

Statement of
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Congressional Budget Office
Before the
Subcommittee on Intergovernmental Relations
of the
Committee on Government Operations
United States House of Representatives

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There should be no
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The Administration has proposed a major reordering of federal spending priorities that would increase spending for national defense and reduce spending for many domestic concerns. Among the areas that would be reduced substantially are grants to state and local government. These proposals raise basic questions about the appropriate division of responsibility among federal, state, and local governments and how federal aid to state and local governments should be structured.

As a background for this Committee's consideration of these issues, I plan to discuss:

- o First, trends in federal aid to state and local governments;
- o Second, the Administration's proposed budget and its implications for federal aid to state and local governments; and
- o Third, approaches that the Congress might consider in reducing or restructuring aid to state and local governments.

TRENDS IN FEDERAL AID TO STATE AND LOCAL GOVERNMENTS

Federal aid to state and local governments has changed in size and in purpose over the last 20 years. From 1960 to 1978, grants increased rapidly both in dollars and in the types of state and local services they supported, but grant funding has declined in real terms in the last two years.

The rapid expansion in grants has made them an important component of state and local, as well as federal, budgets. In 1960, federal grants to state and local governments represented 15 percent of state and local budgets and 8 percent of all federal outlays. By 1978, grants had grown to over one-quarter of state and local budgets and 17 percent of the federal budget.

The range of state and local activities supported by federal aid has also expanded. In 1960, aid in two areas--transportation and income security--accounted for 80 percent of all grants to state and local governments. In 1978, the dependence of state and local governments on federal highway and transportation aid was about the same, but federal aid had become a more important component of funding for education, health services, employment and training programs, and mass transit.

Since 1978, total grants spending has increased in nominal terms, but it has declined as a share of federal outlays, as a share of state and local budgets, and in real terms. Grants for payments to individuals--programs such as Medicaid, Aid to Families with Dependent Children, and child nutrition--have kept pace with inflation, in part because they are indexed directly or indirectly to measures of living costs. But other grants, which are not tied to prices, have not kept up with inflation (see Table 1).

TABLE 1. FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS, SELECTED FISCAL YEARS 1960-1980 (In millions of dollars)

	1960	1965	1970	1978	1980
Grant Funding (Current Dollars)	7,020	10,904	24,014	77,889	91,472
Grant Funding (Constant 1972 Dollars)	11,398	15,807	26,934	49,572	48,384

THE ADMINISTRATION'S PROPOSED BUDGET

The Administration would accelerate the recent decline in federal spending for grants by reducing the share of federal outlays devoted to that purpose from 16 percent in 1980 to 11 percent in 1984. This would be achieved by lowering the 1982 level of spending to 6 percent below the 1980 level, and allowing it to increase from 1982 to 1984 by only about one percent a year in nominal dollars. In real terms, adjusted for the rate of inflation in the Administration's economic projection, spending would decline by 30 percent over that period. These estimates probably overstate the Administration's actual funding for state and local grants, however. The Administration's budget includes \$30 billion in unspecified reductions for 1983 and \$44 billion for 1984 in order to meet its overall spending targets. At least some of these cuts are likely to come from grants, which would reduce grant totals below those presented here.

The Administration's proposal has two distinct features--a sharp overall reduction in federal grants to state and local governments, and a restructuring of the programs that remain. The large overall reduction in grants would come primarily in programs other than assistance to individuals, cutting them by over \$10 billion between 1981 and 1984--a 34 percent reduction in real terms. The largest dollar reductions would be in education, employment, and training programs; in natural resource and environment activities; and in community and regional development assistance. The largest percentage reductions would be in law enforcement programs, which would be virtually eliminated by 1984, and in natural resource and environment programs. Total funding for individual assistance grant programs would fall slightly between 1981 and 1982 but would then grow in nominal terms, although it would decline by 10 percent in real terms between 1981 and 1984 (see Table 2).

The Administration would also restructure many of the remaining programs to lessen federal control and increase state and local flexibility. Major consolidations have been proposed in education, where roughly 50 categorical programs would be combined into two block grants, and in health and social services, where approximately 40 programs would be combined into four block grants. The Administration would also merge three youth employment programs into existing adult programs and would combine the

TABLE 2. THE ADMINISTRATION'S PROPOSED OUTLAYS FOR STATE AND LOCAL GRANTS BY FUNCTION, FISCAL YEARS 1980-1984 (In millions of dollars)

Budget Function	1980 (actual)	1982	1984	Percent Change 1980-1984
Energy (270)	499	399	319	-36
Natural Resources and Environment (300)	5,362	4,710	2,876	-46
Transportation (400)	13,087	12,005	12,816	-2
Community and Regional Devel- opment (450)	6,478	5,964	5,177	-20
Education, Training, Employment, and Social Services (500)	21,862	16,413	15,290	-30
Health (550)	15,758	18,934	21,211	+35
Income Security (600)	18,495	20,482	22,451	+21
General Purpose Fiscal Assistance (850)	8,477	6,310	6,718	-21
Other ^a	1,445	1,167	983	-32
Total	91,464	86,386	87,841	-4

a. Includes National Defense, Agriculture, Commerce and Housing Credit, Veterans Benefits and Services, Administration of Justice, and General Government.

Urban Development Action Grant (UDAG) program with the Community Development Block Grants (CDBG). In addition, it would cap federal payments for Medicaid and give states more flexibility to reduce costs in that program.

OPTIONS FOR REDUCING FEDERAL AID TO STATE AND LOCAL GOVERNMENTS

Several alternatives are available to the Congress as it considers the details of funding for state and local grants. Funding reductions could be combined in various ways with consolidation, restructuring, or elimination of selected programs.

Consolidating Programs

Consolidating categorical programs into broader block grants would allow recipients more flexibility to allocate the reduced federal funds, which in turn could reduce administrative costs and increase the efficiency of service delivery. Concentrating authority in a smaller number of state and local agencies could allow more comprehensive planning of local services, more integration of delivery systems, and less duplication. In addition, it could enable recipient governments to tailor the mix of services more closely to particular local need.

If not carefully planned, however, the loss of federal control might exacerbate the effects of funding cuts. Funds might be focused less directly on specific groups or for specific purposes than they are now. Consolidation might also produce short-term increases in administrative costs, until states and

localities adjusted their staffing and made other necessary administrative changes. There could even be long-term increases in costs, if the federal government expanded planning and reporting requirements or if states and localities were unable to administer programs as efficiently as the federal government.

Restructuring Programs

Another option would be to structure reductions in grants so that jurisdictions with greater fiscal stress received a higher proportion of remaining assistance. Some opportunities also exist for restructuring programs to increase efficiency or reduce administrative costs.

One way to ensure that the most-distressed jurisdictions would receive proportionately the smallest reductions would be to modify current allocation formulas. For example, the Administration has proposed merging the Urban Development Action Grant and the Community Development Block Grant programs and reducing their total funding. UDAG is presently allocated on a discretionary basis, with funds concentrated among the most distressed jurisdictions. Most CDBG funds are distributed on an entitlement basis among cities of 50,000 or more. Some of the effects of a reduction in total funding could be offset by designing new allocation formulas that are more specifically targeted than the current CDBG formulas.

Another way to offset the impact on distressed jurisdictions would be to change the measures of fiscal capacity. Several formulas, such as those for General Revenue Sharing and Medicaid, use per capita income as a measure of fiscal capacity. But individual income does not reflect the availability of other sources of revenue such as severance taxes and corporation wealth. Using more inclusive capacity measures, such as representative tax capacity, could increase the proportion of aid given to jurisdictions experiencing the most fiscal strain.

Simplifying the administrative requirements that accompany federal grants--whether or not they were consolidated--could save money for federal, state, and local governments, thus lessening the impact of grant reductions. For example, state health offices that are now required to prepare up to eleven separate plans and applications each year could be allowed to prepare just one--an option now being tested.

Similarly, federal programs could be restructured to encourage efficient state and local administration. One option would be to share with states some of the savings that result from their efforts to reduce hospital expenditures. Currently, states that manage to reduce Medicare and Medicaid hospital expenditures through effective rate-setting programs receive back 11 cents on

the dollar in Medicaid funding. Increasing the return to states on their cost-saving efforts could lead to additional state and federal savings.

Eliminating Selected Grant Programs

A third approach that the Congress could consider in reducing federal grant programs would be to eliminate some programs. Numerous criteria could be employed to make such determinations.

One criterion might be overlapping activities. The Administration has proposed, for example, eliminating HUD's Section 312 housing rehabilitation program because it provides services that are also provided under the Community Development Block Grants.

In other cases, programs might be eliminated when they have met their original goals. On these grounds, the Administration argues for elimination of HUD's 701 planning grants, which were designed to help state and local governments build their planning capacity.

A third strategy would be to review the benefits that are being achieved with current funding levels and to eliminate programs with excessive costs. For example, the Administration argues that jobs provided through the Comprehensive Employment and

Training Act's public service employment programs and through the Economic Development Administration's public works program cost more than they are worth.

A final criterion might be to ask whether, in the absence of federal aid, program activities would continue. The Advisory Commission on Intergovernmental Relations argues that if federal grants contribute less than 10 percent of total government funding for an activity, the federal government should withdraw its support. This criterion could have different effects depending on whether it was applied to individual programs, to subfunctions, or to functions. If applied to whole functions, for example, federal aid for law enforcement and education would be eliminated.

CONCLUSION

In conclusion, the Congress faces a number of difficult decisions as it considers spending for 1981 and 1982. If defense spending is to increase, if selected benefits for individuals are to be maintained, and if interest on the public debt is to be paid, then reductions must be concentrated on a relatively small proportion of total spending. The Administration has proposed that the budget cuts fall heavily on grants programs other than those providing assistance to individuals. Consequently, the necessity of reviewing federal spending priorities offers the Congress an opportunity to reconsider old patterns of federal aid and to restructure relations between the federal and state and local governments.