architectural Barriers Act of 1968, which mandate similar standards. Since many buildings are already being built to be barrier free, the incremental cost (as opposed to the total cost) imposed by the proposed regulations was estimated to be very small.

- In contrast, the requirement that programs run in existing structures be made accessible to the handicapped was estimated to entail substantially greater costs--between $299 and $544 million. To reach these totals, the analysis considered the cost implications for each major category of recipient. Educational institutions were expected to bear the greatest burden.

In the absence of information on the characteristics of the physical structures in which HEW grant recipients operate

programs, the methodology for estimating the costs of making the structures accessible to the handicapped is inevitably somewhat rough. For example, the HEW analysis built up its estimates of costs for higher education based on existing surveys of what compliance would cost several universities in diverse situations. Assuming costs were proportional to the value and age of structures, and using data on the value of university buildings and changes in enrollments over time (a proxy for age of structures), the HEW analysis extrapolates from cost information available for a few specific universities to all universities. Whether or not there were slightly better ways to arrive at the estimate is not at issue; what is clear is that severe data limitations result in very uncertain estimates.

The costs resulting from HEW's proposed regulations will fall on grant recipients in both the public and the private sectors. HEW's economic impact analysis did not distinguish how much of the total costs would fall on state and local governments, although it seems that the methodology used would have allowed at least a crude estimate of the split. Given that educational institutions were expected to bear the greatest cost burden, and that state and local governments finance a large part of education at all levels, the cost impact on state and local governments would be relatively large.

The possibility of indirect costs is an additional consideration in the analysis of the proposed regulations. If direct costs of compliance are relatively large and if they differ among recipients that are in direct competition with each other, then indirect costs could result. For example, to cover the cost of making their programs accessible to the handicapped, universities may have to raise tuition. Since compliance costs are bound to differ, some schools will raise tuition more than others. If, as a result, enrollment declines, then the regulation has imposed an additional indirect cost. The HEW analysis did not include any estimate of indirect costs.

Most of the costs imposed are of a one-time nature. For recipients that must shift the way a service is delivered, however, as opposed to modifying a facility, the costs could be of a continuing nature. The HEW analysis asserts that such costs would be relatively small. To facilitate comparison with benefits, which are expected to be recurring over time, one-time costs are expressed on an annual basis.

Analyzing the Benefits. The benefits of the proposed regulations are expected to accrue to handicapped individuals whose opportunities for education, jobs, and other social services are now restricted by the inaccessibility of physical facilities. Many of the benefits will be immeasurable because it is difficult to quantify the improvement in morale that can follow from a handicapped person's ability to lead a more "normal" life.

Some benefits, however, will be tangible. Access to jobs could increase the number of handicapped employees. Increased education might make a severely handicapped person more self-reliant, reducing the need for constant supervision. It could also increase the potential earnings of the handicapped.

The premise underlying the analysis of benefits is that better access will result in increased attendance in schools and that, with more education, disabled persons will hold more jobs and have higher earnings. This assumption seems reasonable since handicapped persons are apt to undertake work requiring more mental than physical skills, and many such jobs demand higher levels of education.

The benefit from making higher education accessible to the handicapped will mount over time as each year more handicapped students graduate and enter the work force. The HEW analysis attempts to measure benefits over the long run. The measurement approach taken was to compare the existing levels of education and earnings for handicapped persons with what they might have been if the regulations had been in effect for a long enough period to have achieved the final steady level of benefits. Specifically, based on the 1970 census, it was found that 3.3 percent of all severely disabled people aged 18 to 44 had completed college. It was assumed that had all institutions been accessable, this proportion might have been twice as high. It was further assumed that a college degree would enable a severely disabled person to earn at the same rate as a partially disabled person. The result of these calculations is an estimated benefit of $100 million earned annually by handicapped persons.

An alternative approach would have been to estimate the number of additional college-educated handicapped persons entering the labor force in each year, and to estimate the increase in their lifetime earnings. The present value of the future flow of benefits could then have been compared with the present value of the total costs of achieving compliance.

Impact on State and Local Governments

From the perspective of state and local officials, the cost calculation is more important than the benefit calculation. After all, costs will be realized in the short run, and to a large extent they will be financed by state and local taxes. For any particular jurisdiction, costs will depend on the degree to which its activities are funded by HEW (in particular, whether it finances higher education) and the characteristics of that area's public buildings.

If handicapped persons benefit as they are estimated to in the HEW analysis, state and local governments will also benefit, albeit indirectly. Greater self-reliance for handicapped prsons could lessen the need for special services. Also, higher earnings would bring more revenue in the form of taxes.

CHAPTER IV. POLICY OPTIONS

State and local officials have raised the issue of intergovernmental constraints in hopes of reducing the number of constraints and lightening the financial burden imposed on states and localities by the federal government. Many of these officials argue that the constraints are excessive and that, in many instances, the political and financial costs exceed the benefits. Whether or not the Congressional policy changes urged by state and local officials should be adopted is essentially a political question. Quite possibly, the constraints imposed--though burdensome for state and local officials--are necessary to achieve important national goals.

The Congress might consider several responses to the critics of intergovernmental constraints. One is to take no explicit action. This approach is based on the premise that the political process can be relied on to prevent or correct excesses of federal authority and to modify regulations that are not cost effective.

A second approach would involve the Congress' changing its decisionmaking procedures to increase attention to--and provide greater information on--the costs and benefits that proposed federal actions might impose on state and local governments. The Congress might consider two specific changes:

- Requiring that analyses of state and local effects be made part of legislative and administrative decisionmaking, and
- Increasing Congressional oversight over rule making in the agencies.

A third approach would be to attempt to decrease the number of intergovernmental constraints by changing the structure and substance of federal policy. Three specific sorts of changes have been proposed:

- Reforming the administration of grant programs;

- o Consolidating existing grant programs and relying more on block, as opposed to categorical, grants; and

- o Establishing a policy of fiscal reimbursement for costs imposed on state and local governments by federal constraints.

These procedural and policy changes are discussed in the remaining sections of this chapter.

STATE AND LOCAL IMPACT ANALYSES

State and local impact analyses have been proposed as a way to provide more information to federal decisionmakers. The desired effect would be to lessen the number of new constraints which, relative to their alleged benefits, are either very costly or inefficient. Such analyses could be required for any bill considered by the Congress and for proposed administrative regulations. The scope of the requirement might also be extended to include periodic review of existing laws and regulations.

While primary emphasis has been placed on the need for reliable estimates of the costs that federal actions would impose on state and local governments, a full state/local impact analysis ideally would consider what benefits are to be achieved and whether alternative actions might be more effective.

Current Practice

The Legislative Branch. State and local impact analyses are not currently part of the legislative process, although the implications for state and local governments of proposed federal actions are often explored in committee hearings and reports.

The Congressional Budget and Impoundment Control Act of 1974 requires the Congressional Budget Office to prepare estimates of costs for public bills reported by all Committees except Appropriations.[1] To date, most of CBO's analyses have

1. See Section 403 of the Congressional Budget and Impoundment Control Act (Public Law 93-344).

been limited to federal costs, although state and local impacts have occasionally been considered. F'or example, cost analyses of the various welfare reform proposals considered by the Congress last year included estimates of the fiscal relief to be accorded to the states. The House Committee on the Budget has recommended that CBO's cost estimating responsibilities be expanded to include--whenever possible--consideration of state and local government costs.

Some precedent for federal action requiring state/local impact analyses is established by the 26 state legislatures, which require "fiscal notes" detailing for all proposed legislation the resulting local government costs. Usually such analyses are limited to estimates of direct costs; no consideration is given to benefits or to alternative actions that could produce similar results more efficiently. Estimates are generally produced by Executive Branch agencies and reviewed by legislative staff.

The Executive Branch. Two recently issued Presidential orders require agencies to analyze proposed regulations and legislation. These analyses may fulfill the need identified by state and local officials. The two orders are described in the following paragraphs:

- Executive Order 12074 requires that "urban and community impact analyses" be prepared to identify "aspects of proposed federal policies that may adversely impact cities, counties, and other communities." The analyses are to consider possible economic, demographic, and fiscal changes and their associated costs and benefits as they affect central cities, suburban areas, and nonmetropolitan areas.

- Executive Order 12044 requires federal agencies to analyze "the economic consequences for the general economy, geographical regions or levels of government" of any proposed "significant" regulation and of possible alternatives. (Any regulation that would result in an annual effect on the economy of $100 million or more, or that would result in "major" increases in costs or prices for individual industries, levels of government or geographic regions is defined as "significant.") Agencies are also directed to establish procedures for a

periodic review of existing regulations. In support of the process, two interagency groups have been established. The Regulatory Council is charged twice a year with compiling a comprehensive list of all regulations being developed. The lists are to include preliminary assessments of costs and statements of the legal constraints within which agencies are operating. The Regulatory Analysis Review group, chaired by the Council of Economic Advisors, will review and comment on selected regulatory analyses produced by the agencies.

Although it is too early to evaluate the effect of these orders, they do seem to set up procedures for analyzing federal actions that impose costs on state and local governments. Whether the analyses will be used to influence rather than justify decisions remains to be seen. A possible problem is that the threshold for determining "significance" as defined above is set too high to subject many important regulations to analysis. Some regulations, when taken singly, may have little effect but when considered as part of a larger course of action may impose sizable burdens. For example, the application of Davis-Bacon wage standards specifically to the Urban Development Action grant program involves relatively few dollars. But when all the grant programs to which the Davis-Bacon standards apply are considered altogether, the cost implications may be substantial.

The Judicial Branch. No proposal for analysis of state and local impact prior to decision involves the judiciary. Although the courts frequently make decisions affecting state and local governments, a decision process based on the adjudication of particular cases is not well structured for analysis of broader implications for categories of people, businesses, or governments.2

Assessment

Although in principle, requirements for comprehensive analysis offer great promise, in practice they are likely to fall short of expectation. The discussion in the preceding

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2. For a discussion of the limited capabilities of the courts as policymakers, see Donald Horowitz, The Courts and Social Policy, Brookings Institution, 1977.

chapter indicated the complexity of performing state/local impact analysis. Better data and causal models need to be developed before reliable estimates can be produced of the various types of costs and benefits that might result from intergovernmental constraints.

Tangible, direct, public costs would be the easiest to estimate. Whether incremental costs--that is, those directly attributable to the requirement--could be distinguished from total costs would depend on the substance of the mandate or the contractual agreement. Less tangible, indirect, and private costs, as well as most benefits, would be harder to measure. Furthermore, breaking down costs and benefits to the level of individual jurisdictions would be difficult if not impossible given the speed with which analyses would have to be performed to be useful in decisionmaking. Whether, despite a positive assessment in the aggregate, a proposed constraint would put significant burdens on certain jurisdictions would be difficult to know. Despite these difficulties and the inevitable uncertainties that surround estimates, however, analysis of state and local impact would nevertheless produce information useful to decisionmakers.

Good analysis will more easily be done for proposed administrative regulations than for new laws. This is so because costs and benefits depend to a large extent on administrative interpretation and practice. When a statute is considered, interpretation and practice are not known.

Perhaps the greatest benefit could be derived from a selective but intensive review of existing intergovernmental constraints. The possibility for good analysis is much greater in evaluating past experience than in projecting future impacts. The Congress, in consultation with state and local officials, could direct that studies be done to assess whether changes in certain mandates and program requirements are warranted.

INCREASED CONGRESSIONAL OVERSIGHT

Federal policy is to a large extent shaped by administrative regulations. Statutes cannot include the level of detail needed to guide all the decisions necessary to implement a program; indeed, this is the essence of the Executive Branch's

function.[3] That state and local officials' ire is mostly directed toward federal agencies for excessive and unwise rule making is not surprising. State and local officials also argue that agencies issue regulations that are contrary to, or that go beyond, legislative intent.

The Congress is an important point of access for state and local officials having difficulty implementing federal agency regulations. The Congress can direct agencies to change the rules and guidelines governing program administration, and it has done so. In its reauthorization of housing and community development programs last year, the Congress directed the Department of Housing and Urban Development (HUD) to change its interpretation of law in several respects.[4] For instance, in developing housing assistance plans, communities are required by statute to allow for the needs of low-income individuals who are not at the time residing in the community but who might be expected to if appropriate housing were available. HUD's regulations were based on a "fair share" approach--estimates of "expected to reside" were to be based on the size of the low-income population in the metropolitan area. The Congress directed that a much narrower interpretation was intended; that the estimate of the low-income population expected to reside in a community should be based on the number of existing and projected job opportunities within that community.

The Congress has indicated its intention of scrutinizing HUD regulations closely. It has directed the agency to notify it of proposed rulemaking and to provide it with draft language in advance of public release. If the relevant Committee in either House has difficulty with the regulation, the date the rule goes into effect is to be delayed to allow the Congress time to give further legislative guidance to the agency. Similar procedures could be adopted with respect to other federal agencies.

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3. In the case of General Revenue Sharing and block grants, much of the Executive function is assigned to state and local officials.

4. Housing and Community Development Amendments of 1978 (Public Law 95-557).

While many conditions of aid governing program administration seem not to be particularly burdensome when considered singly, taken together they absorb considerable resources and generate frustration in state and local officials. Improved management of intergovernmental grant programs, they argue, could make a considerable difference--that the number and complexity of requirements could be reduced by better coordination and greater standardization across programs and agencies.

Steps have been taken over the past 10 years to improve the grants management system.[5] Prompted by the Intergovernmental Cooperation Act of 1968 and several interagency studies, three major federal management circulars (FMCs) were put into effect:

- FMC 74-7 standardizes and simplifies 15 areas of grant administrative requirements, for the most part affecting financial management.
- FMC 74-4 establishes principles for determining allowable costs under grant programs.
- FMC 73-2 standardizes procedures for federal audits and calls for the coordination of federal/state/local audit requirements.

In addition, the Joint Funding Simplification Act of 1974 requires federal agencies to facilitate state and local governments combining grants from several programs in support of a single project.

Despite these steps, however, state and local officials argue that more needs to be done to eliminate duplicative planning and reporting requirements, to standardize rules and regulations (particularly with respect to the generally applicable conditions of aid such as the environmental and nondiscrimination provisions discussed in Chapter II), and to increase consultation among federal, state, and local officials at early

5. For an extensive discussion of efforts to improve grants management, see ACIR, Improving Federal Grants Management, Report A-53, February 1977.

stages of the federal rulemaking process. State and local officials maintain that a stronger central management staff is crucial to further progress. They argue that central coordination is necessary both to enforce agency compliance with existing management policies and to initiate additional changes.[6]

GRANTS CONSOLIDATION

The overall number of federal grant regulations can be cut if the Congress is willing to give state and local government officials greater authority over the use of federal grant funds. It can do so by consolidating narrow categorical programs that are similar in purpose and by reversing the tendency to recategorize and add additional strings to existing block grant programs.

Federal grant programs are generally considered to be of three types:

- o General purpose fiscal assistance, typified by General Revenue Sharing, whereby funds are allocated by formula and are given to state or local governments with few, if any, restrictions regarding use.

- o Block grants, such as the Community Development Block Grant program, whereby the Congress specifies the objective to be achieved and a broad range of permissible uses. Funds are generally allocated by formula. Local officials decide what activities are to be supported.

- o Categorical grants, which are given by the Congress to finance narrow, circumscribed kinds of activities.

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6. Similar recommendations for improving the administration of grants programs have been made by several groups. See for example, ACIR, Improving Federal Grants Management; Commission on Federal Paperwork, Federal/State/Local Cooperation (July 1977); National Governors Conference, Agenda for Intergovernmental Reform, Vol. 2 of Federal Roadblocks to Efficient State Government (February 1977). See also The Federal Assistance Monitoring Project of the ACIR, Streamlining Federal Assistance Administration; An Interim Report to the President (September 8, 1978).

Examples include Aid to Families with Dependent Children, Environmental Protection Agency grants for wastewater treatment construction, and project grants for the promotion of the arts. Funds may be distributed by formula or on a project basis. Either way, federal administrators retain a fair amount of control and responsibility for overseeing programs, which are administered by state and local governments,

For the most part, general purpose fiscal assistance and block grants are developments of the last decade. Whereas in 1968, categorical programs accounted for 98 percent of all federal grant outlays, by 1977 their proportion had declined to 76 percent.[7]

In the last couple of years, the trend toward decentralization in the federal grant system has, to some extent, been reversed. The tendency in the reauthorization process and in the administration of block grants and General Revenue Sharing has been to recategorize and to increase restrictions and regulations. For example, when General Revenue Sharing was reauthorized, provisions regarding nondiscrimination, financial management, and citizen participation were strengthened. A second example is the reauthorization in 1978 of Comprehensive Employment and Training (CETA) programs. Although CETA is commonly considered to be a block grant, it now contains numerous requirements concerning individual eligibility and the mix of employment services that may be provided.

An analysis of which grants are appropriate for consolidation is beyond the scope of this paper. The ACIR, however, has analyzed the topic in some depth and has proposed the merger of 170 categorical grant programs into 24 programs.[8] some of the bigger consolidations suggested (involving nine or more separate programs) are in the areas of transportation safety, comprehensive regional transportation, comprehensive state transportation, pollution prevention and control, omnibus education assistance and preventive and protective health. The ACIR has also recommended that the Congress enact legislation

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7. ACIR, In Brief the Intergovernmental Grant System: An Assessment of Proposed Policies (1978), p. 8.

8. ACIR, Categorical Grants: Their Role and Design (1977), A-52, pp. 298-305.

giving the President authority over program consolidation similar to his involvement in government reorganization. Under such legislation, upon submission of a Presidential plan, the Congress would be required to approve or disapprove the plan by resolution within 90 days.

FISCAL REIMBURSEMENT

A policy of full fiscal reimbursement has been proposed to minimize the financial burden placed on state and local governments by intergovernmental constraints. If such a policy were adopted, the federal government would be obligated to pay the full cost of any state or local actions taken in response to federal requirements. As proposed by the National Governors Association (NGA), the principle would not apply to court ordered mandates. It would apply, however, for all other mandates or contractual obligations put into effect by statute or administrative regulation after the date of adoption.[9]

State Precedent

The primary model for a policy of fiscal reimbursement is the one adopted by the State of California to govern its relationships with local governments.[10] In 1972, the California state legislature passed the Property Tax Reform Act of 1972 (SB90). This law established rate and revenue limitations for local governments and at the same time adopted the principle of reimbursement for increases in local costs attributable to new state mandates regarding service provision or local taxing.

Under the provisions; of SB90, the State of California is to reimburse local governments for revenue losses arising from new exemptions granted by the state affecting property, sales, or use taxes, and for the costs of new services or increases in service levels mandated by state law, administrative regulation, or executive order subsequent to 1972. A local government may

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9. National Governors Association, Policy Positions 1978-1979, p. 26.

10. Other states such as Montana, Louisiana, and Pennsylvania have also adopted the principle of reimbursement for state mandates.

apply for reimbursement of the full cost of a mandated service even if that government had been providing the service before the state mandate. If it does so, however, it must reduce its maximum property tax rate or revenue limit by an equivalent amount. Excluded from coverage are: legislation specifically requested by local governments, programs mandated by the federal government, court decisions, or voter initiatives, mandates that provide for self financing or result in no new duties; and laws that define crimes or establish new penalties.

The reimbursement process works as follows. The State Department of Finance is responsible for estimating mandated costs associated with new legislation. The department also reviews agency-prepared estimates of costs associated with administrative regulations. Appropriations are to be provided to cover both one-time and continuing costs associated with covered mandates. Each year local governments submit claims for reimbursement to the State Controller. If local governments believe that reimbursement ought to be forthcoming and none is provided, they may lodge a claim with an independent administrative Board of Control. The Board reports to the Legislature on the number and amount of claims it awards. Upon receipt of the report, an appropriations bill sufficient to cover all approved local government claims for reimbursement must be introduced in the legislature. Decisions of the Administrative Board of Control may be appealed in the state court system.

The reimbursement policy has resulted in only a small increase in state aid for local governments. Between 1972 and 1976, the California State Government provided $85 million in reimbursement for newly imposed mandates. Over the same period, total state aid equalled $26,500 million.[11]

Current Practice

Neither a clearly articulated policy nor consistent practice exists regarding the placement of financial responsibility for costs incurred by state and local governments in meeting

11. Reimbursement amount reported in ACIR, State Mandating of Local Expenditures, p. 26. Total state aid reported in Bureau of the Census, State Government Finances, volumes for 1973 through 1976.

federal requirements. In some instances, state and local governments must bear the costs; in others the federal government provides full or partial compensation.

Costs imposed by mandates are more likely to be borne by state and local governments than are the costs associated with other constraints. This is so because many mandates derive from the courts and only rarely is federal assistance provided to cover the costs of compliance. Federal financial assistance is more common when mandates stem from federal statute and associated regulations. For example, when the Congress passed the Water Pollution Control Act of 1972 mandating sewage treatment, it also established a capital grant program for wastewater treatment facilities to share the cost of constructing required municipal facilities. Not all mandates have corresponding grant programs, however. For example, no grant funds are earmarked for assisting local governments to establish treatment capabilities required to meet safety standards for drinking water.

The federal government pays most of the costs associated with grant-in-aid requirements. This is true almost by definition, since the primary purpose of grant requirements is to govern the use of federal funds.

In certain circumstances, however, state and local governments bear direct costs generated by grant requirements. When actions or standards are required for participation in a grant program, but the cost of taking those actions or achieving the standard is not covered by the grant, a financial burden is imposed on the recipient. For example, a state that must upgrade its hospitals in order to receive medicare or medicaid payments may face significant costs. Similarly, the requirement that public facilities be accessible to the handicapped before federal aid can be received could impose high costs on state and local governments.

A comparable situation arises when state and local governments are required to share the costs of a grant funded activity; in such instances, any requirements increasing the cost of that activity will create financial burdens. For example, if the federal government pays 75 percent of the cost of constructing sewage treatment plants, and Davis-Bacon requirements increase total project costs by 5 percent, then state/local costs will increase by the same proportion.

In addition, grant requirements can result in indirect costs the full burden of which fall on state and local governments. For example, Davis-Bacon requirements might affect the price of state and local construction that has no federal funding.

Whenever federal regulations specify actions that are contrary to program goals, prohibit grantees using the money as they choose, or impose a financial burden, the benefits to state and local governments of participating in a federal grant program are lessened. So long as states and localities continue to participate, however, one must assume that there are net benefits for the recipient governments and their citizens.[12]

Analysis of Reimbursement Option

A policy of fiscal reimbursement can be justified on three grounds:

- To minimize the extent to which federal requirements claim local resources, thereby crowding out actions with greater local priority;
- To make the distribution of costs more equitable; and
- To deter the federal government from imposing additional requirements.

Crowding Out. Advocates of a reimbursement policy argue that the resources available to state and local governments are limited. When such resources are used to pay for actions ordered by the federal government, they are unavailable for activities judged to be important by the local citizenry. In other words, residents' choices regarding local public services are crowded out by federal requirements.

12. There are instances of state and local governments' refusing assistance for which they are eligible on the grounds that the conditions associated with the program impose costs that exceed benefits. For example, Montgomery County, Maryland, has refused Urban Mass Transit Authority assistance grants because of objections to Section 13(c), which requires labor sign-off on grant applications.

ability to pay. In the case of some regulations, other considerations may affect equity judgments. For example, if the purpose of a regulation is to curb abuse, having the offending parties bear the costs of remedial action seems reasonable. Few would argue that the federal government should reimburse private business for the cost of complying with minimal health and safety standards for places of work.

An across-the-board policy of fiscal reimbursement is unlikely to enhance equity regardless of how equity is defined, since the circumstances underlying federal regulations differ. Depending on the geographic pattern of costs relative to benefits, the fiscal ability of governments facing the greatest costs, and the reasons for the imposition of the federal requirement, equity may or may not be enhanced by the federal assumption of costs. Equity is more likely to be advanced by a flexible policy of considering each federal requirement on its own merits.

Deterrence. A third reason for supporting a policy of fiscal reimbursement is that it might act as a deterrent to the imposition of new constraints. If federal officials have to raise taxes to cover all of the costs, some advocates reason, they will think twice before requiring that actions be taken by state and local governments. A reimbursement policy might be limited in scope to areas judged to be better left to state and local discretion.

ACIR's recommendations regarding reimbursement by state governments seem in large part to be based on the "deterrent effect." In policy areas where the state interest is large, and/or where the effects of local actions "spill over" to places outside their jurisdictions, partial reimbursement is considered appropriate. But "to minimize state intrusion into matters of essentially local concern," such as public employee working conditions, the commission recommends that full reimbursement be required to accompany relevant mandates.[14]

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14. ACIR, State Mandating of Local Expenditures, Report A-67, July 1978, pp. 9-12.

Possibility for Limited Reimbursement

While the NGA has recommended a policy of fiscal reimbursement applicable in a broad range of circumstances (including some not caused by intergovernmental constraints), the Congress may prefer to embrace the concept but to a limited extent. The scope of applicability of such a policy could be restricted by attention to the following factors:

- Types of constraints to which the policy would apply. Determining when reimbursement would apply is much harder at the federal level, where constraints take a variety of forms involving different degrees of coercion, than at the state level, where mandates are the common practice.

- Types of costs eligible for reimbursement. Reimbursement could be limited to only certain of the costs described in Chapter III (for example, incremental direct public costs). Measurement problems identified as posing difficulties for the analysis of costs and benefits would make implementation of a reimbursement policy very difficult.

- Extent of reimbursement. State and local governments could be reimbursed in part or in full.

CONCLUSION

Relations between levels of government in the U.S. federal system have clearly been changing over time. Constraints have increased in number and, with them, the degree of federal control over state and local government actions has grown. Whether or not this change in intergovernmental relationships should be viewed as problematic is essentially a political question.

Regardless of one's judgment concerning the desirability of the expanding federal role, particular constraints may be ineffective or they may impose relatively high costs. If there are to be changes, inquiry must be redirected from the general to the particular. Individual programs and requirements must be analyzed to determine their costs and benefits and to discover whether better courses of action exist.