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The Federal Government has a vital stake in State and local productivity improvement for two reasons: the national economy is strengthened by State and local productivity improvement and the effectiveness and efficiency of these governments directly affect the costs of the Federal assistance programs they administer.

Over the past twenty years, State and local governments have assumed positions of considerable economic importance. State and local budgets now account for roughly 13 per cent of the gross national product. While one in every six persons in the workforce is employed by government, State and local governments represent 80 percent of all public employment. At a time of increasing public pressure to curb government costs, improving the productivity of State and local governments can help control government spending and help fight inflation.

State and local governments play an especially critical role in accomplishing national objectives. Through the Federal assistance system, these governments carry out many federally mandated programs, at times functioning as the administrative arm of the Federal Government and its national domestic policies. It is through this same assistance system that the Federal Government also has its greatest impact on State and local government productivity. Together, the structure of Federal assistance programs and the management capacity of State and local governments administering them tend to determine the efficiency, effectiveness and costs of the programs. Those costs (i.e. Federal grant-in-aid outlays) for fiscal 1980 were in excess of $90 billion.

[Federal Role in State and Local Productivity Improvement]

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In an earlier GAO report, "State and Local Government Productivity Improvement: What Is The Federal Role?" (GGD-78-104, Dec. 6, 1978), we found that the Federal assistance system has a largely negative affect on State and local productivity. Principal reasons for this negative impact included the myriad of Federal regulations and excessive "red tape" which imposes delays and additional costs on State and local governments administering Federal assistance programs. In addition, we found that most major Federal assistance programs neither encourage nor reward State and local productivity in the distribution of funds or the evaluation of recipient use of funds. As a result, State and local governments generally have little incentive on their own to be concerned about productivity in using Federal funds. We concluded, therefore, that one way the Federal Government could help State and local governments improve their productivity was by making fundamental changes in the assistance system to remove negative barriers and promote positive incentives for productivity improvement.

Our recent report "Millions Can Be Saved By Improving The Productivity Of State And Local Governments Administering Federal Income Maintenance Assistance Programs" (AFMD-81-51, June 5, 1981) corroborates our earlier findings and recommendations. In this latest review, we concentrated on three major Federal income maintenance programs--Unemployment Insurance (UI), Aid to Families with Dependent Children (AFDC), and Food Stamps. We selected these particular State-administered programs because they are national in scope and because their administrative costs are either paid fully or shared by the Federal Government. From our review, we identified millions of dollars associated with inefficient procedures used by State and local governments administering the programs. As our review was limited to only eight States and certain common administrative functions (e.g. claims processing, check processing) performed by those States (and selected local jurisdictions within them), we believe the millions identified represent only a small percentage of the potential for cost savings in the UI, AFDC, and Food Stamp programs. Moreover, these millions may demonstrate the potential for savings in the administration of similar Federal assistance programs, as well.

As in our earlier report, we found that Federal methods for allocating and distributing funds in the programs we reviewed do not reward or encourage productivity improvements in State and local governments administering them. Rather, the funding systems serve primarily as mechanisms for justifying how limited resources are allocated to the States with little, if any, regard as to how efficiently the resources are used. Furthermore, most Federal evaluations and oversight activities address only the allowability of costs and compliance with regulations and do not consider productivity or efficiency.

Because Federal funding formulas do not take productivity levels into account, and because no limits are based on reimburseable costs, States receive no Federal recognition or reward for achieving cost savings with Federal funds. Thus, if a State has 2,000 workers servicing the AFDC program, for example, the Federal Government will reimburse 50 percent of the costs, regardless of whether the agency could function as well with fewer employees. If the State then increases or decreases the number of staff, Federal funding is increased or decreased proportionately. The "reward" for decreasing staff and improving efficiency, is reduced Federal funding. As a result, State and local governments generally have no financial incentive to improve efficiency. Further, in programs such as AFDC where costs are shared, States know that their total expenditures, not their efficiency predicate the amount of Federal funds available to cover administrative costs.

Federal funding mechanisms also tend to influence the level of State and local oversight in federally assisted programs. Generally speaking, State and local governments do not exercise the amount of oversight on federally funded programs that they do on State-funded programs. Although federally funded programs usually move through the same appropriation process as those funded by a State, programs fully funded by the Federal Government are not as closely scrutinized as those with a substantial State share. Often 100 percent federally-funded programs are not audited by States because Federal auditors perform the function. On the other hand, in programs where administrative costs are shared, States may conduct a financial audit, but not a management review, because again, Federal auditors usually perform such reviews. As a result, Federal funding mechanisms tend to dilute State and local accountability for program management and fiscal control, creating a productivity problem Federal in origin and responsibility.

We believe that changes are needed in the Federal assistance system to encourage productivity improvement in State and local governments. While these changes may require greater Federal involvement with State governments in particular, we view this involvement as leading more to increased collaboration between Federal and State agencies, rather than to increased absolute Federal control. Specifically, we believe that productivity measurement and incentive systems are needed to achieve management and fiscal accountability in Federal assistance programs.

Productivity measurement provides a mechanism for developing goals and evaluating progress toward reaching those goals; incentives, on the other hand, afford a mechanism for encouraging and rewarding productivity improvement. None of the three programs we reviewed had a productivity measurement and/or incentive system. Yet, without these tools, accountability in these and other Federal income maintenance assistance programs may not be attainable.

Therefore, we believe that

(1) Systematic approaches should be developed where appropriate to measure, analyze and help improve the productivity of State and local governments administering Federal assistance programs. In addition, the data generated by these systems should be used in the funding/budget process; and

(2) Demonstration or pilot projects should be undertaken to test approaches for providing States incentives for making productivity improvements in Federal assistance programs.

We view incentives, in particular, as a largely untested, but potentially significant tool for encouraging productivity improvements. To be effective, however, incentive systems should be designed to reward, not penalize States for meeting established goals. We have found that the use of sanctions and high matching requirements have primarily negative consequences and therefore should not be considered as "true" incentives. In our review of AFDC's quality control system for reducing errors in eligibility determinations 1/ for example, we concluded that fiscal sanctions create an adversary relationship between the Federal Government and States at a time when a cooperative effort is needed to reduce errors. Moreover, sanctions often serve as a disincentive to States for reducing error rates; States with high error rates simply identify fewer errors rather than taking all the necessary corrective actions that will result in reduced Federal reimbursements.

Similarly, in another review, 2/ we found that Federal matching and maintenance requirements are not often effective for promoting State and local government oversight of Federal assistance programs. Although a strong matching requirement may engender a higher level of State and local management attention to fiscal and program operations, we concluded that a high match can adversely affect the interests of all three levels of government, by distorting State and local priorities and forcing jurisdictions to cut resources in nonmatched programs to meet matching requirements in others.

1/ "Better Management Information Can be Obtained from the Quality Control System Used in the Aid to Families with Dependent Children Program," HRD-80-80, July 18, 1980.

2/ "Proposed Changes in Federal Matching and Maintenance of Effort Requirements for State and Local Governments," GGD-81-7, Dec. 23, 1980.

Incorporating positive incentives, such as sharing cost savings achieved through productivity improvements, could encourage States to develop needed accountability mechanisms in Federal assistance programs. Under this approach, States would retain some percentage of the savings from improving productivity. States could either be allowed unrestricted use of of the savings or be required to use the savings within the program. An incentive, such as sharing cost savings, would require no additional Federal funding to underwrite productivity improvements while it would return a portion of the cost savings to the Federal Government, thereby reducing the overall costs of the the Federal assistance program.

We should point out that the demonstration and pilot projects we suggest would also not necessarily require additional funding. Rather, existing demonstration funds could be reprogrammed to include projects on incentive systems. In fact, we believe, much can be done in the area of productivity improvement under existing funding.

We should also point out that incentive and productivity measurement systems may not be appropriate in all Federal assistance programs. For example, in programs whose primary purpose is to financially assist State and local governments meet their own priorities, such as crime reduction or fiscal relief, measurement and incentive systems would probably be inappropriate. In these cases, the assistance is more of a grant than a contract. On the other hand in programs of a more contractual nature, such as the income maintenance assistance programs we studied, where States and localities basically carry out national policies and objectives, we believe incentives and productivity measurement systems are appropriate.

In summary, we believe that the Federal assistance system lacks mechanisms to hold State and local governments and their employees accountable for productivity improvement and to reward those who meet or exceed productivity goals. Instead Federal funding and oversight mechanisms serve as disincentives to productivity improvement. We believe that to achieve accountability, productivity measurement and incentive systems need to be incorporated where appropriate in Federal assistance programs. Realizing productivity improvements can help both the Federal Government and State and local governments meet growing fiscal pressures in providing services through the Federal assistance system.