Issued in Spring, Summer, Fall, and Winter, POLITICAL SCIENCE QUARTERLY (ISSN 0032-3195) is published by the Academy of Political Science, 619 West 114th Street, Suite 500, New York, New York 10025. Subscriptions are obtained through membership in the Academy. Regular membership, $17.50 a year. Three years, $46.00. Students, $13.00 a year. Libraries and institutions, $24.00 a year. Foreign postage, $2.00 additional per year. Second-class postage paid at New York, N.Y., and additional mailing offices. Volume 96 Number 1 Spring 1981.

8648

The Centralizing Effects of Austerity on the Intergovernmental System

CHARLES H. LEVINE
PAUL L. POSNER

Even though the attractiveness of devolving public decision making and policy implementation to state and local governments is widely acknowledged, changes are occurring in the U.S. system of intergovernmental relations that are eroding local autonomy and centralizing authority. This is not a new observation. In recent years, observers of intergovernmental relations have noted that the discretionary portion of local government budgets has been declining in proportion to the growing presence of federal funding. But now the processes of erosion of state and local autonomy and centralization of authority appear to be accelerating as resource scarcity and the structure of federal grants, *in combination*, are causing subtle, yet fundamental, changes in the scope and role of state and local governments.[1]

[1] For a recent discussion of the importance and methods of democratic decentralization, see Samuel H. Beer, "Federalism, Nationalism, and Democracy in America," *American Political Science Review* 62 (March 1968): 9–21; for a discussion of the debates of the Founders on federalism, see Samuel P. Huntington, "The Founding Fathers and the Division of Powers," in *Area and Power*, ed. Arthur Maass (Glencoe, Ill.: Free Press, 1959). For a discussion of centralizing trends in the intergovernmental system, see David B. Walker, "The New System of Intergovernmental Assistance: Some Initial Notes," *Publius* 5 (Summer 1975): 131–45, and idem., "A New Intergovernmental System in 1977," *Publius* 8 (Winter 1978); for a discussion of the erosion of state and local discretion, see Paul L. Posner and Stephen M. Sorett, "A Crisis in the Fiscal Commons: The Impact of Federal Expenditures on State and Local Governments," *Public Contract Law Journal* 10 (December 1978): 341–79.

CHARLES H. LEVINE is director of the Bureau of Governmental Research at the University of Maryland, College Park. He is the author of *Racial Conflict and the American Mayor* and several anthologies and articles in the field of urban politics and public management. PAUL L. POSNER is senior evaluator, Intergovernmental Relations Group, in the U.S. General Accounting Office. He has directed several major GAO studies of the intergovernmental grant system and formerly directed the federal program review office for the New York City Office of Management and Budget.

017423

At the core of the issue are displacement effects that occur when local priorities are skewed and distorted by the need to generate and commit local funds to match federal categorical grants in program areas such as criminal justice and law enforcement, water pollution control, transportation, health, and education rather than using local funds for some other purposes that may have greater local priority. These displacement effects threaten to undermine the advantages of decentralized government: its greater responsiveness to local needs and priorities, its greater accountability and access for citizens wishing to influence policy, and its greater variety of services for citizens and businesses making location decisions. Increased centralization promises to produce instead a homogenized package of services formulated in Washington by obscure bargains among nearly anonymous interest-group representatives, bureaucrats, and congressional committee staffs.[2]

Now that many state and local governments are entering a period of austerity, they are attempting to stretch locally generated resources as far as possible. One obvious means is to use local dollars to match federal grants. But this practice has a major pitfall: even though local governments may have increased their revenues through these grants, they have also increased their dependency on external resources, thereby accelerating the erosion of their discretion over policy, program, and service decisions. As a result, local budgets have increasingly come to resemble the structure of the federal government's domestic program, and local decisions are being shaped by federal constraints and directives at an accelerating rate. In short, the joint impact of displacement effects and resource scarcity is creating a serious structural problem for local government autonomy and for the functioning of American federalism. The growing severity of this problem poses a number of political and administrative dilemmas that evidence the appropriateness of reform in both the intergovernmental grants system and the revenue-raising mechanisms of state and local governments. In a uniquely American fashion, the United States may be on the way to "buying" a unitary style of national government through the grants system by enticing states and localities to adopt the growing federal agenda of priorities and policies.

This article summarizes the forces leading toward centralization within the federal system and the erosion of local autonomy by the federal grants system and explains how resource scarcity accelerates the erosion of local discretion. Some administrative and policy dilemmas posed by the impact of resource scarcity on the federal system are discussed in the conclusion.

The Fiscal Impact of Federal Grants

The effects of federal grants on state and local budgets and priorities have become more pronounced over the past twenty-five years due to the growing dependence on federal funds. By virtue of general revenue sharing, federal assistance has been extended to nearly every state and local government in the nation. Furthermore, through the growth of block and categorical grant programs during the 1960s and 1970s, the federal government has become involved in the funding of services traditionally dominated by state or local governments. This growth in the scope of federal assistance led the Advisory Commission on Intergovernmental Relations (ACIR) to comment that by 1976 it had become difficult to identify "a single major state and local function in which the Federal Government was not involved."[3] Thus, the impact of federal expenditures has been felt by states and localities in an ever-growing number of program areas.

This growing range of federal assistance has been provided primarily through categorical grants, each serving a narrow purpose allowing the grantee only minimal discretion. Since 1962, the ACIR has recorded a 300 percent increase in the number of categorical federal grant programs available to state and local governments, placing at 492 the number of federal categorical grant programs available to state and local governments in January 1978. In budgetary terms even after the advent of the five block grant programs and general revenue sharing, categorical grants still constitute over 75 percent of total federal grant outlays to state and local governments.[4]

By 1980 federal grant outlays constituted 25 percent of state and local spending, capping a twenty-five year period of relatively steady growth. While federal grants of $2 billion in fiscal year (FY) 1950 constituted only 10.4 percent of state and local expenditures, FY 1980 federal grant outlays are estimated to be $88.9 billion, constituting 25.3 percent of total state and local expenditures.[5] Major cities are even more dependent on federal funds for support than the aggregate figures suggest. In 1957, forty-seven of the nation's forty-eight largest cities received only 2.6 cents from the federal government for every dollar raised locally. In 1978, these cities received 50 cents in federal funds for every locally raised dollar.[6] A recent Treasury Department study calculates that the nation's ten most distressed cities would have to raise property tax rates by an average of 65 cents per $100 of assessed valuation if federal funds were withdrawn.[7]

Federal mandates and grant requirements, such as match and maintenance of effort, have effectively extended the federal fiscal presence to a larger share of state and local budgets. Even though compliance with grant requirements may be questionable, nevertheless, state and local funds needed to satisfy these requirements can be substantial. According to Office of Management and Budget (OMB) figures, states and localities will spend an additional one dollar from

[2] See Beer, "Federalism, Nationalism, and Democracy in America," pp. 17-20; also idem., "The Adoption of General Revenue Sharing: A Case Study in Public Sector Politics," *Public Policy* 24 (Spring 1976): 127-95.

[3] Advisory Commission on Intergovernmental Relations, *Categorical Grants: Their Role and Design* (A-52) (Washington, D.C.: Government Printing Office, 1977), p. 39.

[4] U.S. Executive Office of the President, Office of Management and Budget, *Special Analysis of the Budget, Fiscal Year 1981* (Washington, D.C.: Government Printing Office, 1980), p. 254.

[5] Ibid.

[6] See Rochelle Stanfield, "Federal Aid for Cities: Is It a Mixed Blessing?" *National Journal Reports* 10 (1978): 869.

[7] Ibid.

their own funds in FY 1979 to match these dollars in federal grant money. Matching requirements effectively extend the influence of federal grants to 36 percent of aggregate state and local expenditures. Minimum nonfederal match is also growing as a percentage of state and local expenditures. Between FY 1971 and FY 1980, minimum match required for all federal grants increased from 8 to 12 percent of state and local expenditures. In some states, the federal influence is more pronounced. For example, at least 45 percent of Michigan's budget is tied to federal funds; 25 percent in direct federal funds and 20 percent in matching funds.

Stimulative Effects

The federal grants system, by design, is a powerful mechanism for stimulating spending at all three levels of government. Grants stimulate spending in three ways. First, categorical grants are premised on the notion that state and local sectors are not spending enough for services with high external or national benefit. The system intentionally seeks to broaden the public-policy agenda of state and local grant recipients through price incentives and, thus, to add to expenditure pressures. Grants also stimulate expenditures because grants structures provide only weak incentives to economize; and by dividing financial management responsibilities among several layers of government, federal grants tend to short-circuit the normal management constraints on expenditures. Third, the grant system, through mandates, matching, and maintenance of effort requirements stimulates additional state and local expenditures as a condition for receiving federal assistance, while discouraging spending reductions in federally funded areas by penalizing reduced fiscal effort with the loss of federal funds.

In large part, the grants system is predicated on the need to induce state and local government participation in the service of national programs and priorities. In this way, the federal government can act on an expanding agenda of national concerns without bearing the full fiscal impact or political risks associated with implementing controversial national policies in a complex, heterogeneous society.

Federal grants entice state and local government participation and increase their expenditures for both economic and political reasons. In economic terms, a grant lowers the cost to the states and localities of performing the aided activity. A grant thus reduces the price that the recipient must pay for the service and hence increases the attractiveness of the funded activity. According to the theory of grants, state and local governments are encouraged to fund activities with high external benefits they otherwise would not fund.[8]

The response of the state and local governments to these price incentives is further influenced by the political process. The presence of federal grant funds encourages or stimulates the development of strong political constituencies at the state and local level, which often use the federal fiscal presence as a way to press for increased and long-term involvement of the state or local jurisdiction in the aided program. Federal funds flow to most grantees in a somewhat automatic fashion, presenting a grantee who chooses not to participate with the unenviable task of returning available federal money that could have been used to benefit local residents. State elected officials seeking to control their public-policy agendas in the face of the onslaught of federal grant funds are thus in a bind. As one state legislator perceptively noted, he would rather spend federal funds on nonessential projects in his state than have them reallocated to a neighboring state.[9]

Traditional management constraints on spending at the state and local level are typically not operative within federal grant programs. Grant programs produce a functional disjuncture in the tax and spending structure of local governments that removes a potential brake on expenditure growth. Both federal and local officials are largely spared dealing with the potential conflict between groups concerned with *how much* money is collected (revenue providers) and those groups concerned with how money is *spent* (service consumers). As Edward K. Hamilton has noted, the public sector does not know how to control expenditures in an era when so much public spending is dominated by banker transactions from higher to lower levels of government. He has argued forcefully that "we do not know what disciplinary forces can resist impulses to excessive spending when the spender bears no responsibility for raising the revenue being allocated."[10]

A recent General Accounting Office (GAO) study joined in this observation by noting that grantees have little or no incentive to improve productivity in federally funded programs, because dollar savings achieved through expenditure controls in federal grant programs largely accrue to the federal government. The study further noted that most nonfederal matching requirements are too low or too weak to stimulate state and local management interest and oversight for grant programs. As a result, for example, Wisconsin recently excluded federal programs from the purview of its productivity-improvement program. Similarly, a 1979 survey showed that state legislative fiscal officers in two-thirds of the states indicate that their oversight of federally funded programs is typically less intensive than their oversight of state funded programs.[11] Clearly, when the responsibilities for management and finance in a program are separated, the process of management and control tend to wither away.[12]

[8] See Wallace Oates, *Fiscal Federalism* (New York: Harcourt Brace Jovanovich, Inc., 1972), esp. chap. 3.

[9] See Comptroller General of the United States, *The Federal Grant Process Should Be Changed to Permit Greater State Legislative Involvement* (GGD-81-3) (Washington, D.C.: General Accounting Office, 1980).

[10] Edward K. Hamilton, "On Non-constitutional Management of a Constitutional Problem," *Daedalus* 107 (Winter 1978): 111-28.

[11] Unpublished data from the National Conference of State Legislatures based on responses from forty-eight states, Denver, Colorado.

[12] See Comptroller General of the United States, *State and Local Government Productivity Im-*

Federal grant programs also weaken the analytic controls normally exercised by state and local officials in deciding on alternative program strategies and levels of spending. State and local attempts to compare the costs and benefits of federally funded projects with nonfederally funded alternatives can be futile because of the fundamental economic incentives in grant programs. Federal grants dramatically reduce the costs of federally eligible alternatives without affecting the benefits. While the benefits of most grant programs are concentrated in the local recipient area itself, the costs are typically spread throughout the nation. For example, a study of the process leading to New York City's decision to rebuild its West Side Highway concluded that the federal funding formula strictly constrained the range of feasible alternatives considered. In this case, the mayor argued that mass transit alternatives to a new highway could not be considered because of federal funding rules that gave the city more federal funds for highways. The author of the study concluded that while the project selected had substantial environmental and economic disadvantages compared with other alternatives, federal grant funds made the outcome inevitable: "From the city's perspective the funds are costless. From the state's perspective, the money is pretty close to costless [nine to one federal match]."[13]

Categorical grant programs often increase state and local spending over and above the amount of the federal grant. A 1977 nationwide survey of local officials indicated that over two-thirds of these officials believed that the spending of local funds over and above required match was stimulated by federal funds.[14] Much of the expenditure impact can be explained by the political processes of state and local governments. By arousing new expectations and dormant constituency groups, federal grants can induce state and local governments to spend more than required for programs. But even more of the expenditure impact can be attributed to provisions of the grants themselves or to the "strings" that require additional spending as a condition for receiving grants. The impact of three types of provisions—mandates, matching requirements, and maintenance of effort requirements—require detailed examination.

Restrictive Mandates

The disjuncture between the functions of developing policy and raising revenues has also contributed to the rapid growth of federal mandates imposed on states and localities. The process of developing new mandates at the federal level does not often benefit from the discipline of having to raise revenues to cover the costs of these mandates. Again, benefit-cost analysis is impractical in cases where one level of government realizes the benefits without considering the costs.

A wide range of federal assistance programs impose burdensome and costly federal regulations as conditions for participation. While state and local governments are not directly required to comply, the potential loss of federal assistance is usually punishing enough to force compliance. For example, the Department of Housing and Urban Development (HUD) requires all local building codes in flood-prone areas to incorporate federal flood-control standards. If local governments fail to comply, the entire local area loses its eligibility for any federal subsidy for construction or acquisition of property. A similar program requiring local implementation of building energy conservation standards certified by HUD is currently being phased in, pursuant to the Energy Policy and Conservation Act of 1975. The codes must be statewide, uprooting long traditions of local control over building codes in many states.

In 1977, Congress extended coverage of regular unemployment compensation to all state and local employees, requiring state and local governments to fund the necessary payroll costs. Instead of using directly the commerce clause in the United States Constitution to require state and local coverage, the Congress chose to use the grants system to enforce state and local compliance. States that refuse to cover public employees will lose federal certification of their entire unemployment compensation programs, resulting in direct federal administration and significantly higher payroll costs for private-sector employers within the state.

Similarly, the Education of All Handicapped Children Act of 1975 requires, as a condition for state receipt of federal handicapped grant funds, that local school districts integrate all physically and mentally handicapped children, including those with learning disabilities, into the public-school system. Besides the basic expense imposed, the act requires each district to prepare an individual education plan for each child, to consult regularly with parents, and to identify millions of children with hidden learning disabilities. The federally mandated costs involved in achieving this worthwhile objective are substantial, but federal grant funds are not expected to cover more than 12 percent of the anticipated costs, according to the Office of Management and Budget.[15] More generally, Section 504 of the Rehabilitation Act requires grantees to provide access by the handicapped to all facilities built with federal grant funds. A recent Congressional Budget Office study found that $6.8 billion would have to be spent by transit systems alone to comply with this mandate, even though relatively few handicapped persons would actually benefit.[16]

Other examples of the extension of federal regulatory control over state ac-

---

provement: What Is the Federal Role? (GGD-78-104) (Washington, D.C.: General Accounting Office, 1978).

[13] Regina Herzlinger, "Costs, Benefits, and the West Side Highway," *Public Interest* 55 (Spring 1979): 94.

[14] Advisory Commission on Intergovernmental Relations, *The Intergovernmental Grant System as Seen by Local, State and Federal Officials* (Washington, D.C.: Government Printing Office, 1977), p. 19.

[15] U.S. Executive Office of the President, Office of Management and Budget, *Appendix, Fiscal Year 1981 Budget* (Washington, D.C.: Government Printing Office, 1980), p. 365.

[16] U.S., Congress, Congressional Budget Office, *Urban Transportation for Handicapped Persons: Alternative Federal Approaches* (Washington, D.C.: Government Printing Office, 1979).

tivity through grant strings abound. As a condition for receiving energy-planning money from the Department of Energy, states are required to make significant changes in their laws to conform with federal standards. The Federal Highway Administration forces states to control outdoor advertising by reducing the federal match by 10 percent for states that do not adopt appropriate regulation of billboards pursuant to federal law. As a condition for receiving federal juvenile justice grants, the Law Enforcement Assistance Administration (LEAA) requires that states develop programs to deinstitutionalize juvenile "status" offenders, resulting in major legal changes and new fiscal outlays by the states.

Most major federal grant programs also incorporate a number of non-programmatic guidelines for implementing national policy objectives. ACIR has estimated that thirty-seven conditions exist that are applied by most grant programs. In order to qualify for federal assistance, state and local governments must achieve a broad range of national social objectives in addition to specific grant program requirements.[17] Some of these include mandates to provide equal access to the handicapped and disadvantaged to services; to protect environmental quality; to ensure prevailing wages for construction workers under contract; and to implement civil-service systems based on merit.

These mandates are often formulated with little or no attention to the costs imposed on state and local governments. Costs of compliance with the Davis-Bacon Act, the Uniform Relocation Assistance and Real Property Acquisitions Policy Act of 1970, and the National Environment Policy Act of 1969, for example, have resulted in increased costs as well as nonparticipation in federal grant programs. In one instance, delays due to excessive federal monitoring of environmental impact increased the costs of local highway-improvement projects for Ogden, Utah, from $740,000 to $1,950,000.[18]

A recent comprehensive study found that 1,036 federal mandates exist in laws and regulations as conditions for the receipt of federal grant funds. The costs of implementing these mandates attached to federal grant programs were paid from local revenues in over 45 percent of the cases. The study found that over 900 of the mandates were enacted during the 1970s.[19]

Matching and Maintenance of Effort Requirements

Over 60 percent of federal grant programs require some kind of nonfederal financial share as a condition for participating in federal grant programs. OMB estimates that in FY 1979 fully 10 percent of aggregate state and local expenditures were earmarked to match federal grant programs.[20]

Matching requirements stimulate both federal and nonfederal expenditures and enable the federal government to initiate complex new programs without bearing their full costs. They also encourage state and local governments to devote portions of their budgets to programs they might not have initiated on their own in order to draw available federal dollars. Because of the large number of federal programs with relatively low matching requirements, state and local budgets can become crowded with obligations of low local priority. The econometrics literature provides considerable evidence to indicate that grants with matching requirements stimulate state and local expenditures. In one widely cited summary of the literature, Edward Gramlich found that in the aggregate, categorical grants with matching requirements stimulated $1.12 of state and local spending for every dollar of federal grant funds.[21]

Maintenance of effort provisions exist to ensure that state and local governments do not substitute federal funds for locally generated revenues. To prevent substitution, many federal programs institute maintenance of effort provisions that require that the grantee maintain a fixed level of prior spending. Some programs include a "nonsupplant provision" that prevents grantees from using federal funds to supplant funds that they otherwise would have spent for the program in the absence of federal funds. According to GAO, thirty-seven of the fifty-two largest federal grant programs are covered by maintenance of effort requirements.[22]

Federal requirements vary considerably. For example, the Urban Mass Transit Operating Assistance (UMTA) program requires state and local governments to continue their prior two-years average level of funding for transit as a condition for federal operating subsidies. The Comprehensive Employment and Training Act (CETA) requires that federal funds be used to *supplement*, not supplant, local funds and services that would otherwise be available in the absence of federal funds.

Maintenance of effort provisions, if effective, can prevent fungibility and ensure that the federal grant is used by the grantees for the specific purpose intended, not as general fiscal relief. But effective implementation of maintenance of effort provisions is problematic. For example, early studies of public-service employment programs indicate substantial substitution of federal grant funds for state and local funds.[23] More recently, however, this substitution behavior seems to be ebbing. Two major studies by the Brookings Institution of the experience with two major block grant programs—CETA and the Community

[17] Advisory Commission on Intergovernmental Relations, *Categorical Grants: Their Role and Design*, p. 297.

[18] Commission on Federal Paperwork, *Federal/State/Local Cooperation* (Washington, D.C.: Government Printing Office, 1977).

[19] *Federal and State Mandating on Local Governments: An Exploration of Issues and Impacts; Final Report to the National Science Foundation* (Riverside: University of California, Graduate School of Administration, 1979).

[20] OMB, *Special Analysis of the Budget, Fiscal Year 1981*.

[21] Edward Gramlich, "State and Local Governments and Their Budget Constraint," *International Economic Review* 10 (June 1969): 163–82.

[22] See Comptroller General of the United States, *Will Federal Assistance to California Be Affected by Proposition 13?* (GGD-78-101) (Washington, D.C.: General Accounting Office, 1978).

[23] See George Johnson and James Tomola, "The Fiscal Substitution Effect of Alternative Approaches to Public Employment Policy, *Journal of Human Resources* 12 (Winter 1977): 3–26.

Development Block Grant program (CDBG) — found surprisingly low levels of fiscal substitution. Indeed, one study found that 94 percent of CDBG funds provided to the sample jurisdictions were allocated for new spending.[24]

Effective maintenance of effort provisions have the potential to cause serious fiscal and policy problems for state and local governments. One problem is the requirement that a grantee maintain expenditures to reduce spending even after productivity gains have been achieved or the demand for a service has been reduced. The UMTA subsidy requirement that a state maintain its prior year's subsidy or risk losing the entire federal grant, for example, could discourage a state from raising its public-transit fare and decreasing its budgeted operating subsidy.

Maintenance of effort and nonsupplant provisions may result in higher levels of public services than are deemed necessary by state and local officials. State and local budgetary decisions may be distorted far in excess of the required match. State and local officials have reported desires to reduce their own effort in public services only to have HUD officials inform them that they would be in possible violation of Community Development Block Grant maintenance of effort requirements. In the case of CETA, state and local budgetary flexibility is even more severely inhibited due to the program's stringent nonsupplant requirements and protections for regular public employees incorporated in the program since 1978.

The erosion of state and local budgetary flexibility, as a result of maintenance of effort, can best be appreciated in the aggregate. A larger local government is required to maintain spending levels of the prior year as a condition for receiving federal assistance in the following areas, among others: law enforcement to qualify for LEAA funds; mass transit for UMTA operating subsidies; services to meet the needs of the poor for community action funds; pre-grant community health expenditures for community mental health staffing grants; general education for a host of federal education programs; child nutrition for several child nutrition programs; and local public services for the Community Development Block Grant program.

During the explosion of state and local government expenditures over the past twenty-five years, maintaining the expenditures of previous years rarely was burdensome. As the pace of growth in the state and local sector declines, however, and as tax and expenditure limitations force absolute budget reductions, local governments may increasingly be hard pressed to meet maintenance of effort requirements. In addition, by continuing to maintain local effort in federally favored issue areas, local officials may not be able to fund locally favored programs at desired levels. Furthermore, the prospects for state and local budget flexibility can become even more imperiled if maintenance of effort requirements rigorous enough to prevent grantee fiscal substitution were spread to incorporate each of the 492 federal grant programs for state and local governments.

Generating New Clienteles

In addition to stimulating short-term spending, federal grants drive up future spending as well. Federal grants that start new services create a clientele that continues to be dependent on the service regardless of the availability of federal funds. When federal funds do expire, local officials face the painful dilemma of either increasing the budget to accommodate the new service or alienating a public that has grown accustomed to the service. A recent GAO report identified a number of federal programs whose avowed purpose is to stimulate new projects initially with federal funds and then to withdraw funds after a prescribed period of time. Evidence gathered by GAO indicates that many state and local governments are absorbing these federally inspired projects once grant funds terminate. For example, this has been the case in over 60 percent of LEAA-funded projects that are now terminated.[25]

A report of the South Carolina General Assembly points to a number of cases where federal grant projects, started without the knowledge or approval of the state legislature, became a permanent part of state government when federal funds expired. The report quotes one state agency boasting that it had never lost one employee initially funded through a federal demonstration grant: "Specifically this means that in the last five years over 400 highly trained staff members have been assimilated and absorbed by regular state appropriations."[26]

Finally, state and local governments must pay off the long-term operating costs of capital construction projects funded with federal grants. In the case of interstate highways and sewage treatment plants, for example, federal matching funds stimulate the construction of new facilities. However, while it is apparently in the national interest to build these new projects, Congress has not yet determined it to be in the national interest to fund the long-term operating and maintenance costs of these facilities. The costs to a locality can be substantial. The city of Wilmington, Delaware, for instance, recently rebuilt its sewage treatment plant with heavy federal funding to meet Environmental Protection Agency (EPA) water quality standards. To operate the new, sophisticated plant, however, Wilmington has had to increase its work force threefold, from twenty to sixty-two people, and has increased its locally funded payroll costs proportionately.

[24] See Richard P. Nathan, "The Brookings Monitoring Research Methodology for Studying the Effects of Federal Grant-In-Aid Programs" (Paper presented to the Annual Meeting of the American Political Science Association, Washington, D.C., 31 August 1979).

[25] See Comptroller General of the United States, *Federal Seed Money: More Careful Selection and Application Needed* (GGD-78-78) (Washington, D.C.: General Accounting Office, 1979).

[26] South Carolina General Assembly Legislative Audit Council, *A Study of the Impact of Federal and Other Funding on Legislative Oversight* (Columbia: South Carolina General Assembly Legislative Audit Council, 1977), p. 35.

The impact of these federally driven expenditure increases on state and local budgets is a combination of two effects: those that stimulate overall expenditures; and those that distort priorities. These effects are accelerated by fiscal stress. In a time of abundance, it is possible to finance federally induced costs from the growth increment of new locally generated revenues without having to reduce nonfederally funded services correspondingly. During a period of austerity, however, programs are forced into zero-sum competition with one another. Financing the costs of existing or new federally funded programs means sacrificing local programs not eligible for federal assistance.

There is evidence to indicate that local governments experiencing budget cuts will tend to protect federally funded programs at the expense of their own locally funded programs. There is a considerable economic reason for this—budget cuts are needed to reduce expenditures based on insufficient locally derived revenues. In order to live within a contracting local resource base, it is not nearly as productive to cut a program funded mostly from external resources, that is, federal grants. In a 75 percent federally funded program, for example, a cut that saves only 25 percent in local revenue would nevertheless have the consequence of reducing the program by a ratio of 4 to 1—for every dollar of local funds, four dollars of total program funds would be reduced. When a program is funded entirely from local revenues, however, a one dollar cut is less devastating in programmatic terms.

Thus it is likely that the tendency to protect federal grant programs in a time of budget cuts will extend the distortion of local priorities. A GAO study of the impact of federal matching provisions found that seventeen of the twenty-three state and local governments reviewed had to cut disproportionately nonfederally funded services to avoid losing federal grant funds in time of budget cuts; in some cases, the reduced services were basic services such as fire, sanitation, and street cleaning that were not eligible for federal funds.[27] A recent report on New York City provides some interesting support for this proposition as well. In New York, a marked shift was found in city spending, away from basic services such as police, fire, and sanitation toward social services and health areas with heavy federal funding. The study shows the following trend for city expenditures.[28]

The report shows that during periods of growth, the city decided to invest new revenues among competing functions based in part on the federal dollar return. Similarly, the city's budget-cutting experience in 1975 and 1976 indicates that major budget cuts occurred primarily in locally funded services not eligible for federal funds, for example, police, fire, and sanitation. The report concludes that the disproportionate reduction in the basic services and the shift toward

[27] Comptroller General of the United States, *Proposed Changes in the Federal Matching and Maintenance of Effort Requirements for State and Local Governments* (GGD-81-7) (Washington, D.C.: General Accounting Office, 1980).

[28] Temporary Commission on City Finances (TCCF), *An Historical and Comparative Analysis of Expenditures in the City of New York* (New York: TCCF, 1976).

Function	FY 1961	FY 1976	Percentage Increase or Decrease
Welfare (including social services)	12.3%	22.6%	+ 10.3%
Hospitals	8.2%	9.7%	+ 1.5%
Higher Education	1.9%	4.5%	+ 2.6%
Subtotals	22.4%	36.8%	+ 14.4%
Police	9.5%	6.4%	− 3.1%
Fire	4.9%	2.8%	− 2.1%
Sanitation	5.4%	2.7%	− 2.7%
Education	25.6%	18.4%	− 7.2%
Subtotals	45.5%	30.3%	− 15.1%

federally funded services was a product of the federal categorical grant system and was counterproductive to New York City's long-term fiscal, administrative, and social well-being because services that attracted dependent groups to the city continued to be funded while basic "housekeeping" services that benefit the entire city were cut.

The phenomenon is not limited to New York. The recent budgetary experience of California local governments in dealing with the impact of property-tax reductions mandated by passage of Proposition 13 tends to confirm this hypothesis. In planning for the potentially large reductions, local governments proposed greater retrenchments in locally supported basic services than in social-service programs that receive higher federal and state funding but are low in voter approval.[29]

In short, the strictures and structures of the federal grant system cause problems for local governments experiencing resource scarcity. Resource scarcity, however, also poses problems for the federal government. Resource scarcity could lead some state and local governments to preserve local priorities and sacrifice federal funds that involve matching requirements, maintenance of effort, or mandates. This practice would, however, tend to distort the distribution of federal funds away from those areas that may need them most. Thus, the fundamental purposes of many grant programs—to promote equity and to encourage uniform minimum levels of services throughout the country—may not be achieved. Resource scarcity therefore can lead to zero-sum conflict between federal and nonfederal interests. If federal programs are retained during a cutback period, state and local interests suffer; if state and local programs are retained, the federal interest suffers.

In sum, the entire intergovernmental system is distorted at all levels by the confrontation of grant requirements premised on growth with the political and

[29] Comptroller General of the United States, *Proposition 13—How California Governments Coped with a $6 Billion Revenue Loss* (GGD-79-88) (Washington, D.C.: General Accounting Office, 1979). See also, L. Cannon, "California Finds That Repealing the New Deal Is Not Easy," *Washington Post*, 5 June 1978.

administrative realities of resource scarcity. The theoretical and public-policy issues raised by this confrontation cannot be easily ignored.

Jurisdictional Conflicts

By design, the American system of intergovernmental relations contains cleavages, both among levels and within jurisdictions, that are made more apparent by resource scarcity and fiscal retrenchment. Essentially, resource scarcity diminishes the control by each level of government over its own boundaries. State and local governments lose discretion over their budgets and policy agendas in proportion to their dependence on federal aid. The federal government comes to rely more on other sectors of the economy—including states and localities—to implement national policies that are too expensive to be done by the federal government alone. The political accountability of each government for policies and programs becomes muddled as a consequence of this intensified interdependence.

Yet, the blurring of institutional boundaries and "policy space" sows its own antithesis—the redefinition of core interests intrinsic to each level of government and a consequent sorting out of priorities. Conflict among and within all levels of government intensifies as a result. In fact, it can be argued that intergovernmental cooperation is predicated on abundance as well as on the nature of the grant mechanism itself. When the responsibility for the costs and benefits of public programs are institutionally separated among levels of government, a critical incentive to discipline the size of public programs may be removed. The rather undisciplined proliferation of the imposing costs of federal mandates and the rather unselective acceptance of new federally funded programs by state and local governments offer further support for this proposition. Resource scarcity accentuates the realization of costs at all levels of government, however, and can induce the kind of critical evaluation and oversight at state and local levels that naturally occurs when benefits and costs become institutionally joined.

The institutional ambiguity in intergovernmental relations that tends to obscure the dominance of the federal government could be a luxury during a time when state and local governments are seeking to redefine their mission to accord with reduced resources. Under conditions of austerity, states and localities typically attempt to sort out and to rank programs and priorities so that dwindling resources can be used in the most essential areas.[30] Because state and local budgets are heavily dependent on federal funds, these cutback strategies affect and are affected by the federal grants system, triggering two kinds of conflicts that may ultimately weaken and undermine the intergovernmental system: conflict among levels of government; and conflict within jurisdictions.

Under conditions of resource scarcity, state and local policymakers seek new ways to relieve their financial burdens, including the use of federal funds to supplant state and local funds and support services previously supported by state or local revenues. This process can conflict with the federal grant system itself, which seeks to provide funding for new programs of national interest that state and local governments would not otherwise fund on their own. Indeed, the rationale for the existence of mandates as well as maintenance of effort requirements is that state and local governments cannot be left to implement national policies without some kind of federal intervention. Operationally, this means that state or local projects should qualify for federal funding only if their local priority is low enough that they would not have been funded with nonfederal funds. Fiscally well-off jurisdictions can tolerate peaceful coexistence between federally supported projects of low local priority and locally supported projects. If jurisdictions undergoing fiscal stress are to continue to receive federal grant funds and continue to comply with the structures of these programs, however, they would be forced to witness an erosion in the levels and quality of their traditional locally funded services while maintaining federally funded services of relatively low local priority.

For example, during the period of severe budgetary retrenchment, New York City argued that LEAA regulations, including maintenance of effort, required the city to use LEAA funds for new, innovative projects to improve the criminal justice system at the same time that the criminal justice system itself was experiencing large cutbacks and employee layoffs. The city felt that it should have been allowed to use these LEAA funds to restore the basic infrastructure of the system before launching innovative projects to improve it.[31]

It becomes a matter of vital self-interest for local governments to avoid cuts in locally funded services by shifting federal funds away from projects perceived to be nonessential by local officials but which may, nevertheless, be part of a major federal program. Maintenance of effort provisions, however, can prevent this by requiring that the brunt of cuts fall on those locally funded services with no federal fiscal involvement. Thus, if federal grant purposes are to be achieved, a priority inversion must occur, as local governments may be forced to harbor federal programs and mandates with low local priority and cut programs and services with high local priority. In addition, when abundant state and local resources are no longer available to cushion the impact of displacement effects, federal agencies themselves may be faced with a new conflict: whether to withdraw funding from state and local governments to satisfy federal requirements and priorities or to tolerate a significant amount of noncompliance and in doing so to sacrifice the federal interest.

[30] For a more in-depth discussion of this process, see Charles H. Levine, "Organizational Decline and Cutback Management," *Public Administration Review* 38 (July-August 1978): 315–25; and idem., "More on Cutback Management: Hard Questions for Hard Times," *Public Administration Review* 39 (March-April 1979): 179–83.

[31] See statement submitted by Mayor Beame, New York City, in U.S., Congress, House, Committee on Banking and Currency, Subcommittee on Economic Stabilization, *Debt Financing Problems of State and Local Governments*, 94th Cong., 1st sess., 1975, pp. 898–902.

Resource scarcity at the federal level can also intensify conflict with state and local objectives in a different way. In an era of tightened budget constraints, the federal government may be more tempted to implement national policies without paying for the costs through mandates and direct regulation. Of course, these federal attempts to shift costs to other levels of government are bound to meet resistance in direct proportion to the budgetary constraints faced by state and local governments.

Conflict within a jurisdiction is also stimulated during cutback periods as bureaucracies and interest groups compete for a share of a shrinking economic pie. As this occurs, policymakers soon realize that the percentage of their budget under their discretionary control is decreased drastically.

During times of resource abundance, central state and local managers can more easily tolerate program expansion by agencies heavily funded by federal programs since other agencies funded mostly by state and local revenues are likely to be growing also. The greater autonomy of administrators of federally funded programs is not so obvious when compared with administrators of state and locally funded programs. Under conditions of fiscal stress and retrenchment, however, conflict is stimulated between constituencies and bureaucracies dependent on federal funds and state and locally elected officials responsible for controlling the size of the public sector and ultimately financing the second-order cost impacts of federal grants.

State legislatures, for example, have moved in recent years to assert stronger control over federal grant funds received by states. According to the National Conference of State Legislatures (NCSL), legislatures in twenty-six states attempted to increase their control over federal funds in the past two years by appropriating federal grant funds or reviewing state grant applications prior to submission to federal funding agencies. In a recent report, the NCSL concludes that this recent development has been prompted by tax and spending limitations which have provoked legislative concerns over the following impacts of federal grants for state budgets: predominance of federal priorities; ability to comply with match and maintenance of effort requirements; stimulative effects of federal seed money grants on state budgets; and inadequate federal funding to implement fully federal mandates and programs.[32]

Theoretical Implications and Policy Dilemmas

Even though these conflicts between levels and within jurisdictions may be ultimately muted through traditional means of intergovernmental lobbying and bargaining, it is difficult to account for them within frameworks of intergovernmental relations that emphasize cooperative federalism. These theories tend to emphasize the collaborative aspects of federalism and downplay the sources and significance of conflict between and within levels of the federal system.[33] It is imperative to ask: cooperation among whom for what purpose, and under what conditions?

If the diminution and distortion of state and local discretion and priorities become as severe as expected, then a reformulation of these explanations of intergovernmental relations is clearly appropriate. Resurrecting traditional theories of federalism and reviving time-worn discussions of the attributes of sovereignty, albeit under new conditions of intense interdependence and extensive externalities, may be needed. It is important during a time of heightened intergovernmental conflict to understand not only how conflicts are resolved, but also *how they arise*. Under conditions of resource scarcity, it is important to understand better how each level of the system *redefines* its own interests, priorities, and institutional boundaries.

Another missing element of cooperative bargaining models of intergovernmental relations revealed by resource scarcity is the limited influence of the state and local political officials most responsible for dealing with these aggregate impacts. Mayors, city managers, budget directors, and legislative officials are not full partners in the implementation of the variety of ongoing federal grant programs. Rather, the dominant actors are the functional specialists who control the vertical links of the intergovernmental picket fence. As a result, the officials most sensitive to defining and preserving the boundaries of state and local government autonomy are overshadowed by officials more concerned with protecting narrow programmatic boundaries than with enhancing the systemwide problem-solving capacity.

It is therefore quite possible that the mutual bargaining relationships thought to characterize the implementation of intergovernmental programs by some prominent students of intergovernmental relations theory may not, in fact, adequately describe the political problems of dealing with the residual effects of that system under conditions of scarce resources. These displacement effects are not a function of direct transactions within the intergovernmental system, but rather represent aggregate residual effects of the system as a whole. In its present form, cooperative bargaining models of intergovernmental relations theory do not and cannot adequately account for the aggregate impacts of the intergovernmental grants system functioning in its entirety. Indeed, residual or second-order consequences of that system are not recognized as *inter*governmental problems at all, but rather are dealt with in theory and practice as *intra*governmental issues. For example, waivers of federal mandates and grant requirements for fiscally distressed jurisdictions are not widely available in federal

[32] See Winnifred M. Austermann, *A Legislator's Guide to Oversight of Federal Funds* (Denver, Colo.: National Conference of State Legislatures, 1980).

[33] See, for example, Daniel J. Elazar, *The American Partnership* (Chicago, Ill.: University of Chicago Press, 1962); Helen Ingram, "Policy Implementation through Bargaining: The Case of Federal Grants-in-Aid," *Public Policy* 25 (Fall 1977): 499-526; Deil Wright, *Understanding Intergovernmental Relations* (North Scituate, Mass.: Duxbury Press, 1978); and Catherine Lovell, "Where We Are in Intergovernmental Relations and Some of the Implications," *Southern Review of Public Administration* (June 1979): 6-20.

programs; and these waivers have not been widely lobbied for either.[34] Instead, state and local governments, no matter how fiscally strong or weak, have been left to their own devices in order to meet compliance requirements. Rather than considering this a problem in the grants structure, the displacement effects of federal programs are often celebrated as a *positive* consequence of the design of intergovernmental programs.

Ironically, the period that spawned the explosion of fiscally destabilizing categorical grants has also been marked by the emergence of a series of countervailing federal policies that seek to give fiscal relief to state and local governments. It could be argued that the distortion effects of categorical programs are somewhat muted by these countervailing policies, such as general revenue sharing, which provides discretionary "no-string" federal funds to states and localities. These strategies, however, are a very roundabout and indirect way for the federal government to deal with the displacement problem.

If the phenomenon of resource scarcity becomes a permanent feature of the public sector, the federal assistance system will face several significant policy dilemmas. Should the federal government, for example, continue to reward increases in the size of the state and local sector? Or, alternatively, should it remain neutral or actually encourage decreases? If expenditure reductions are encouraged through the federal grants system, is there a risk that federal funding will merely displace state and local funding, thus encouraging greater dependency on federal funds and less local autonomy? Can the federal government moreover tolerate decreased participation in grant programs developed to meet nationwide needs by state and local governments undergoing fiscal retrenchment? Is the resultant distribution of federal funds skewed away from areas or groups especially in need of federally funded services?

If this skewed distribution is to be rectified, should the federal government adjust grant requirements through waivers and other variances for all governments in fiscal distress? Or should policy distinctions be made between fiscal distress caused by secular economic decline and fiscal crisis brought about through the voluntary actions of wealthier communities? How should these distinctions be operationally determined?

If participation in grant programs begins to fall off, should the federal government itself directly provide for areas in need that cannot or will not participate in federal programs? What impact might this have on a federal budget which is also feeling the force of the taxpayer revolt? And how can emerging federal policies to shore up the fiscal and economic vitality of state and local governments through such efforts as general revenue sharing, countercyclical assistance, and emergency public-works assistance be reconciled with federal grant requirements such as matching and mandated costs that exacerbate state and local fiscal pressures?

Paralleling these dilemmas facing the federal government are numerous policy dilemmas confronting state and local governments that are rooted in federal grants structure and resource scarcity. One of these dilemmas is especially noteworthy: By trying to reduce local government expenditures, voters supporting tax limitation initiatives may have inadvertently helped to increase the cost of government by pushing decision making to higher levels of government. This could add to the alienation that contributed to the tax limitation movement at the outset. At higher levels government feedback on local problems is weak, inaccurate, and sluggish, making control and implementation more difficult and cumbersome. Furthermore, by forcing policymaking upward, the danger of overloading state and national policymaking bodies with problems that used to be the exclusive concern of governors, mayors, state legislators, and city councilmen is increased. This leaves the central question of intergovernmental administration: Is it possible to transfer responsibility for funding services upward in the political system—and thus remove the link between revenue-raising levels of government and levels which expend and implement—without eroding traditional constraints on spending and the traditional responsiveness of local government?

Finally, the federal grant system and resource scarcity present a dilemma for the design and administration of the intergovernmental system considered as a whole: By increasing state and local reliance on federal grant programs, the state and local policy agendas are likely to become "cluttered" by programs of national but not necessarily local priority. During times of cutbacks, the national priority programs tend to be protected while locally funded programs suffer the brunt of cuts. From the local viewpoint, it can be argued that protected federal programs are wasteful because they support innovations and program initiatives that local citizens and public officials consider frivolous—especially when the basic service infrastructure of local government is being retrenched. Thus a basic question for democratic theory and practice remains: Will sheltering federally funded programs while locally funded programs wither eclipse state and local political discretion? And, in so doing, will such a policy also promote cynicism, alienation, and the loss of efficacy among citizens who fund and are dependent on the services state and local governments deliver?*

[34] The GAO found that most grant programs with these requirements do not provide for waivers. See Comptroller General of the United States, *Matching and Maintenance of Effort Requirements*.

* This article is a revised version of a paper originally prepared for delivery at the Annual Meeting of the American Political Science Association, Washington, D.C., 31 August–3 September, 1979. The authors wish to thank David B. Walker of the Advisory Commission on Intergovernmental Relations for his helpful comments on the earlier draft.