Dateline Raleigh

Assessing the "New" Federalism

by Ferrel Guillory

"The question can be posed very simply. Do we want a single national government, or a federal government which combines a national government with governments of the several states?"

This quotation does not come from Ronald Reagan's 1982 State of the Union address, where he formally proposed his "new federalism." It appeared, instead, 15 years ago in *Storm Over the States*, an analysis of the changing function of state governments by Terry Sanford.[1] In his book, written during a two-year research project that followed his gubernatorial term in North Carolina (1961-65), Sanford argued for a revitalization of state governments as a fundamental step in restoring order and balance to the federal system.

During the 1950s and 1960s, the Sanford group, funded by the Ford Foundation and the Carnegie Corporation, and others such as the Joint Federal-State Advisory Commission examined a growing trend in intergovernmental relations. Since the establishment of the New Deal programs of the 1930s, the nation's problem-solving functions had increasingly become centralized in Washington. The federal government set more and more of the rules of government, requiring in many cases that the states and local governments execute these rules. In short, by the 1960s, the states and municipalities were starting to become "branch offices" for the federal government, administering and helping to pay for programs mandated from Washington.

As this pattern accelerated, a growing number of researchers continued the mission of Sanford and the others. In the largest study to date, the Advisory Commission on Intergovernmental Relations (ACIR) reported that from 1960 to 1981 the number of federal grant-in-aid programs to the states jumped fourfold, from 130 to 534.[2] By 1981, the national government had become so overextended, the ACIR study concluded, that a "fanciful form of federalism" had emerged in which the federal government set the rules and state and local governments carried them out.

Analyzing the interrelationship among the three levels of government does not date, of course, from the 1930s. The tenth amendment to the U.S. Constitution, part of the Bill of Rights, addressed the issue this way: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states, respectively, or to the people."

In 1982, President Reagan proposed, as he put it, to "take the country back to the Constitution," by transferring responsibilities for most welfare and social services programs from the federal government to the states. But while the Constitution enumerates the powers of Congress, it does not say with precision which government programs should be federal, which state, and which local. Such arrangements stem from the interpretation of the

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Since 1972, Ferrel Guillory has been a political reporter for the Raleigh News and Observer, *as the chief capital correspondent and head of the Washington bureau. Now associate editor, he is responsible for the editorial page.*

"States are laboratories for testing ideas..."

— Terry Sanford

tenth amendment and from congressional debates and court rulings over what should be proper federal functions.

Coming on the heels of his first round of federal budget cuts, President Reagan's new federalism has stimulated primarily a debate over the fiscal nature of the proposals. Most states already faced fiscal difficulties even before the federal budget cuts exacerbated their financial pressures. Consequently, the type of question most often asked about the President's proposed federalism concerns the cost of a specific program. For example: Can the states afford to absorb the cost of the Aid to Families with Dependent Children and food stamp programs even if the federal government takes over Medicaid?

While such questions demand close attention, they represent primarily a reaction to the President's proposals. They do not go to the root of the problem, which might be framed like this: What criteria should determine which level of government administers which government program? Generating such criteria independently from the current wave of Reagan proposals not only can provide some thoughtful means for reacting to the 1982 brand of federalism but also can suggest some lasting basis for analysis.

Establishing Criteria for Federalism

Applying the tenth amendment of the U.S. Constitution to today's governmental structures requires policymakers to assess at least three things: 1) the capabilities of each level of government; 2) the nature of the different tax bases of each level of government; and 3) the importance of overriding national values and the best level of government for protecting these values. These three standards of measurement, viewed as separate yet closely intertwined, provide a backdrop for understanding any federalism proposal.

The relative capabilities of these three levels of government have shifted in recent years. Since the 1930s, government analysts have increasingly gauged the states and their local divisions as less capable than the federal government of performing complex functions. Hence, rules for administering services tended to accumulate in Washington rather than in state capitals.

In *Storm Over the States*, Sanford pointed out the weakness in this assumption. "To abandon the states, to seek answers to social questions without them, is to misunderstand our system and undermine it. To build them up, to involve them to their utmost capacity, is to strengthen our system." States conduct essential government business in building highways, operating universities, and administering civil and criminal law, Sanford explained. And citizens depend on local governments for the most fundamental, eyeball-to-eyeball services: police and fire protection, libraries, water and sewer, building inspections, and neighborhood preservation through zoning. Indeed, as Sanford put it, states are laboratories for testing ideas; they stand "in the warp and woof of our national political fabric."

Recent assessments of the states' capabilities reinforce the Sanford judgment. The ACIR, the National Governors' Association, and others contend that legislative reapportionment, the growth in state bureaucracies, the expansion of state tax bases, and improved administrative structures have upgraded the skills and sophistication of state governments. North Carolina's Gov. James B. Hunt, Jr. agrees that the states have developed a new level of self-assurance. "A lot of people in this city [Washington] don't know what's going on in the states," Hunt said recently, testifying before the U.S. Senate Committee on Labor and Human Resources. "Give the states a chance to run these programs."

Political leaders from Jim Hunt to Ronald Reagan want the states to direct more government programs. But a wide range of opinions exist on which programs the states should actually run. A careful analysis of the different tax bases is a critical step in sorting out the different functions that each level of government should perform. The federal government is a superior revenue collector, and its income tax, for all its faults, is a flexible, progressive tax that expands as the nation's economy grows. The states, on the other hand, depend

The Debate on Federalism: A Set of Principles

by Ran Coble

Public interest in the concept of federalism – the proper roles of the federal, state, and local governments – blows hot and cold. It was a hot topic in the early days of the Republic in the 1780s, in the Reconstruction decade following the Civil War, in the Roosevelt Administration's response to the Great Depression of the 1930s, and now in the Reagan Administration's "new federalism."

President Reagan has adopted federalism as a vehicle to reduce federal spending and to shift the balance of power and program responsibility from the federal level back toward the state and local governments. In the current federalism debate, President Reagan and state officials are each trying to unload their most expensive programs on the other. North Carolina officials, for example, advocate placing all of the ever-increasing Medicaid costs in the federal budget while the President contends that the states should take total fiscal responsibility for the Aid to Families with Dependent Children and food stamp programs. Conspicuously absent from this debate is a set of principles that can guide government officials in allocating responsibilities among the three levels of government.

Principles That Argue in Favor of a Program Being Handled By the Federal Government

Principle 1. Is this a program which knows no borders and thus cannot be provided in the varying amounts the states and counties would offer? This principle has consistently dictated that defense be a federal program because the United States cannot take the chance that defense expenditures – and protections – might stop, for example, at the South Carolina line. Environmental protection also would seem to be more properly a federal concern since the air and water in Tennessee today are the air and water in North Carolina tomorrow.

Principle 2. Is the program one where national uniformity is important or where some national minimum of services is needed? The Advisory Commission on Intergovernmental Relations and the National Governors' Association reflect this principle in arguing that welfare programs should rest at the federal level in order to assure a minimum guaranteed income and to retard the practice of interstate flight toward the highest welfare benefits.

Principle 3. Is the program one of protection of citizens' rights that is based in the United States Constitution? This principle serves to protect certain citizen rights, regardless of a person's state or county of residence, through the jurisdiction of the federal courts. Minority races, women, the handicapped, and others rely on this principle in arguing for federal protections of their rights.

Principle 4. Is the program such a costly one that the ability to raise revenue is a primary consideration? Since the federal income tax is so much more productive and flexible than state and local sources of revenue, many programs automatically get elevated to national stature because that is the only level of government that can pay for them. National health insurance seems to be one such proposal.

Principles That Argue in Favor of a Program Being Handled by the State Governments

Principle 5. Is the program one where the idea of using the states as laboratories for experimentation is especially applicable? This

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Ran Coble is executive director of the North Carolina Center for Public Policy Research.

much less on the income tax and must rely extensively on sales and other excise taxes. And municipalities rely heavily on the property tax.

After a policymaker determines which programs are best handled at which level of government, he or she must then determine if that level of government has the revenue capability to perform that task. For example, virtually every thoughtful analyst agrees the federal government must provide for the national defense. Two aspects of the federal revenue system allow the federal government to perform this function. First, unlike the state budgets, the federal budget can run a deficit; and second, the progressive income tax, the primary base of the federal revenue system, tends to grow as the economy grows.

If the federal tax structure makes national defense possible, then the same tax system should allow the federal government to support all programs demanding steadily increasing revenues and national uniformity. But here lies a major point of contention. Agreeing that a certain governmental

principle is grounded in the fact that some programs are so new that part of the legislative debate concerns whether or how well the program might work. No-fault automobile insurance and state lotteries, for example, were tested first at the state level.

Principle 6. Is the program particularly susceptible to regional differences or conditions? For example, economic development programs seem to be better suited for governors to pursue than presidents because a governor is more likely to be sensitive to future needs of a state's changing industrial mix (i.e., among tobacco, textiles, furniture, and microelectronics). Unemployment insurance is another program where federal responsibilities might shift to the state since regional and state employment rates and conditions vary so much.

Principle 7. Would the program be too expensive to run if it were offered by all local units? In other words, do economies of scale argue against 100 universities or 100 rural health clinics in North Carolina? In the same manner, the number of mentally retarded citizens in a county may be too small to justify having county-by-county centers, so North Carolina has opted for regional programs and a few state institutions.

Principle 8. Does the program affect basic rights or property such that it needs to be close to the people but involves regulatory functions too big for counties to handle? Coastal area management is a good example. Though strong local input is needed for this program, the primary responsibility should lie at the state level for financial reasons and for guaranteeing uniform standards along the entire coastline.

Principles That Argue in Favor of a Program Being Handled by Local Governments

Principle 9. Is the program one which is particularly susceptible to different community standards or priorities? Law enforcement and libraries are two examples of programs that should be based with the counties under this principle.

Principle 10. Is the program one where face-to-face contact or administration is necessary? Manpower training is an example of just such a program that has long been paid for and administered at federal and state levels but perhaps is best suited to local government — simply because counties are most familiar with the industry and the skills of the people in the area.

Principle 11. Since the counties have been saddled with the worst tax base (the property tax), should they be given programs that are either the most popular or which are likely to receive the most public scrutiny? Water and sewer, fire protection, and public health programs fall into this category, and, for the most part, presently reside at the county level.

Conclusion

A program may shift from one level of government to another. Transportation is an excellent example of this federalist shift of purpose and allocation of responsibilities. In order to create a national system of railroads, interstate highways, and air travel, the federal government had the primary role in the early years of each of these transportation systems. Now, however, these programs either have been deregulated and shifted from the public to the private sector or shifted from the federal government to the states.

One may disagree with some of the principles or examples above. Without some set of guideposts, however, the latest debate in federalism will be governed solely by program costs and by what one level of government wants to unload on the other. The philosophical and economic dimensions of previous federalism debates, from the 1780s to the 1930s, can serve as a basis for establishing lasting principles for today's "new" federalism.□

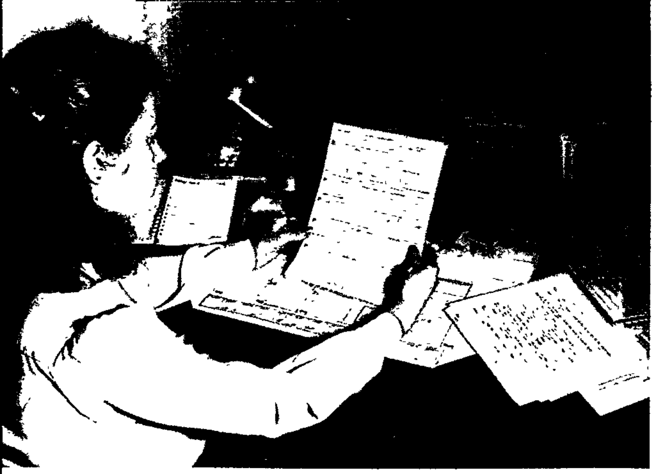

Photo by Paul Cooper

North Carolina social worker reviews application form for Aid to Families with Dependent Children.

function — such as national defense — demands "national uniformity" requires a political and fiscal commitment to the overriding national value represented by that governmental function. While many contest the level of the defense budget, few argue over its location at the federal level. But arguments are intense indeed over more controversial functions.

Author and political analyst Jack Bass contends in his book *Unlikely Heroes*, that from the civil rights movement in the South emerged "a concept of federalism that finally recognized the full role of the federal courts as the primary guardians of constitutional rights." Bass, who covered the civil rights movement as a reporter and later co-authored a major study called *The Transformation of Southern Politics*, alludes in this single sentence to a complex array of governmental functions — from school busing to equal housing opportunity — that have to be sorted out in any system of federalism. (See box on pages 22-23 for an outline of what types of functions might be handled by each level of government.)

The Reagan Proposal

After establishing criteria for rearranging the federal system, three different, though related, means might be employed: 1) block grants in which the federal government gives states money in broad categories; 2) "turnbacks" of tax sources from one government to another in which, for example, the federal government cuts its gasoline tax so that states can raise theirs; and 3) a sorting out and exchange of actual programs.

In undertaking his new federalism, Reagan has chosen a combination of all three methods. First, he has proposed six new block grants for fiscal 1983, which follow the nine already established in 1982 (see "Federal Budget Cuts," *N.C. Insight*, Vol. IV, No. 4). Second, the President's plan provides for a $28 billion trust fund composed of certain excise taxes, including a portion of the gasoline tax and the oil windfall profits tax; the trust fund and the taxes are to be phased out by 1991, when states could enact those taxes for themselves (see box on page 25 for an analysis of this shift in tax structures). And third, at the core of the Reagan plan, is the *"big swap"* between the federal and state governments.

In his State of the Union message, Reagan proposed that the federal government take over Medicaid completely; in return, states would assume full responsibility for Aid to Families with Dependent Children (AFDC) and food stamps. In addition, the federal government would transfer 43 social programs, consisting of 124 grants-in-aid, to the states. The White House later modified the swap and suggested that states run medical, food, and income programs for the younger poor, while the federal government assumes responsibility for the aged and severely disabled. Whatever the details, the fulcrum upon which federalism turns finds expression in one word: welfare. Is it a state or a national responsibility?

Reagan contends that welfare belongs mostly to state and local governments. "The problems of a welfare client in New York City are far different from those from out in some small town in the rural areas of the Middle West," said the President. "I believe that there is much more chance of waste and of fraud in trying to run it from the national level than there is in running it at the local level."

But, among proponents of "federalism," Reagan stands almost alone in suggesting that states run welfare. The ACIR and National Governors' Association contend that only through federal administration can the nation achieve an equitable and uniform level of benefits in assistance for basic human needs. The President's proposal to shift AFDC and food stamps to the states has threatened the potential for wide acceptance of his overall plan.

By mid-April, negotiations between the Reagan administration and state and local government officials had bogged down with little movement toward a package agreeable to all sides. On April 7, *The New York Times* reported that the administration had suspended efforts to submit legislation to Congress enabling the federal government to shift responsibilities for AFDC and food stamps to the states in exchange for taking over all Medicaid costs. The White House denied *The Times* story, although officials acknowledged that time for legislation was running short. On April 15, *The Washington Post* reported that the administration, in an effort to keep its "new federalism" alive, had offered to retain food stamps as a federal responsibility but intended to pursue the "turnback" of

New Federalism: Tax Base Falls Short

by Jim Newlin

Since the 1930s, the federal government has redistributed income from those citizens able to maintain living standards above minimum levels to those unable to support themselves — the disabled, elderly, unemployed, and children. The basic funding mechanism for this redistribution has been the progressive income tax, which is based on an "ability to pay" principle in an effort to equalize the relative sacrifices taxpayers must make.

The decision of the federal government to use the personal and corporate income taxes to fund the majority share of federal expenditures has effectively preempted that revenue source for the federal government. While most states and a few local government units use the income tax as a major revenue source, the rates are kept quite low because the federal government extracts its own high percentage. The federal preemption of the income tax is not necessarily unfair, as the federal government uses income taxes to finance income redistribution programs and its other major function, national defense.

Reagan's "new federalism" plan would change this arrangement drastically. The federal government would turn back a large proportion of cash and in-kind income redistribution programs to the state and local government units (AFDC, food stamps, community development, CETA, etc.)

Initially, the federal government would share revenues with the states through a federal "trust fund." However, the revenues to be shared are not the income taxes that distribute the tax burden of funding income redistribution programs. Instead, Reagan proposes to share flat-rate or small percentage excise taxes that apply to specific users (telephone, alcohol, tobacco, and motor fuel). None of these taxes is as responsive to economic growth and inflation as is the income tax; in fact, some of the taxes are declining.

In 1991, the trust fund would expire, and the federal government would then turn these flat-rate, user-oriented tax bases back to the states to decide whether to continue their use. One of the major revenue-producing taxes to be turned back is the oil windfall profits tax, which could only be used by a handful of states.

The tax sources proposed for the states depend on the purchase of products in which society is trying to reduce consumption either for foreign policy (motor fuel) or health reasons (alcohol, tobacco). The states and local governments would still be unable to tap income redistribution programs because the federal government would continue to preempt income taxes, in spite of recent tax cuts.

This proposal would have an adverse impact on two levels of society: the needy who require direct assistance, and all people in lower-income or economically depressed states or regions. Because of the disparity in the relative wealth of the states, Congress has recognized the need for national responsibility in financing and setting of standards for minimum income security for the poor. These standards would be endangered by forcing the states to fund the programs from flat-rate revenue sources.

While Reagan seems to call for the continuation of some minimum standards for income redistribution programs, the abilities of the states to fund programs with current or proposed "turnback" revenue sources vary widely. Consequently, unless taxpayers in low-income states pay higher taxes than do those taxpayers in high-income states, lower-income citizens in the less wealthy states will suffer disproportionately. Economic differences among the states would then be exacerbated.

If the inflation rate continues to fall and the national economy recovers, the real income of people able to participate in the work force will increase. But under the Reagan proposals the states would still have to rely on flat-rate, no-growth revenue sources to fund income redistribution programs. Consequently, the income gaps between wage earners and those unable to work will increase at a rate equal to overall income growth. The truly needy will become worse off relative to the rest of the population.

Finally, the Reagan proposals would require the states to finance most economic development programs primarily from flat-rate, often regressive taxes, from either traditional sources such as property taxes or proposed sources such as telephone excise taxes. But those states and regions most in need of economic development can least afford to fund the necessities for economic growth (job training, education, transportation, water and sewer). The federal government, through the Reagan tax and program reorganization proposal, would in effect be abandoning its traditional national commitment to persons of all incomes in low-income regions and states. □

Jim Newlin is a senior fiscal analyst at the Legislative Fiscal Research Division. Portions of this appeared in The News and Observer *of Raleigh, reprinted with permission.*

more than 40 social programs to states. In any case, the President's federalism plan, just three months after he proposed it, appears to be in political trouble, particularly the big swap. Yet, the debate over federalism continues.

Alternative proposals also seek to balance the federal system but without jeopardizing the progress the nation has made in ensuring that no one goes without a basic minimum subsistence. The Advisory Commission on Intergovernmental Relations, a bi-partisan panel created by Congress whose members include N.C. Congressman L.H. Fountain, has produced the most detailed alternative. The ACIR, in an 11-volume study released in 1980 and 1981, proposed that the federal government assume full financial responsibility for welfare, income security, employment security, nutrition, and health and housing for the poor.[3] It proposed that state and local governments assume from the federal government such programs as aid to education, libraries, fire protection, police and corrections, health and hospitals, natural resources, and airports.

At its February meeting, the National Governors' Association supported the federal assumption of Medicaid but voted to negotiate other elements of the swap. Gov. Hunt's position roughly parallels that of the governors' association. He favors federal assumption of AFDC, food stamps, and Medicaid and supports state takeover of law enforcement, transportation, and most federal aid to education.

In particular, Hunt has expressed concern that the President's proposed swap would not be an even trade financially. The N.C. Office of State Budget and Management has found that maintaining AFDC and food stamps at current levels after the swap would cost North Carolina $193 million more than the state would save by the shift of Medicaid to the federal government. And in 1991, when the federal trust fund ends, the program swap would cost North Carolina about $1 billion a year, according to Hunt.

Conclusion

When he wrote his book on the states, Sanford did not advocate an actual exchange of programs but opted instead for block grants and revenue turnbacks. He called for the establishment of a national policy that would ensure that all federal programs would be designed to enhance, rather than hurt, state governments, and he envisioned a role for states as a coordinator of programs for local government. The federal system is not a "layer cake" in which each level of government acts in its own sphere, Sanford contended. Federalism is more intermingling like a marble cake, a system of joint responsibilities and partnerships in solving problems.

"The debate should not be defined in terms of state government versus national government," wrote Sanford 15 years ago. "The citizens constitute both and ultimately the citizens must control both. The question is not whether national government will triumph, or state government will triumph; but whether the citizen will triumph in protecting his liberties while broadening his opportunities."

The Reagan advisors do not seem to have read Sanford's book, or perhaps they simply discarded his advice. Reagan's plan envisions a shift of some three-fourths of current federal domestic responsibilities to state and local governments. And this new federalism rides on the back of the President's continuing efforts to cut deeply into federal domestic programs – AFDC by $1.1 billion, food stamps by $2.2 billion, and the 43 other social programs by a total of $5.2 billion.

Because of their high cost and controversial nature, such programs as AFDC and food stamps are the least likely to be assumed by the states. Since the states have neither the tax-power nor the historical commitment to operating welfare programs, the Reagan plan almost assuredly will mean a shrinking of the nation's assistance to its least fortunate citizens. In combination with his domestic budget cuts, Reagan's brand of federalism looks suspiciously like an attempt to dismantle substantially the programs of aid to the needy erected by the New Deal and Great Society. It is right to propose a swap, but Reagan has proposed the wrong one.

James Madison described the hybrid government established by the Constitution as "neither wholly federal nor wholly national." If it is true that the founding fathers could not have imagined a national government managing 500 grant-in-aid programs, it is also true that certain "federalism" issues were settled at Appomattox and in the Great Depression. This was not to be a nation in which states were sovereign to ignore human rights and human poverty. □

FOOTNOTES

[1]*Storm Over the States*, Terry Sanford, McGraw-Hill, 1967, p. 8.

[2]*A Catalogue of Federal Grant-In-Aid Programs to State and Local Governments: Grants Funded FY 1981*, Advisory Commission on Intergovernmental Relations, February 1982.

[3]*The Federal Role in the Federal System: The Dynamics of Growth*, Advisory Commission on Intergovernmental Relations, eleven volumes, 1980-1981. In *An Agenda for American Federalism: Restoring Confidence and Competence*, Vol. X, released in June 1981, the ACIR outlines its version of federalism.