United States General Accounting Office

GAO

March 2003

HIGHLIGHTS OF A GAO SYMPOSIUM

Addressing Key Challenges in an Intergovernmental Setting

Accountability ★ Integrity ★ Reliability

GAO-03-365SP

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GAO Accountability•Integrity•Reliability

Highlights

Highlights of GAO-03-365SP

Addressing Key Challenges in an Intergovernmental Setting

Why GAO Convened This Symposium

Responding to many of the nation's critical challenges—such as meeting the health care needs of the poor or countering terrorist threats—has been the joint responsibility of all levels of government. The effectiveness of federal programs has increasingly become dependent on state and local management and resources, as well as constructive interactions between federal, state, and local actors, including private and non-profit actors who are joining with government officials to carry out national policies and programs.

This increased interdependence among levels of government presents many challenges. While many policy areas have been nationalized and federally funded, greater responsibility has been devolved to state and local governments for implementing programs to achieve national goals. The intergovernmental system is facing the complexity of managing programs involving numerous actors, and the flexibility and capacity of the federal system to respond to unique local needs is challenged by long-term national and international trends.

On November 20, 2002, GAO convened a symposium to identify and discuss the key policy and fiscal issues facing the intergovernmental system. The invited participants represented federal, state, and local governments, national associations, public interest groups, and research and academic institutions.

www.gao.gov/cgi-bin/getrpt?GAO-03-365SP.

To view the full report click on the link above. For more information, contact Paul Posner at (202) 512-9573 or posnerp@gao.gov.

What Participants Said

Participants discussed key intergovernmental challenges facing all levels of government and identified the following four as the most significant:

1. Mismatch between current revenues and spending demands. Increased spending demands and revenue shortfalls during economic downturns affect states' ability to fund their share of key programs. Participants discussed the causes of the spending and revenue mismatch, federal and state options for addressing it, and their respective advantages and disadvantages. Beyond current shortfalls, participants focused on long-term structural fiscal pressures that will continue to test the capacity of the intergovernmental system. Certain structural forces, such as changes in the global economy and the aging of the population, will continue to prompt stress on both the revenue and spending sides of the budget at all levels of government.

2. Intergovernmental financing of health care, particularly long-term care for the elderly and disabled. Participants agreed that funding health care costs for a growing aging population is the most significant intergovernmental fiscal challenge. Medicaid costs will likely continue to grow at a high rate due to such factors as increasingly high health care costs and the aging of the population. The discussion focused on the need to restructure health care financing for the disabled and aged and to develop a sustainable intergovernmental solution.

3. Current tax structures at all levels of government and inter-relationships between them. Participants agreed on the need to review the tax structures of all levels of government collectively and for policy makers to better consider the relationships between them. The national economy is becoming increasingly interconnected and global as business is conducted across state and national boundaries—potentially undermining the capacity of current tax systems to reach transactions in such an economy.

4.Consider reassessing the assignment of responsibilities. In recent years, the federal government has continued to mandate new responsibilities for achieving national goals on state and local governments, by law or regulation. Participants agreed that the fiscal and administrative resources of state and local governments vary and may not be sufficient to fulfill this increased responsibility for national priorities. One model involves sorting out intergovernmental functions with the federal government assuming responsibility for functions that are redistributive in nature, and delegating other responsibilities to states and localities.

Contents

Letter 1

Appendixes

Appendix I: Participants Attending the November 20, 2002 GAO Symposium—"Addressing Key Challenges in an Intergovernmental Setting" 5
Introductory Speakers 5
Participants 5

Appendix II: GAO's Symposium on Addressing Key Challenges in an Intergovernmental Setting 7
Background and Highlights of the Discussion 7
1. Mismatch Between Current Revenues and Spending Demands 8
2. Intergovernmental Financing of Health Care, Particularly Long-term Care for the Elderly and Disabled 14
3. Current Tax Structures at All Levels of Government and Interrelationships Between Them 18
4. Consider Reassessing the Assignment of Responsibilities 22
Discussion of Need for an Ongoing Dialogue and Possible Framework 28

Appendix III: Summary of Introductory Remarks 31

Appendix IV: Intergovernmental Relations Symposium Slide Presentation 33

Appendix V: Grant Programs to State and Local Governments 44

Figures

Figure 1: Composition of Spending as a Share of GDP Assuming Discretionary Spending Grows With GDP and the Tax Cuts Do Not Sunset 9
Figure 2: State Spending by Function as a Percent of Total State Spending After 1, 5, and 10 Years 16
Figure 3: Federal and State Revenue Trends 19
Figure 4: Number of Federal Preemption Statutes Enacted Per Decade 26
Figure 5: Summary of the Number of Grant Programs to State and Local Governments: Fiscal Year 2001 44
Figure 6: The 20 Largest Grant Programs to State and Local Governments: Fiscal Year 2001 (obligations in billions) 45
Figure 7: Trend in the Number of Federal Grant Programs to State and Local Governments 1980-2001 46

United States General Accounting Office
Washington, D.C. 20548

March 31, 2003

Highlights of a GAO Symposium on Addressing Key Challenges in an Intergovernmental Setting

Addressing many of the nation's critical challenges—such as meeting the health care needs of the poor or countering terrorist threats—increasingly depends on the joint efforts of all levels of government. The effectiveness of federal programs has increasingly become dependent on state and local management and resources, as well as constructive interactions between federal, state, and local actors, including private and nonprofit actors.

Consequently, the fiscal and policy fortunes of each level of government in our system are increasingly interdependent. While citizens have demanded federal action and many policy areas have become nationalized, this has been accompanied by a growing reliance on state and local governments to implement national goals. These arrangements confer mutual benefits: the federal government gains valuable political and fiscal partners and state and local governments gain federal resources and support.

However, the increasing connections among governments in our system have also raised vexing governance challenges. State and local governments have been confronted with the challenge of addressing their own unique responsibilities while at the same time assuming stewardship for a growing number of national goals. The federal government must reconcile its accountability for achieving national outcomes with its growing reliance on independent third parties. It can be confusing for the public to identify responsibilities for outcomes when so many players at all levels of government are involved.

The intergovernmental system is now being tested by a complex array of specific short-term and long-term challenges. For example, in areas ranging from homeland security to education and health care, federal, state, and local governments are facing an increasing range of daunting problems in managing programs involving numerous actors inside and outside of government. Moreover, the unique advantages of a federal system—the flexibility and capacity to respond to unique local needs—are challenged by long-term trends such as advances in technology and communications that span state and even national boundaries and inspire demands for consistent national regulatory and tax policies.

Currently, the system's challenges are most sharply defined by increasingly acute expenditure and revenue pressures occurring at all levels of government. In the near term, revenues have fallen, while other developments, such as health care price increases, unexpected homeland security threats, and the war against terrorism have greatly increased spending demands at all levels of government. Over the longer term, pressures will continue, driven in large part by the aging of the population. At the same time, other trends, such as increased global interdependency and rapidly advancing technology, could work to undermine tax bases as more economic transactions occur within and across our nation's borders. In addition, state and local tax systems are not designed to adequately capture services—the biggest growth sector of the economy. Together, such trends present fiscal and policy choices that will become far more difficult over time if not addressed in a timely fashion.

Recognizing that decision makers can greatly benefit from a better understanding of the constraints and challenges that our federal, state, and local partners face, GAO convened a symposium on November 20, 2002, to discuss the key policy and fiscal issues facing the intergovernmental system. The invited participants consisted of a cross section of current and former federal, state, and local officials, as well as observers from academia, think tanks, public interest groups, and the private sector. The summary of the participants' discussion reflects the views expressed by the attendees and does not necessarily represent a complete perspective on these issues or reflect the views of GAO.

As agreed with the participants, our goal was to reach consensus on the top challenges facing the intergovernmental system and to engage in an open and not-for-attribution-based dialogue. As expected, the forum participants expressed a range of views on the challenges facing the intergovernmental system. After a lengthy discussion, the following were identified as the most significant intergovernmental challenges:

- mismatch between current revenues and spending demands;
- intergovernmental financing of health care, particularly long-term care for the elderly and disabled;
- current tax structures at all levels of government and interrelationships between them; and
- consider reassessing the assignment of responsibilities.

Another major topic of discussion was the need for ongoing dialogue about national priorities and shared challenges. There was general agreement that since the Advisory Commission on Intergovernmental Relations (ACIR) was abolished, there has been a lack of a focal point and forum for comprehensive discussions of intergovernmental issues and a formal mechanism for forging partnerships. While no consensus was reached on the type and format for such a renewed forum or focal point, we hope that this symposium will serve as a springboard for future dialogue among intergovernmental partners on the long-term challenges facing the nation and advising the Congress on emerging domestic policy issues.

Appendix I provides a list of the symposium participants, and appendix II provides highlights of the most significant challenges discussed by the participants, as well as subsequent comments we received from them on a draft summary of the discussion. It also includes a discussion of the need for a forum for ongoing dialogue on intergovernmental issues. While appendix II largely reflects the insights and perspectives of the participants, it also contains additional information, such as that provided in the background sections, to provide context and clarity for the discussion. Appendix III provides a summary of introductory remarks made by David M. Walker, Comptroller General of the United States, and David Broder of the *Washington Post*. Appendix IV contains a set of slides presented by GAO at the beginning of the symposium. This presentation was designed to provide background information to spur the discussion among symposium participants. Finally, appendix V contains an informative summary of grants to state and local governments provided to us by the Office of Management and Budget.

I wish to thank the participants for taking the time to share their knowledge and provide their insights and perspectives on the important matters this document discusses. We look forward to working with them on intergovernmental issues of mutual interest and concern in the future. Key contributors to this report were Ann Calvaresi-Barr, Thomas Yatsco, and Amelia Shachoy.

Paul L. Posner

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Participants Attending the November 20, 2002 GAO Symposium—"Addressing Key Challenges in an Intergovernmental Setting"

Introductory Speakers

David M. Walker, Comptroller General of the United States, U.S. General Accounting Office

David M. Broder, Columnist, *Washington Post*

Paul Posner, Managing Director, Federal Budget Analysis and Intergovernmental Relations Issues, Strategic Issues, U.S. General Accounting Office

Participants

Jonathan Breul, Director, Federal Management and Performance, IBM Business Consulting Service (formerly with the United States Office of Management and Budget)

Enid Beaumont, Georgetown Public Policy Institute, Georgetown University

Tim Conlan, Associate Professor, Public and International Affairs, George Mason University

Harley Duncan, Executive Director, Federation of Tax Administrators

Julia Friedman, Deputy Chief Financial Officer/Chief Economist, Government of the District of Columbia

Natwar Gandhi, Chief Financial Officer, Government of the District of Columbia

David F. Garrison, Vice President, National Academy of Public Administration

William T. Gormley, Professor, Georgetown Public Policy Institute, Georgetown University

Robert Greenstein, Executive Director, Center on Budget and Policy Priorities

John Kincaid, Professor and Director, Meyner Center for State and Local Government, Lafayette College

Iris Lav, Deputy Director, Center on Budget and Policy Priorities

Larry Naake, Executive Director, National Association of Counties

Richard P. Nathan, Director, The Nelson A. Rockefeller Institute of Government, State University of New York, Albany

Sue Nelson, Democratic Deputy Staff Director, Committee on the Budget, United States Senate

Robert O'Neill, Jr., former President, National Academy of Public Administration

Sallyanne Payton, Professor, The University of Michigan Law School

Scott D. Pattison, Executive Director, National Association of State Budget Officers

William Pound, Executive Director, National Conference of State Legislatures

Andrew Richardson, Majority Staff Director, Subcommittee on Oversight of Government Management, Restructuring and the District of Columbia, Committee on Governmental Affairs, United States Senate

Ray Scheppach, Executive Director, National Governors Association

Hannah Sistare, Visiting Fellow, The Brookings Institution

Christopher Smith, Counselor to the Secretary, Department of the Treasury

Carl Stenberg, Dean, College of Liberal Arts, University of Baltimore

Carl Tubblesing, National Conference of State Legislatures

Cameron Whitman, Director, Policy and Federal Relations, National League of Cities

Henry Wray, former Senior Counsel, Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform, House of Representatives

GAO's Symposium on Addressing Key Challenges in an Intergovernmental Setting

Background and Highlights of the Discussion

This symposium was convened as a springboard to enhance constructive discussions among federal, state, and local actors about national priorities and resources; discuss possible formats for an ongoing dialogue to forge links between all levels of government; help to shape GAO's future work in this area; and eventually advise the Congress on emerging domestic policy issues. Our goal in sponsoring the symposium was to have participants discuss the full range of challenges facing the intergovernmental system—with an eye toward those that are long term in nature—and come to consensus on the top challenges that need to be addressed collaboratively.

Discussion of Key Challenges

After introductory remarks, a lengthy discussion ensued of the key challenges facing the intergovernmental system. At the close of this discussion, participants identified the top intergovernmental challenges that need to be addressed collaboratively. Symposium participants identified the following four as the top long-term intergovernmental challenges:

- mismatch between current revenues and spending demands;
- intergovernmental financing of health care, particularly for long-term care of the elderly and disabled;
- current tax structures at all levels of government and interrelationships between them; and
- consider reassessing the assignment of responsibilities.

Each section of this summary is prefaced with supplemental background information derived from introductory presentations,[1] research and interviews conducted by GAO in preparation for the symposium, and previous GAO reports.

[1]Introductory presentations were delivered by David M. Walker, Comptroller General of the United States; Paul Posner, GAO Managing Director, Federal Budget Analysis and Intergovernmental Relations Issues; and David Broder, Columnist, *Washington Post*. Summaries of remarks by Mr. Walker and Mr. Broder can be found in appendix III and slides presented by Mr. Walker and Mr. Posner can be found in appendix IV.

1. Mismatch Between Current Revenues and Spending Demands

Background

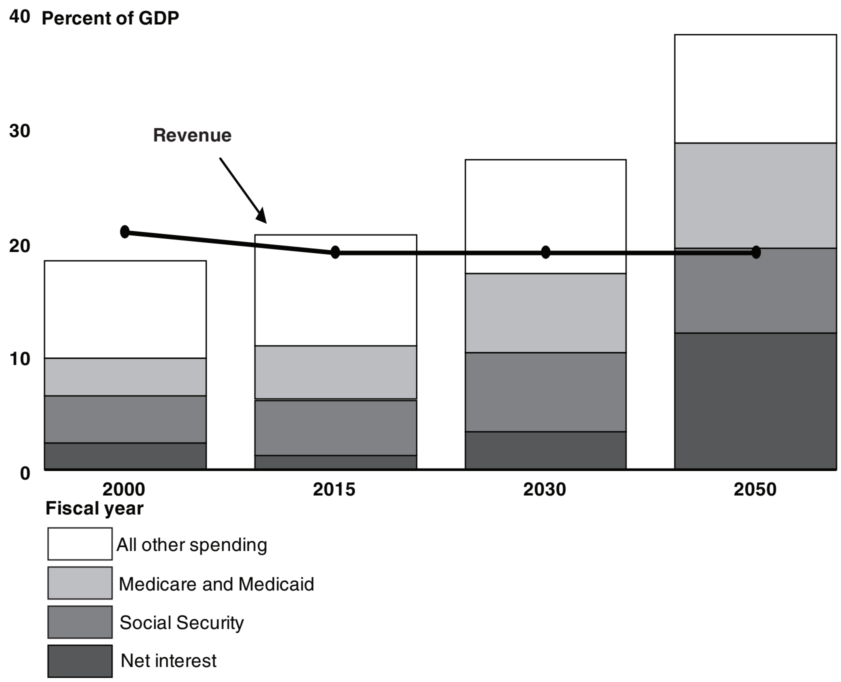
After the economic boom of the 1990s, all levels of government are now experiencing serious fiscal challenges, and are likely to face even more fundamental ones in the future. In the short term, revenues are down, while other developments, such as higher demand for health and long-term care services, health care price increases, and unexpected homeland security threats, have greatly increased spending demands. In addition, certain long-term trends, such as the aging of the population, will continue to put spending demands on federal and state governments, while other trends, such as increasing global interdependency and advancing technology, will likely affect traditional sources of government revenues by reducing tax bases.

Current and projected fluctuations in resources have had serious repercussions for the entire intergovernmental system. The federal budget has moved from unprecedented federal surpluses of the late 1990s to deficits. The Congressional Budget Office (CBO) now projects federal deficits of $246 billion in fiscal year 2003 and $200 billion in fiscal year 2004 as the baseline before further policy actions.[2] Along with a decline in revenues, spending demands have increased. Within the past year alone, the impact of the terrorist events of September 11, 2001, required the federal government to take on greater responsibilities, health care costs continued to grow at double-digit rates, and the war on terrorism has increased defense needs.

Over the longer term, the retirement of the Baby Boom generation will place greater demands on federal programs like Social Security, Medicare, and Medicaid if they remain unchanged. Under most scenarios, rapidly escalating and unsustainable deficits will emerge over the next several decades absent structural changes to the spending or revenue side of the federal budget (see fig. 1).

[2] The March 2003 budget outlook under CBO's adjusted baseline assumes discretionary budget authority for 2003 will total $751 billion and grow with inflation thereafter.

Figure 1: Composition of Spending as a Share of GDP Assuming Discretionary Spending Grows With GDP and the Tax Cuts Do Not Sunset



Source: GAO's January 2003 analysis.

The need to fund mandatory programs such as Social Security, Medicare, and Medicaid—as well as increased spending for defense and homeland security—will heighten tensions with other domestic spending priorities, such as education, the environment, physical infrastructure, and housing and community development. State and local officials worry that heightened federal funding pressures could mean that state and local governments will be faced with using more of their own resources to meet service demands.

As greater expectations and spending pressures are being placed on states and localities—including new federal initiatives such as raising educational standards, enhancing homeland security, implementing election reforms, and rising Medicaid costs—they are experiencing significant, recurring revenue shortfalls that are negatively affecting their budgets. For example, fiscal year 2002 personal income tax collections missed states' targets by 13 percent and corporate income taxes were nearly 22 percent lower than projected. Revenue declines are generally attributed to factors such as the economic downturn, the steep stock market declines, the events of September 11, 2001, and tax cuts in certain states.

In response, 37 states reduced their fiscal year 2002 budgets by over $12 billion. This shortfall translated into reductions in aid to local governments, hiring and salary freezes, cuts in infrastructure projects and discretionary programs aimed at low-income individuals and families, and even across-the-board spending reductions. Many states have also taken other actions like tapping "rainy day funds," using tobacco settlement funds, or raising "sin" taxes. Further, as states have exhausted many of their options, they are now faced with taking more dramatic actions to balance their budgets, such as reductions in entitlement coverage and income tax increases. For fiscal year 2004, projections released by the National Association of State Budget Officers (NASBO) suggest that states will face a fiscal gap of over $80 billion.

Participants' Discussion

Participants agreed that fiscal stress on all levels of government are greatest during periods of economic downturn like the current one, when revenues are down. Participants noted that the current economic downturn has been even worse than past ones—perhaps the most severe in the postwar period. While increased spending demands and declines in revenues are being felt at every level of government, some participants observed that state and local governments do not have the flexibility to weather a downturn like this one because, unlike the federal government, many are precluded from having an operating deficit.

Near-term Fiscal Stress

Some participants observed that recent fiscal stress has undermined the ability of states and localities to uphold their share of the intergovernmental partnership in key policy areas in which the federal government has a stake, including Medicaid, education, discretionary programs for low-income individuals and families, and infrastructure projects like roads, bridges, and improvements in public buildings. This has repercussions not only for state and local governments' ability to help the federal government achieve national goals but also for those vulnerable populations that rely on government for needed assistance and services. Some participants further recognized that actions taken by states and localities to close deficits—tax increases and deep spending cuts—could serve to undermine an economic recovery overall, thereby offsetting at least some of the economic stimulus provided by other federal fiscal and monetary policy actions.

While most participants acknowledged the severe effects of the economic downturn on state and local budgets, some pointed out that certain state and local choices during prosperous economic periods significantly contributed to their current budget crisis. Although in recent years states have tried to build up reserves and "rainy day funds," they also made choices, such as cutting taxes and increasing spending, during the prolonged economic boom of the 1990s. For example, between 1990 and 2000 state spending grew twice as fast as federal domestic spending. Once the economic boom was over, some participants noted that the tax structures and spending commitments they had entered into were no longer sustainable. States have quickly used up much of their savings and are taking or contemplating even more dramatic actions, such as increasing income taxes and reducing spending levels, even in entitlement programs. Some participants noted that states would not be in as serious a crisis today if they had resisted pressures for large tax cuts and spending increases and saved more during the 1990s. One participant observed that states would have needed much larger reserves than they accumulated to avoid deficits stemming from a downturn similar to that faced in the early 1990s—a downturn which now seems less severe in its fiscal impact than the current period.

Participants also commented that the federal government has contributed to the fiscal challenges of state and local governments by placing greater responsibilities on them for achieving national goals and objectives. For example, state and local governments are now being asked to improve educational performance to meet national standards and enhance homeland security preparedness. In addition, they are responsible for paying for the rising costs of health care and long-term care needs for the aged and disabled through Medicaid. For example, a participant observed that Medicaid has grown from about 10 percent of total state budgets in 1987 to 20 percent today. Additionally, several participants observed that recent federal tax cuts could further diminish the tax bases of other governments, particularly states, since most states' tax bases are linked to the federal tax base.

Policy Options

Following the participants' discussion about the nature and causes of the mismatch between spending and revenues in periods of economic downturn, participants talked in detail about options for addressing a mismatch. Many participants discussed the need for short-term federal aid to help the state and local sector weather this downturn. However, it was also recognized that states and localities can do their share in the future by building up "rainy day funds" and constraining unsustainable tax cuts and spending increases, and working towards greater economy and efficiency across programs during healthy economic periods.

Participants then discussed specific actions that the federal government could take to assist states in remedying any fiscal mismatch. A key option discussed centered on federal financial aid during economic downturns. Participants noted that federal aid would help implementation of state and local intergovernmental programs while also reducing the likelihood that states would make spending and tax choices that might undermine federal efforts to revive the economy.

Participants then offered a few examples of the form that such aid could take. Examples mentioned included an enhanced federal Medicaid matching share and greater funding for homeland security preparedness. Others discussed a form of general revenue-sharing or countercyclical aid to be available during economic downturns. According to a few participants, key considerations that probably would need to be addressed prior to creating any countercyclical aid or general revenue-sharing program include: 1) the triggers for starting and ending the aid, 2) the formulas used to distribute the aid, 3) the conditions, if any, to be attached to the aid, and 4) the overall level of support to be provided.

Most participants also acknowledged that increased federal assistance would likely result in larger federal deficits. While it is generally agreed that running deficits during downturns is not harmful to the economy in the near future, they noted that the federal government may find it difficult to limit increased aid to the period of economic downturn. In addition, a few participants worried that setting a precedent for federal aid could create a disincentive for states and localities to save for rainy days when the economy is strong. In response, one participant noted that a condition of federal aid could be that states would be required to have significant "rainy day funds" or reserves before triggering financial aid.

Longer-term Structural Factors

The symposium discussion then moved to longer-term structural factors that could also be contributing to the fiscal mismatch between spending and revenues. Most participants acknowledged that structural long-term forces, such as changes in the global economy and the aging of the population, are in part responsible for the mismatch that states are experiencing. For example, the aging of the population will create significant demands for Medicaid long-term care services, placing increasing fiscal pressures on states' ability to fund their share of the program. On the revenue side, state revenue systems have not kept up with rapid technological developments in the economy. State sales taxes in particular do not adequately capture services—the largest growth sector of our knowledge-based economy—nor do they effectively tax the increasing numbers of Internet and mail order sales. States have also faced challenges in capturing income generated by increasingly global corporations.

The current intergovernmental grant system was another structural factor that participants identified. This system is largely categorical in nature as most funds are provided through defined programs offering little flexibility for adapting to unique state and local needs. Some participants argued that federal grants are not always provided in areas where state and local spending needs are greatest or funding gaps are most serious. It was further noted that the trend in favor of categorical grant programs is not exclusive to the federal government, as state policy makers have shown a tendency to do the same thing with regard to grants to local governments. (For more information on federal grants, refer to app. V.)

Some participants then debated the pros and cons of consolidating the hundreds of categorical grants into a series of block grants in several policy areas related to the core services of government. Some state and local interests contend that they would accept greater accountability requirements, such as national performance goals, from the federal government in exchange for greater funding flexibility. Major areas identified as possible targets for consolidation include education, health care, employment and training, the environment, and physical infrastructure. However, other participants expressed concern about block grants as past experiences have shown that increased state and local flexibility has often been accompanied by federal funding cuts. The Congress also tends to provide less funding for these broader purpose programs over time. For example, the consolidation of several categorical grants into the social services block grant in the 1980s resulted in an overall decrease in total funding to states for those services.

Other participants raised concerns about whether block grants could constrain the federal government's oftentimes legitimate need to fill gaps in areas where state and local governments have not been providing sufficient funding. One example offered centered on federal education funding, which had been largely targeted at low-income and special needs students while state and local education funding for the most part was aimed at the general student population.

One participant highlighted the emergence of a new model for intergovernmental grants, referred to as performance partnerships. As implemented by agencies like the Environmental Protection Agency, the goal of a performance partnership is to provide states with greater flexibility in shifting federal funds among categorical programs while establishing more rigorous state accountability for federal performance goals and measures.

Participants emphasized that solutions to these challenges need to be addressed collaboratively. Earlier in the day, David Broder of the *Washington Post* framed this critical issue in his introductory remarks. (See app. III for a summary of the introductory remarks.) In his view, the fiscal policy making process at the national level has a fundamental weakness: even though actors at all levels of government are increasingly focusing on common goals and jointly funding and implementing programs, decision making still proceeds along compartmentalized lines. Specifically, Mr. Broder said the federal government frequently acts in isolation of state and local needs and impacts, often taking credit for new benefits while shifting costs and burdens of making hard fiscal choices to states and localities, who operate under more constrained fiscal rules. Accordingly, many participants agreed with Mr. Broder that a forum is needed in the national fiscal debate where officials at all three levels of government can have serious, collective, and ongoing discussions about national goals and resources.

2. Intergovernmental Financing of Health Care, Particularly Long-term Care for the Elderly and Disabled

Background

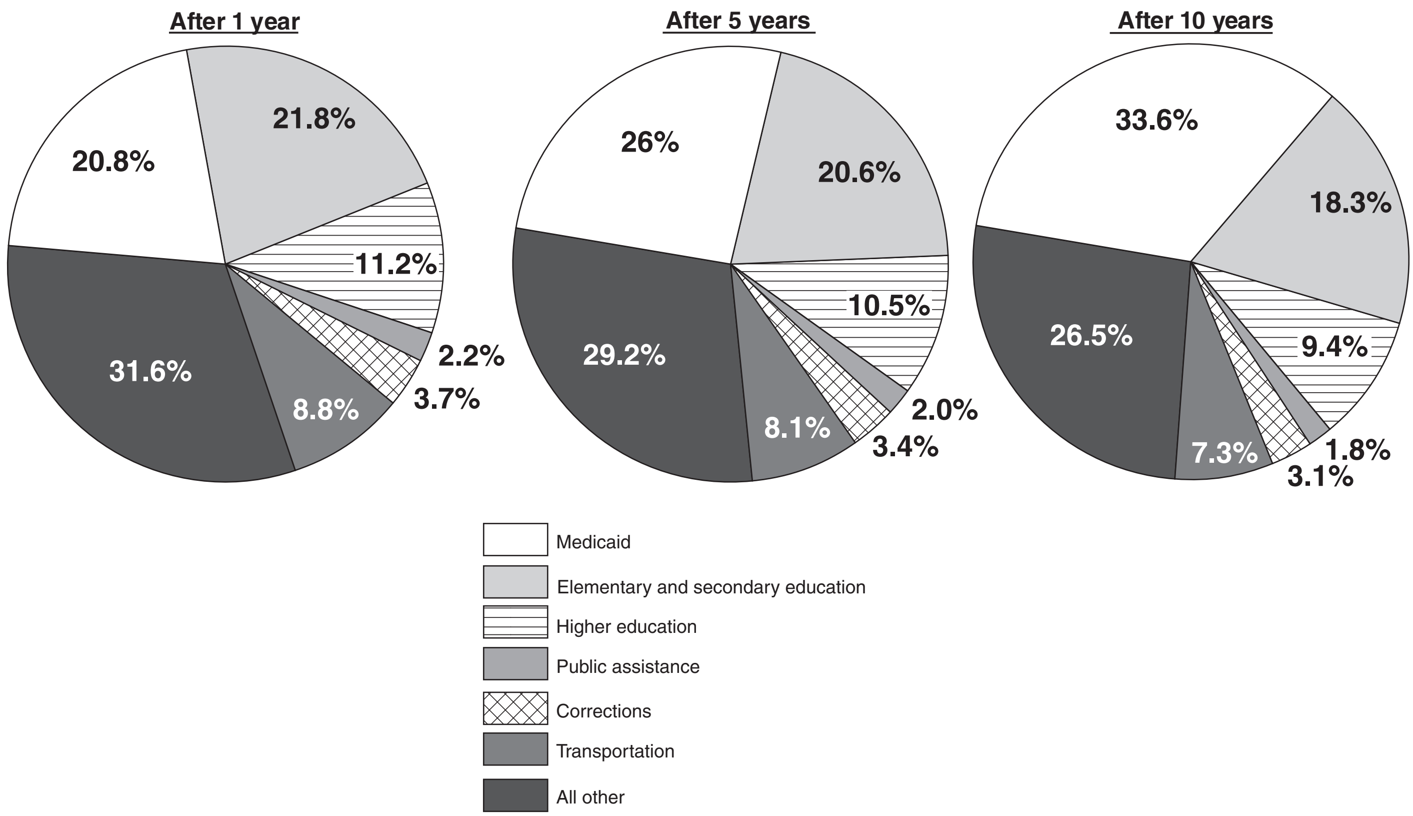
The division of responsibility between federal and state governments for the health and welfare of citizens has traditionally differed for particular clientele. The federal government has been primarily responsible for assistance and health care for the elderly and the disabled through programs like Medicare, Social Security, and the Supplemental Security Income. Financing and administering programs targeted at children and families have largely been a shared responsibility between federal and state governments.

These established roles have become blurred under the Medicaid program. Although the program is widely perceived as providing health care for low-income families and children, in recent years the program has become the main source of financing health and long-term care for the elderly and disabled—over 60 percent of Medicaid spending is now devoted to care for these groups. The program has also assumed responsibility for financing the Medicare premiums for low-income elderly (known as dual eligibles). Eighty-two percent of projected Medicaid expenditure growth reflects increases in the cost of caring for aged and disabled beneficiaries, and states share this burden with the federal government, paying an average of 43 percent of the total costs.

The burden of funding health and long-term care for the aged and disabled has been growing as a share of both federal and state budgets. For example, Medicaid spending already comprises a large portion of most state general fund expenditures–an average of 15 to 20 percent. In the short term, spending growth has been fueled by factors such as overall health care cost growth, particularly in prescription drugs, and increasing costs of long-term care services. In response, most states have either taken or are now contemplating a mix of cuts in Medicaid coverage, increased copayments, and eligibility reductions. In the future, demand for Medicaid services, particularly long-term care, will grow even more as Baby Boomers begin to age. As a result, Medicaid is expected to encompass even higher percentages of federal and states budgets—estimates show Medicaid will be approximately 26 percent of states' total budgets in 5 years and 33 percent 10 years from now.[3] (See fig. 2.) The President's Fiscal Year 2004 budget proposes new flexibility for states in serving nonmandatory Medicaid populations—federal funds would be increased in the near term, but the open-ended federal commitment for financing Medicaid would be capped. The impact of this proposal on state budgets and health care services is being debated.

[3]National Association of State Budget Officers September 2002 estimates.

Figure 2: State Spending by Function as a Percent of Total State Spending After 1, 5, and 10 Years



Source: National Association of State Budget Officers.

Note: Assuming current growth rate for Medicaid and current average growth for all other categories.

Health care spending creates stress at the federal level as well. Combined federal/state spending for Medicaid grew at an annual average of 11 percent between 1980 and 2000. Over the longer-term, federal spending on health care will be the fastest growing element of spending—federal outlays for Medicare and Medicaid are projected to nearly triple as a share of GDP over the next 75 years.

Participants' Discussion

This discussion began with the majority of participants emphasizing concern over Medicaid spending growth. Specifically, everyone was in agreement that Medicaid spending has grown rapidly in the past 2 years and will continue to do so because of rises in costs related to health care services, particularly prescription drugs, and greater demands for long-term care. Moreover, it was noted that other national trends, such as the aging of the population and the retirement of Baby Boomers, would create even greater demands for health and long-term care services over the next several decades, and consequently drive spending upward. There was unanimous agreement that funding health care costs for a growing aging population is clearly one of the biggest shared challenges for all levels of government and that the country is on the cusp of a crisis in health care and long-term care.

There was general agreement that states are not well positioned financially to meet the future demands related to Medicaid, and that current arrangements may not be sustainable in the future. While all levels of government will be faced with very large health and long-term care demands once the Baby Boomers retire and age, there was general agreement that the burdens will fall heavily on states. Participants observed that this not only has consequences for states but for beneficiaries of the program. Due to state balanced budget requirements, program benefits and policies will be affected by cyclical fiscal shocks which will prompt episodic series of cuts, constraints, tax increases, and cost shifts to providers and beneficiaries. Indeed, all participants agreed that we are seeing this now. For example, many states have lowered payment rates to providers, eliminated optional services like dental care, and tightened eligibility requirements.

As a result, participants agreed there is a pressing need to reevaluate intergovernmental financing of health care for the disabled and aged, who account for the majority of costs. Several participants representing state governments argued that if the federal government took over responsibility and related costs for Medicaid long-term care, this alone would address the states' fiscal problems, allowing states to more easily finance most other spending priorities. The same participants justified this argument by observing that funding states' share of Medicaid long-term care costs is clearly the biggest spending demand in the future, as it will increasingly absorb state resources.

Other less daunting options for assisting states in financing health and long-term care for the aged and disabled were also presented by some participants. One option discussed was increasing flexibility in grants to help states better tailor funds for the particular needs of their aged and disabled populations. Another option advanced by a few participants involved enhancing the federal share of Medicaid matching funds on a temporary or permanent basis.

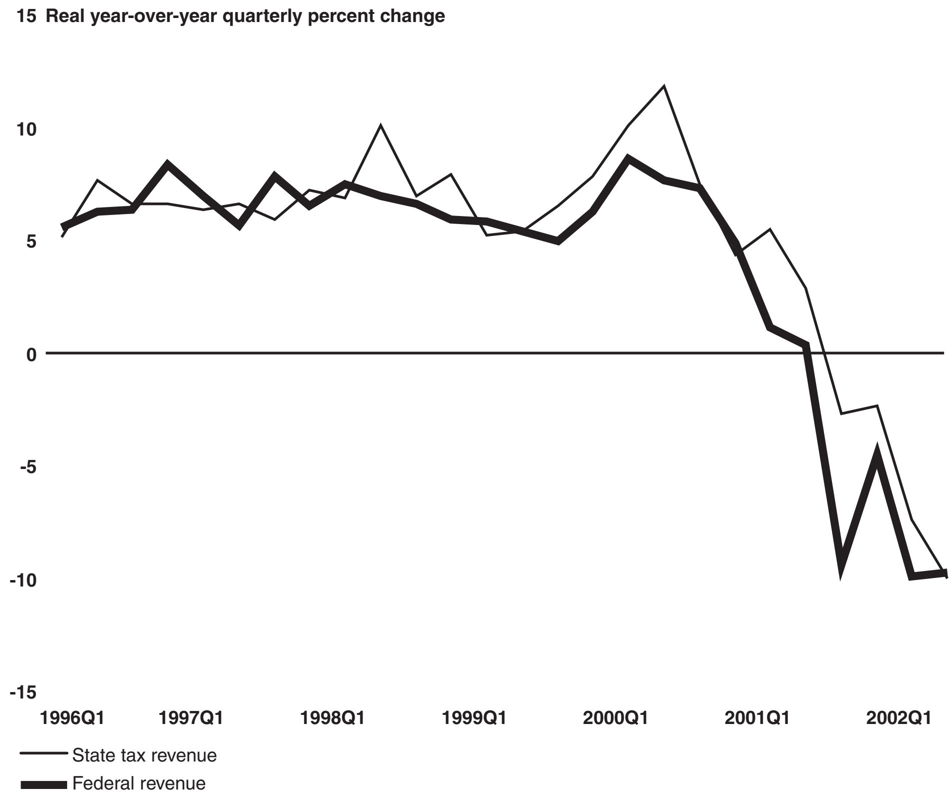
Financing the long-term care of the aged and disabled constitutes a long-term fiscal challenge that will increasingly destabilize the finances of all levels of government in our system. While participants concluded that current financing arrangements have created unsustainable fiscal burdens for the states, they also acknowledged that increasing federal fiscal responsibilities would add further stress to the longer-term federal budget outlook that is already confronted with the burdens of sustaining funding for Medicare, Social Security, as well as its current share of Medicaid. Accordingly, participants agreed that this situation calls for a serious dialogue involving stakeholders from all levels of government regarding the appropriate roles of governments in caring for the aged and disabled.

3. Current Tax Structures at All Levels of Government and Interrelationships Between Them

Background

The revenue challenges facing state and local governments stem from cyclical fluctuations in the economy, which states historically have been able to overcome, as well as long-term structural characteristics. These problems could serve to undermine the longer-term fiscal viability of state and local revenue systems in a global economy. In the short term, the economic downturn has resulted in the rapid decline in revenue from taxation on personal income, corporate profits, and capital gains. Further, the forces that drove income and economic growth may not be repeated on the scale of the late 1990s. Similarly, the federal government has experienced quick declines in tax revenues (see fig. 3).

Figure 3: Federal and State Revenue Trends



Source: State tax revenue from Rockefeller Institute/NASBO. Federal revenue from Bureau of Economic Analysis, Department of Commerce.

In addition, certain long-term structural forces are serving to erode the traditional revenue bases of states. State and local sales taxes, for instance, are levied on the retail sales of products. However, as the service economy grows as a share of total revenues, the economy of the 21st century is increasingly geared toward providing services that are not captured by the sales tax in most states. States also have difficulty imposing this tax on the growing market of remote sales from mail orders or the Internet. Because of the complexity of dealing with thousands of taxing jurisdictions each with its own tax rates and base, the U.S. Supreme Court has held that, absent authorization from the Congress, state or local governments cannot require out-of-state vendors to collect sales or use tax unless the vendor has a physical presence in the state. Buyers are actually required to pay sales taxes directly to their states, but they rarely do and the policy is effectively not enforced. While no one has developed a reliable estimate of the amount of tax revenue losses on all remote sales, the losses will increase as remote sales increase. Moreover, states face growing difficulties in tapping sources of individual and corporate income—as financial transactions and corporations have become more global.

State and local governments have taken some actions to modernize and coordinate their tax systems. For example, the Streamlined Sales Tax Project has laid the foundation for coordinating sales tax administration and methods of collection across the nation. This project is intended to simplify and make the sales and use taxes more uniform for all types of retailers by providing common definitions across states. If states simplify and standardize their tax systems, this could reduce the administrative burden of tax collection on remote vendors, and may help facilitate congressional action to provide states with the authority to require remote vendors to collect the sales tax.

Participants' Discussion

Participants agreed that there is a pressing need to look at the tax structures of all three levels of government collectively, and for policy makers at all levels to better understand the relationships between them. They agreed that the U.S. economy is becoming increasingly interconnected and global as American companies conduct business across state and national boundaries. Economic globalization creates a need for greater legal, financial, and regulatory uniformity among units of government within and outside the United States.

Participants representing state and local interests worried that the effects of the global economy place states and localities in a precarious position, driving greater centralization of authority at the federal level, and eroding available state and local revenues. Currently, industries must deal with a patchwork quilt of state and local tax systems and regulatory policies, which impede the ability of multinational and interstate businesses to operate efficiently and effectively across jurisdictions. Economic globalization has spurred efforts by business to promote greater legal, financial, and regulatory uniformity among units of government. The federal preemption of Internet sales taxation is but one example of a growing trend affecting many areas of state and local authority. Accordingly, the key question considered by most participants was what redesign of our tax structures is appropriate for the modern economy so that the needs and interests of states, localities, and the federal government are respected?

A basic problem raised by most participants is that changes in the global economy have made the design of current tax systems increasingly obsolete. Specifically, the fragmented sales tax system is not designed to capture services, the biggest growth sector of our knowledge-based economy, nor can it effectively tax a significant portion of sales made by remote sellers through the Internet or mail orders.

For the most part, participants agreed that some tax reform is needed at the state and local levels, stating that some standardization of tax policy across states should be on the table. Participants representing state and local interests pointed to the Streamlined Sales Tax Project as a move in the right direction—one that responds to the demands of the global economy. If adopted by the states, the project promises to reduce burdens experienced by national and multinational businesses by harmonizing sales tax bases, rates, and rules across the states.

Because most state tax systems are closely linked to the federal tax code, participants felt that federal policy makers also need to better address the effects of any tax-related decisions on other levels of government. Specifically, due to the linkage of federal and state income tax bases, changes made by the federal government to reduce taxes could also serve to reduce state tax revenues. Some participants noted that in recent years federal tax policy changes have been made without adequately considering the effects on state and local governments. According to some participants, states have already felt the negative impacts from recent tax policy changes, which have exacerbated their current fiscal crisis. Although state tax bases can decouple from the federal tax base, this would likely increase enforcement burdens for the states and compliance burdens for taxpayers. Participants argued that no forum or formal mechanism exists for federal policy makers to consider the impact of their own tax policies on state and local tax systems. One participant suggested establishing a formal process for estimating the effects of proposed federal tax policy changes on state and local governments.

On a final note, participants related that in many instances the taxing authority at the state and local levels also has been restricted by either the legislature or the public through voter initiatives. This situation has put policy makers in a bind in responding to fiscal crises. In states with tax limitations, one of the few options during this downturn is to cut program services at a time when those most in need are even more vulnerable. Participants observed that there is a strong antitax, antigovernment feeling among a large segment of the population and this sentiment needs to be reflected in the dialogue about intergovernmental issues, particularly with regard to the ability of state and local governments to fund their shares of intergovernmental programs. One participant suggested that public officials at all levels of government need to better understand why the public has these feelings and attempt to address the root causes of public disaffection with government.

4. Consider Reassessing the Assignment of Responsibilities

Background

In recent years, state and local interests have reported that their program and fiscal responsibilities are not matched with adequate resource capacity. State and local governments have assumed many new program responsibilities in areas such as education, health care, welfare, and homeland security. At times, states have assumed added responsibilities through greater devolution of federal programs; other new responsibilities have come in the form of mandates and other requirements placed upon them by the federal government. Welfare reform is a key example of devolution, in which states lobbied for and received significant new authority to implement innovative and tailor-made approaches to training and employment. States have also sought and received greater program responsibility and flexibility from the federal government through program waivers—particularly in Medicaid and the State Children's Health Insurance Program.

At the same time, many new responsibilities have been placed upon states and localities by the federal government. For example, within the past 2 years, the federal government has required states and localities to begin meeting new educational standards, carry out significant upgrades to voting systems, and improve their ability to respond to public safety threats. To carry out these program responsibilities effectively, state and local governments must have substantial administrative capacity—e.g., adequate information technology systems and staff with sufficient skills—in addition to fiscal resources. While states and localities have improved their administrative capacity over the past several decades, there are still major capacity differences among these governments. Further, the recent economic downturn and related reductions in revenue collections, as well as long-term forces, such as globalization, that are reducing some state and local tax bases, could challenge their ability to carry out their current and added responsibilities.

Some students of the federal system have observed that each level of government has unique comparative advantages over certain kinds of service and program areas. Paul Peterson, for instance, suggests that intergovernmental competition gives states and localities incentives to reduce tax and regulatory burdens to attract stronger tax bases.[4] Accordingly, state and local governments arguably have strong incentives to promote education and economic development programs that can enhance prospects for local investment in their economies. However, this argument also suggests that competition may undermine state and local support for other policy areas, such as social welfare, in which strong government programs could be viewed as discouraging economic activity and growth.

Some observers believe that the growth of federal roles and responsibilities over time has blurred these distinctions. The federal government has come to subsidize and influence traditional areas of state and local control such as education and criminal justice, while also mandating increasing state and local fiscal responsibilities for such social welfare areas as health and long-term care. The result is the intergovernmentalization of nearly every domestic responsibility, which has prompted tensions across governments and confused accountability for program results. Observers like Alice Rivlin have proposed a sorting out and reallocation of intergovernmental roles and responsibilities.[5] Under this scenario, state and local governments would assume primary responsibility for areas where they enjoy a comparative advantage—such as education and housing—while the federal government would assume national responsibilities for policies and financing for areas, such as health care, to better promote national standards and services.

[4]Paul E. Peterson, *The Price of Federalism* (Washington, D.C.: The Brookings Institution, 1995).

[5]Alice Rivlin, *Reviving the American Dream* (Washington, D.C.: The Brookings Institution, 1992).

Participants' Discussion

Across the board, participants were in agreement that state and local governments have assumed a growing number of new program responsibilities, and simultaneously the funding burdens that accompany them. While states and localities have assumed some program responsibilities by choice or by agreement with federal policy makers, participants also identified what they saw as a troubling trend. Specifically, they stated that in recent years the federal government has continued to mandate costly new responsibilities on state and local governments, by law or regulation. Participants quickly agreed that there is a definite disconnect between the responsibilities that state and local governments have in key program areas and the fiscal and administrative resources needed to carry out those responsibilities. In addition, participants emphasized that along with these mandates comes the requirement that states and localities bear the responsibility of achieving national goals and priorities. Some participants summed up this phenomenon as national dominance without direct national delivery.

According to many participants, the disconnect between responsibility for achieving national goals and needed resources is most pronounced in policy areas such as education; health care for the poor, aged and disabled; and homeland security. The main problem, according to some participants, is that the federal government has not given states and localities adequate funding to achieve federally imposed responsibilities and expectations in such critical policy areas. Accordingly, states and localities are increasingly being forced to choose between using scarce resources to achieve national goals as mandated by the federal government and funding their own local policy priorities. As a result, local priorities often get crowded out in a system where federal or national goals encumber a growing share of state and local budgets. Further, many participants observed that while the disconnect between resources and responsibilities is largely structural in nature—too many responsibilities that are not matched with a sufficient revenue base or enough federal funding—it has been exacerbated by the current, prolonged fiscal crisis.

The participants' discussion addressed the capacity of the state and local sector to carry out these national responsibilities. Some participants noted that fiscal and administrative capacity continues to vary widely across states and localities, resulting in varying degrees of program performance, quality of service delivery, and level of services provided. Many noted that the current fiscal crisis has added to this problem as state and local budget cuts undermine their administrative capacity and services—e.g., hiring and salary freezes and cuts in technology improvements. A few participants argued that effective and consistent implementation of national goals and intergovernmental programs could be promoted by federal initiatives to help overcome disparities in fiscal and administrative capacity among state and local governments.

Participants indicated that the mismatch between responsibilities is greatest at the local level. They observed that, over the past 15 years, county and city government responsibilities have expanded. Mandates from both the federal and state governments have hit local governments the hardest and they often have the least fiscal and administrative capacity or authority to address them. Further, some participants observed that the increased responsibilities of local governments have not been met with increased financial support from either the federal or state governments, or added authority to raise revenues. Most participants agreed that policy makers at the federal and state levels must find a better way to balance differences between local governments, and recognize the particular challenges faced by those jurisdictions with the least resources and the weakest tax bases.

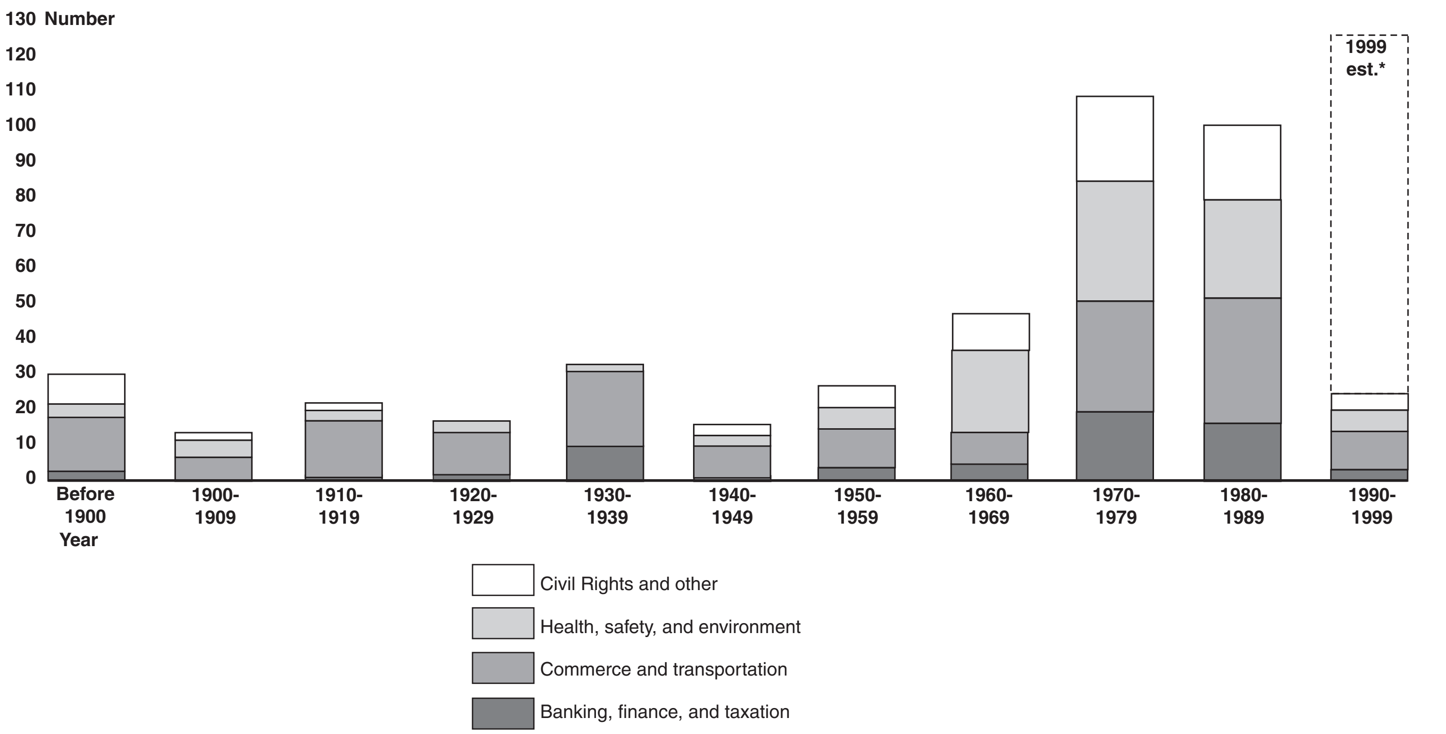
The District of Columbia was highlighted as a vivid example of the many fiscal and administrative capacity concerns that had been raised by participants throughout the day. From a city's perspective, states have all the power, the federal government has all the money, and cities have all the problems. Participants observed that there are major variations in fiscal and administrative capacity among local governments in the Washington, D.C. metropolitan area. These same participants discussed the unique needs of the District of Columbia, indicating that it must carry out state and local responsibilities, as well as the challenges associated with being the Nation's capital. The District is uniquely constrained because it has city and state responsibilities without full state autonomy or revenue-raising authority, along with bearing the challenges of being the capital city.[6]

Another increasingly prominent trend—preemption of state and local authority—was identified among participants as being especially problematic and placing state and local governments in a precarious position (see fig. 4). The most striking example is related to the federal restriction on Internet taxation. Further, participants noted the growth of federal preemption across a wide range of traditional state and local

[6]GAO plans to issue a report on the structural fiscal issues of the District of Columbia in May 2003.

functions varying from health care to law enforcement. Some participants attributed increasing federal preemption to the demands of the global economy for greater regulatory uniformity.[7]

Figure 4: Number of Federal Preemption Statutes Enacted Per Decade



Source: U.S. Advisory Commission on Intergovernmental Relations, Federal Statutory Preemption of State and Local Authority: History, Inventory, and Issues (Washington, D.C., 1992), p.7.

Participants concluded by discussing options for addressing the mismatch between the resources and responsibilities of state and local governments. One option that generated a lively discussion was sorting out intergovernmental functions, in light of growing concerns about fiscal and management capacity. Alice Rivlin's proposals, as laid out in *Reviving the American Dream*, were suggested as a possible basis for such a sorting out

[7]See U.S. General Accounting Office, *Regulatory Programs: Balancing Federal and State Responsibilities for Standard Setting and Implementation*, GAO-02-495 (Washington, D.C.: March 20, 2002) for more background on regulatory programs.

of responsibilities. Along these lines, the participants talked about making health care a federal responsibility and delegating other responsibilities, such as education and physical infrastructure, entirely to states. However, most participants warned that any attempts at sorting out should be taken slowly and tested in certain policy areas. Some noted that the tradeoffs associated with broad sweeping realignments are complex and prompt deep concerns and resistance among many stakeholders.

Participants suggested that long-term care would be a good candidate for sorting out roles and responsibilities. The growing demand and costs for these services have been major drivers of state fiscal stress. Moreover, the cyclical nature of state budgeting subjects long-term care, along with other state funded services, to episodic cuts during economic downturns. Benefits and service levels vary significantly across the nation, reflecting the primary role played by states in determining program policies.

While diversity and choice are the hallmarks of a vital federal system, an increasingly aging nation may come to place a higher value on uniformity and standardized benefits for long-term care across the nation. For social security and disability programs, financing and delivery of benefits has long been a primary federal responsibility, reflecting national expectations for uniform treatment for these potentially vulnerable populations. If the federal government assumes greater responsibility for financing long-term care, it may also be necessary to rethink current federal responsibilities for financing other programs delivered by state and local governments in order to free up sufficient resources at the national level.

One participant observed that, in the early 1980s, states had the opportunity to achieve such a fundamental resorting of roles—when the federal government offered to assume full financial responsibility for Medicaid in exchange for states taking on welfare (known as "Swap and Turnback"). States rejected this offer and many participants representing state governments indicated that they now regret this decision. Participants agreed—at the very least—that more intergovernmental coordination and collective policy making are necessary so that key policy decisions are not made in isolation, and policy makers understand the burdens that their actions might place on the fiscal and administrative capacity of another level of government. This call for greater coordination and collaboration is a theme that ran throughout the day and underscores all of the top intergovernmental challenges.

Discussion of Need for an Ongoing Dialogue and Possible Framework

A significant portion of the day focused on a perceived need raised by all participants regarding the lack of a focal point and forum for a comprehensive discussion of intergovernmental issues. Participants generally agreed that since the demise of the Advisory Commission on Intergovernmental Relations (ACIR) there has been a void in this area.

Background

ACIR was an independent intergovernmental agency established in 1959 to improve the ability of federal, state, and local governments to work together cooperatively, efficiently, and effectively. ACIR was created with a recognition that each level of government had an important and distinct role to play in formulating and administering policies. It was comprised of appointed and elected officials from all three levels of government. The ACIR was charged with several responsibilities: to bring together representatives of federal, state, and local governments to address common problems; to provide a forum for discussing the administration and coordination of federal grant programs; to provide research and make recommendations to the executive and legislative branches on the allocation of government functions; and to recommend methods of coordinating and simplifying tax laws and administrative practices to achieve a more balanced relationship between the levels of government. Over the years, ACIR conducted research on a variety of subjects related to the federal, state, and local governments. For example, it studied and commented on law enforcement, transportation policy, welfare, and environmental protection, as well as a host of other policy issues. Throughout the 1980s, congressional support for the ACIR declined for a number of reasons. The loss of consensus on many policy issues and the federal budget deficit were among the factors contributing to loss of support in the Congress. Several controversial reports in the 1990s heightened calls for its termination and it was abolished in 1996.

Participants' Discussion

Most participants agreed that there is a need for a national focal point to address intergovernmental issues. They observed that the biggest void has been in the lack of consistent data collection and analysis. ACIR used to collect data and publish results regularly on state and local fiscal policies and conditions. According to participants, sophisticated analysis of policy issues from an intergovernmental perspective is also sorely missed. For example, an institutional focal point could help policy makers sort through issues and options for federal aid to states during downturns; such a focal point could also highlight the intergovernmental implications of federal tax policy changes.

Some participants observed that some organizations within specific policy sectors perform intergovernmental coordination, but it tends to be on an issue-or program-specific basis. For example, the Environmental Council of States, the National Association of State Child Care Administrators, and the National Association of Medicaid Administrators frequently meet with their federal counterparts. However, participants commented that the primary focus of these meetings is not policy research, rather the goal is usually to better understand each other. Broader based organizations such as the National Governors Association and the National Council of State Legislatures represent state interests, but the primary focus of these organizations is not necessarily to produce systemic research for a national audience.

Participants also discussed what form such an organization could take. Time limitations did not allow for a full discussion of the form and structure of such a focal point. Participants noted the importance of avoiding some of the difficulties ACIR encountered. For example, it became increasingly difficult for ACIR to reach bipartisan consensus on issues with its members and encourage active participation by high-level federal officials.

Participants contended that, under any circumstance, an essential component of a future organization would be to ensure it has a constructive working relationship with state and local interest groups and others on the front lines of state and local governments. According to participants, a strong analytical function is also a critical component and it was agreed that a body of talented analysts could provide legitimacy to intergovernmental issues. Participants also acknowledged that the challenge is how to obtain consistent data and a framework for analysis, and how to fund these efforts. Any organization would likely need sustained financial support from federal, state, and local or private sources. Moreover, some argued that continuing federal involvement is critical to promote a full intergovernmental forum and national attention to the issues raised.

There was disagreement among participants about whether there is a sufficient demand at the federal level to create and sustain any forum. According to some participants, while an intergovernmental focal point is a good idea in theory, in practice it is difficult to generate interest at the federal level. They observed that these issues would need congressional sponsorship to get attention. They argued that even without a coordinating forum, states had some influence on federal policies in the 1990s in the areas of welfare reform, the tobacco settlement, transportation, and unfunded mandates reform.

Despite their concerns about prospects for support, participants for the most part agreed that a new intergovernmental focal point is needed. Participants observed that the format of such a forum, as well as ways to generate interest among policy makers, should be the focus of future discussions among leaders at all levels of government.

In addition, there was unanimous agreement that homeland security is a great opportunity to start this kind of a dialogue across levels of government. They observed that policy makers appear to be serious about the need to enhance federal, state, and local operations to improve homeland security. Homeland security provides an excellent example of where effective coordination among all levels of government is literally a matter of life or death. Because the nation relies on local governments as the first line of defense, the challenge is to construct financial and administrative relationships to promote improved local protection initiatives consistent with national goals and threats. It was noted that achievements made on this front could spill over into other policy areas.

Summary of Introductory Remarks

Comptroller General David M. Walker opened the symposium and spoke about challenges facing all levels of government and the private sector. Mr. Walker began by outlining several long-term trends that will create shared challenges for all levels of government. Examples of these trends, which are laid out in GAO's strategic plan framework, include the aging of the population, new and diffuse security threats, and globalization. Furthermore, Mr. Walker provided an overview of fiscal trends from the federal perspective and described the changing composition of federal spending over the past 40 years, noting the growth of mandatory social security and health programs as a share of federal spending. Looking ahead, he noted that projected increases in mandatory spending for Social Security, Medicare, Medicaid, and Net Interest will prompt unsustainable federal deficits, absent reforms to the spending or revenue sides of the budget.

Since many of these fiscal challenges are shared by states in our system, initiatives to address these future pressures need to be pursued in an integrated and collaborative fashion. Whether it be health care reform or homeland security, our future policy decisions should be framed as national, rather than strictly federal, responses to problems and issues. Mr. Walker observed that such a collaborative approach can be informed by a series of key national indicators designed to measure the nation's overall position and progress and the role of various governmental actors involved in key policy areas. He concluded that partnerships between levels of government are needed to address the common problems we all share, and all tools of government should be considered in implementing these partnerships.

David Broder, a columnist for the *Washington Post* and keen observer of the nation's political scene, began his comments by noting a striking disjunction between dialogue on federal fiscal issues and the dialogue on state fiscal issues. Both issues seem to be treated as separate and distinct in the press and among political leaders whereas, in his view, the issues are closely intertwined. He said that while federal decision makers enjoy the privilege of enacting new benefits and programs for their constituents, state and local decision makers are left with the hard choices of raising taxes or reducing spending to implement them. Compounding these pressures, revenue systems at the state and local level are constrained—the sales tax is being eroded by the Internet and the service-based economy, while raising income taxes is not politically palatable. Moreover, while state and local decision makers are faced with some hard choices to solve their fiscal crises, he claimed that many recent federal fiscal decisions may have done more to worsen states' fiscal conditions than to provide any fiscal relief.

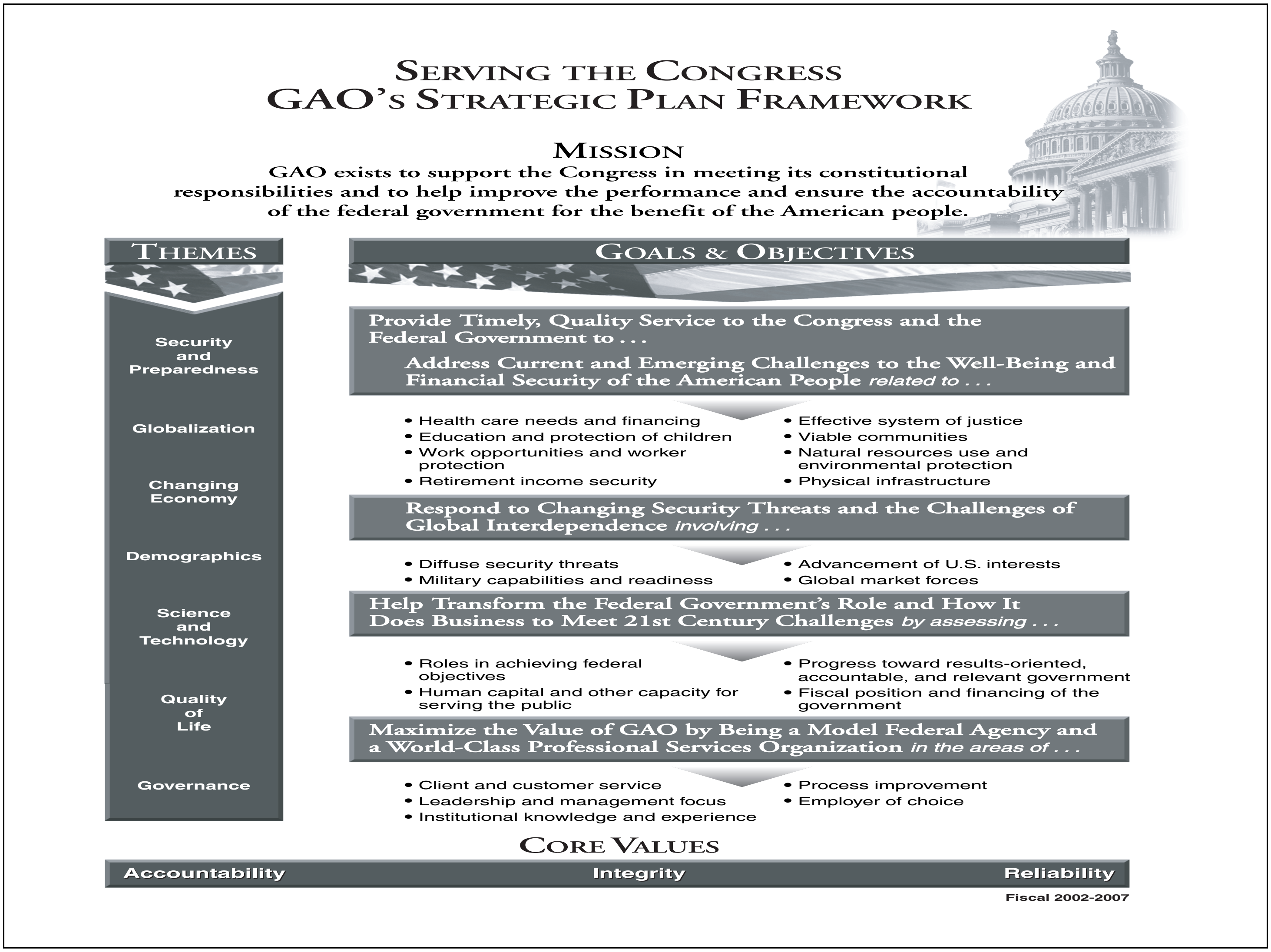
Mr. Broder said he is sure that states and cities will need federal help to get through their current fiscal crises but wondered if they have enough leverage in Washington to get the federal support they will need. Many representatives of state and local interest groups have told him it is more difficult than it has been in many years to get the attention of the Congress or the administration on issues vital to state and local interests. Mr. Broder lamented the absence of an institutional forum in which overall (federal, state, and local) resources could be measured against national priorities. Mr. Broder called for new partnerships to address the fiscal interrelationship among the levels of government and the need to work together to address the key challenges facing the nation.

Intergovernmental Relations Symposium Slide Presentation

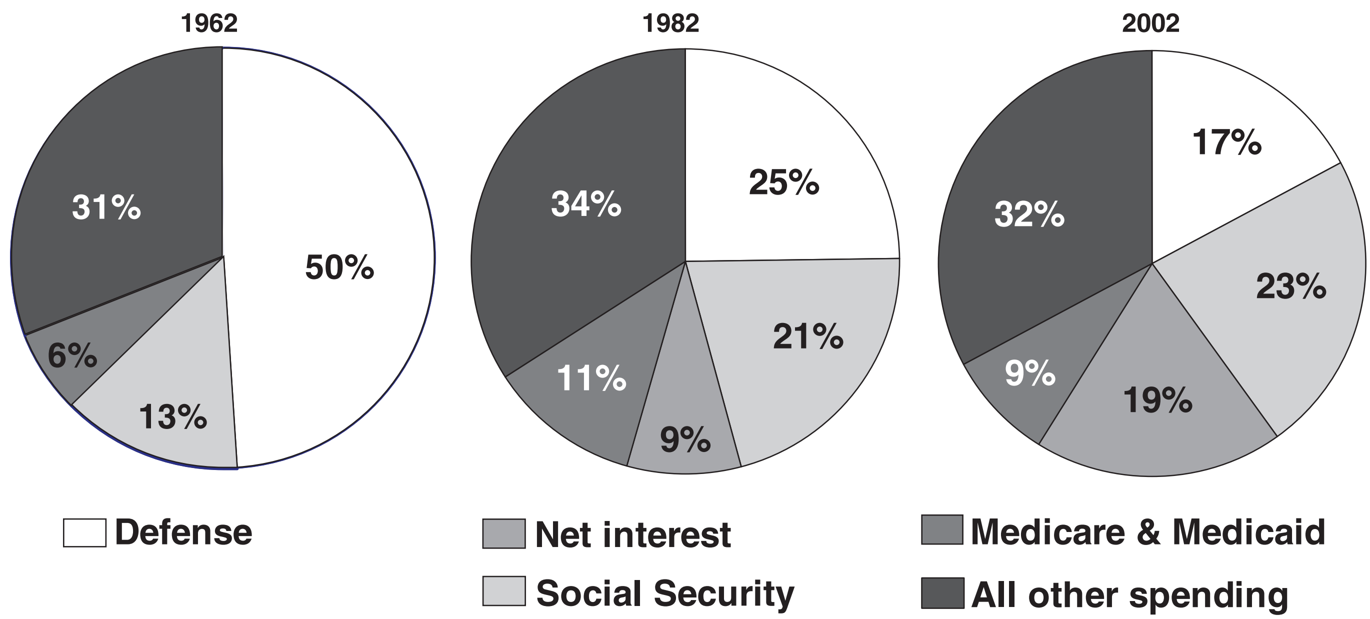
GAO INTERGOVERNMENTAL RELATIONS SYMPOSIUM

Addressing Key Challenges in an Intergovernmental Setting

November 20, 2002


SERVING THE CONGRESS
GAO'S STRATEGIC PLAN FRAMEWORK
MISSION
GAO exists to support the Congress in meeting its constitutional responsibilities and to help improve the performance and ensure the accountability of the federal government for the benefit of the American people.
THEMES
Security and Preparedness
Globalization
Changing Economy
Demographics
Science and Technology
Quality of Life
Governance
GOALS & OBJECTIVES
Provide Timely, Quality Service to the Congress and the Federal Government to . . .
Address Current and Emerging Challenges to the Well-Being and Financial Security of the American People related to . . .
• Health care needs and financing
• Education and protection of children
• Work opportunities and worker protection
• Retirement income security
• Effective system of justice
• Viable communities
• Natural resources use and environmental protection
• Physical infrastructure
Respond to Changing Security Threats and the Challenges of Global Interdependence involving . . .
• Diffuse security threats
• Military capabilities and readiness
• Advancement of U.S. interests
• Global market forces
Help Transform the Federal Government's Role and How It Does Business to Meet 21st Century Challenges by assessing . . .
• Roles in achieving federal objectives
• Human capital and other capacity for serving the public
• Progress toward results-oriented, accountable, and relevant government
• Fiscal position and financing of the government
Maximize the Value of GAO by Being a Model Federal Agency and a World-Class Professional Services Organization in the areas of . . .
• Client and customer service
• Leadership and management focus
• Institutional knowledge and experience
• Process improvement
• Employer of choice
CORE VALUES
Accountability
Integrity
Reliability
Fiscal 2002-2007

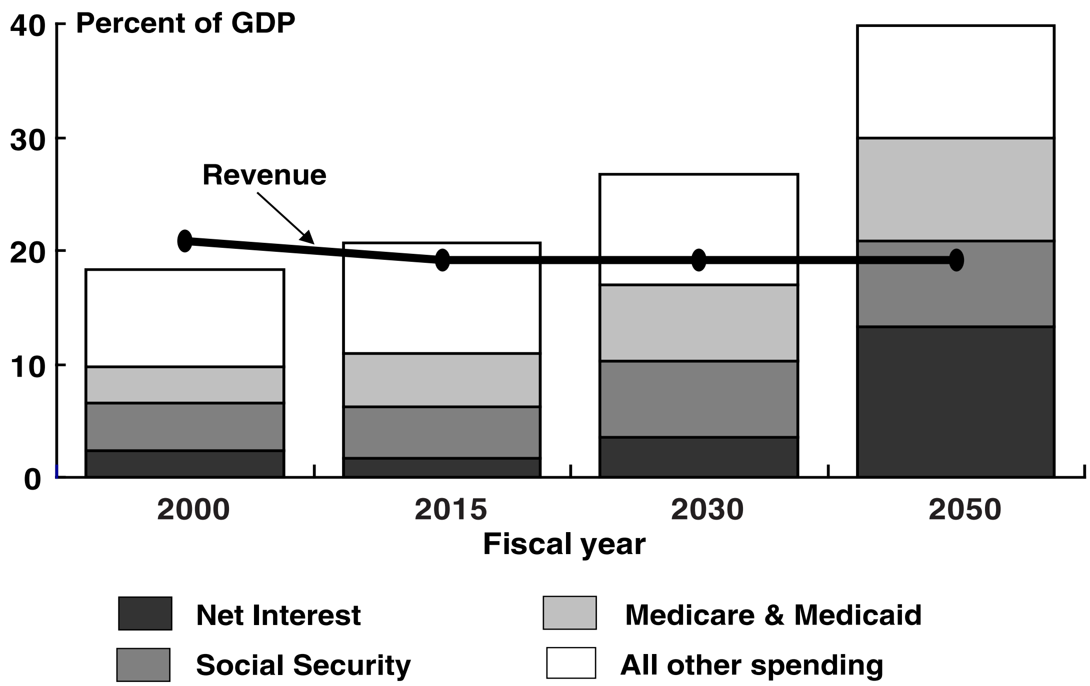
Composition of Federal Spending By Budget Function



Source: *Budget of the United States Government, FY 2004,* Office of Management and Budget.

Composition of Spending as a Share of GDP

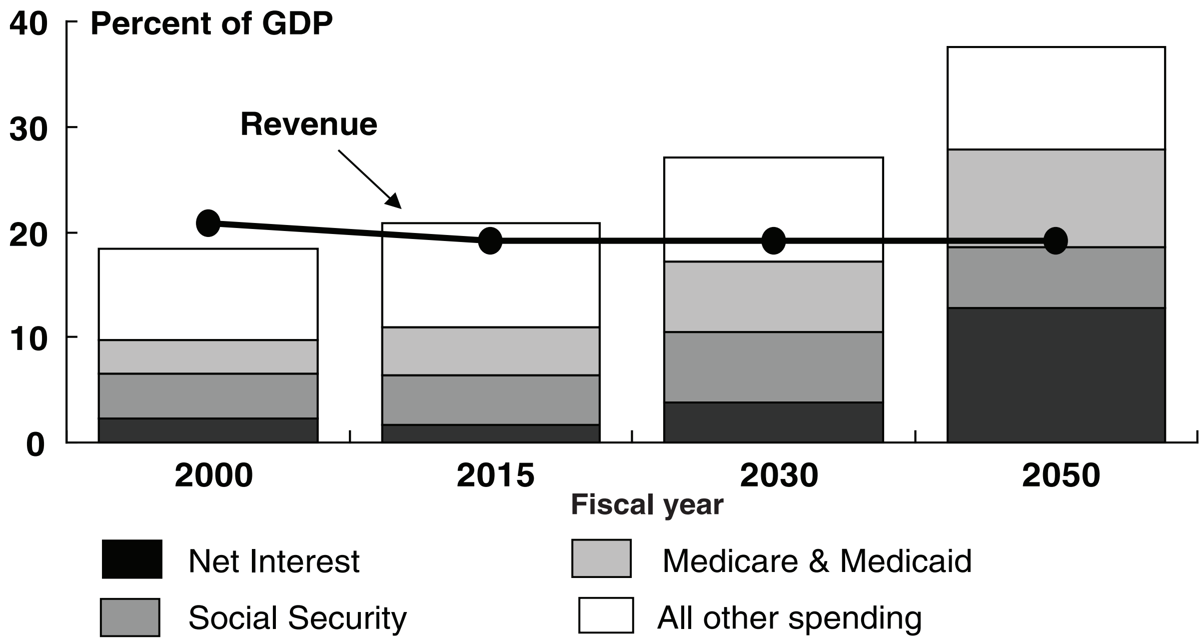
Assuming Discretionary Spending Grows with GDP and the Tax Cuts Do Not Sunset



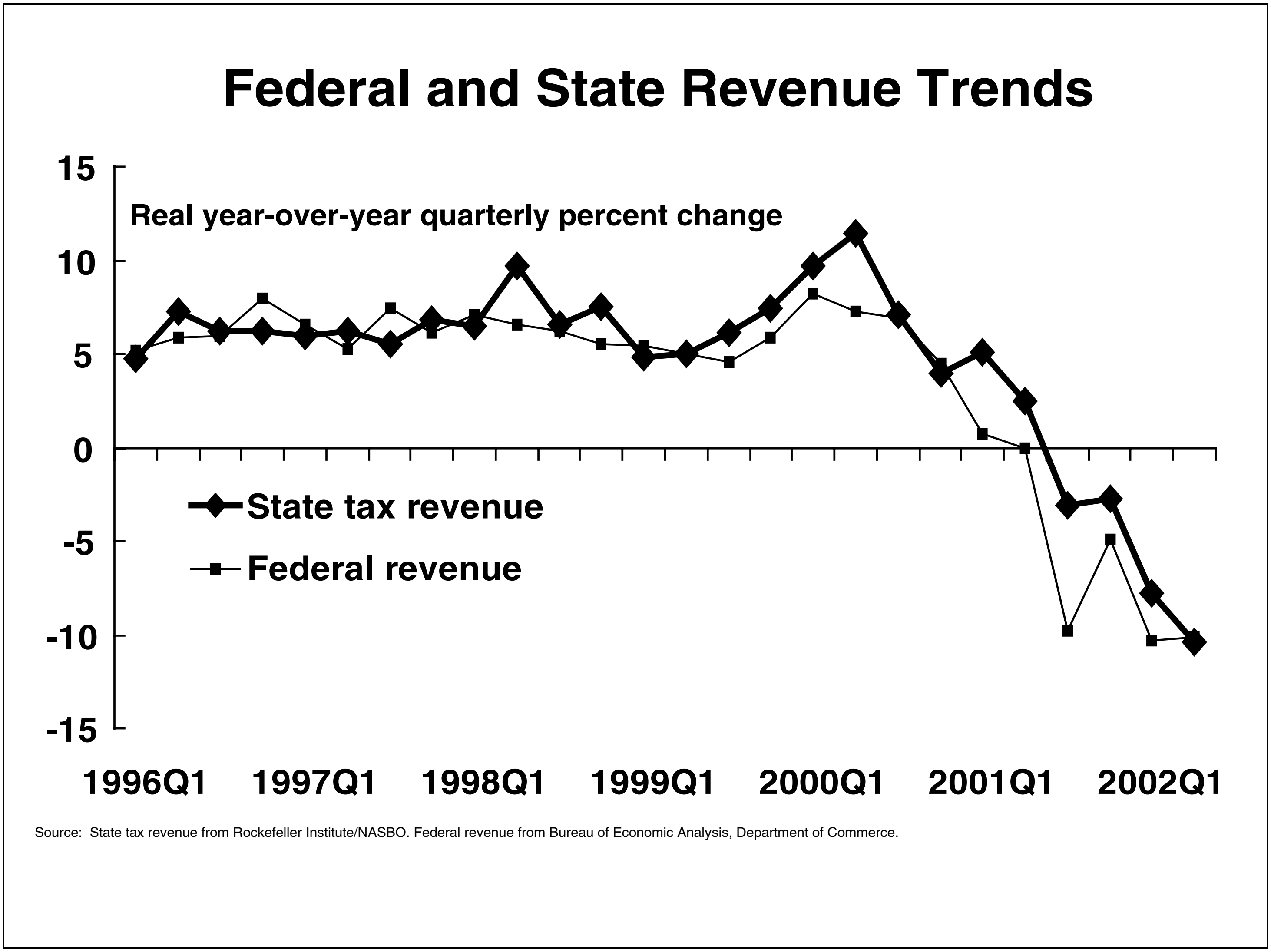
Source: GAO's January 2003 Analysis

Composition of Spending as a Share of GDP

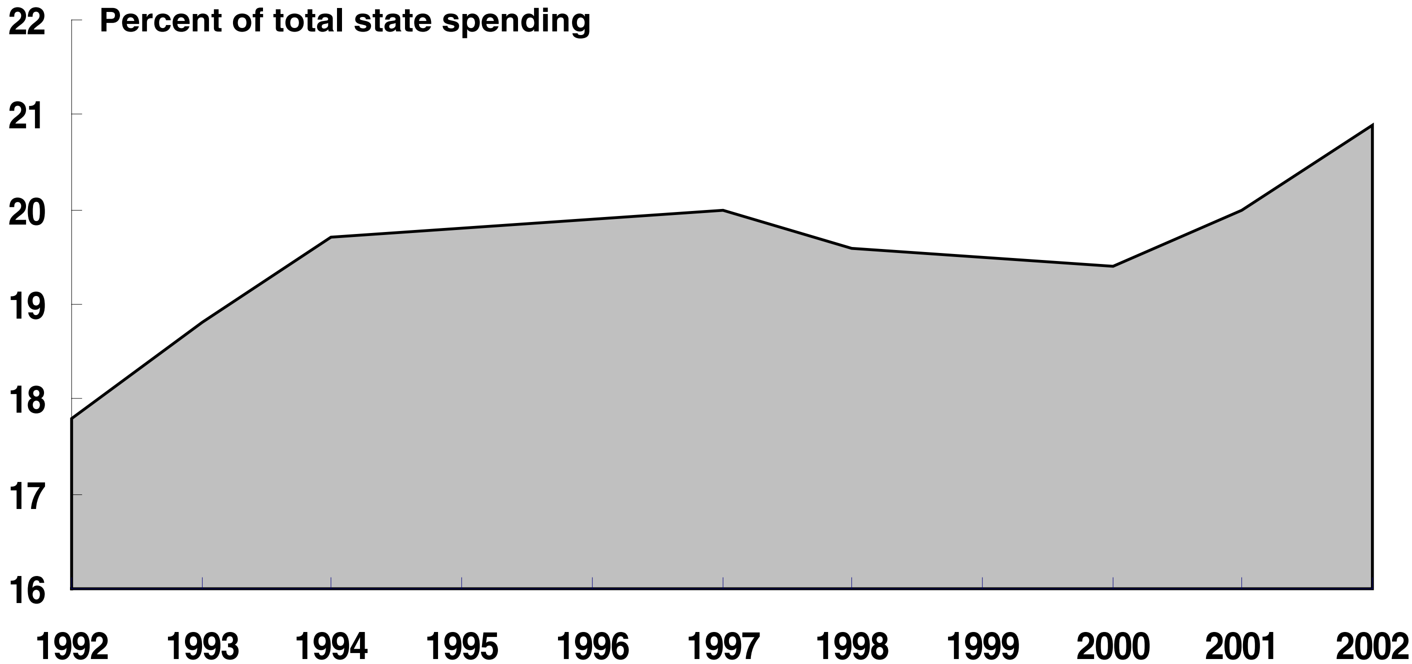
Assuming Discretionary Spending Grows with GDP after 2003, the 2001 Tax Cuts Do Not Sunset, and Social Security Benefits Payable after 2041



Source: GAO's January 2003 Analysis

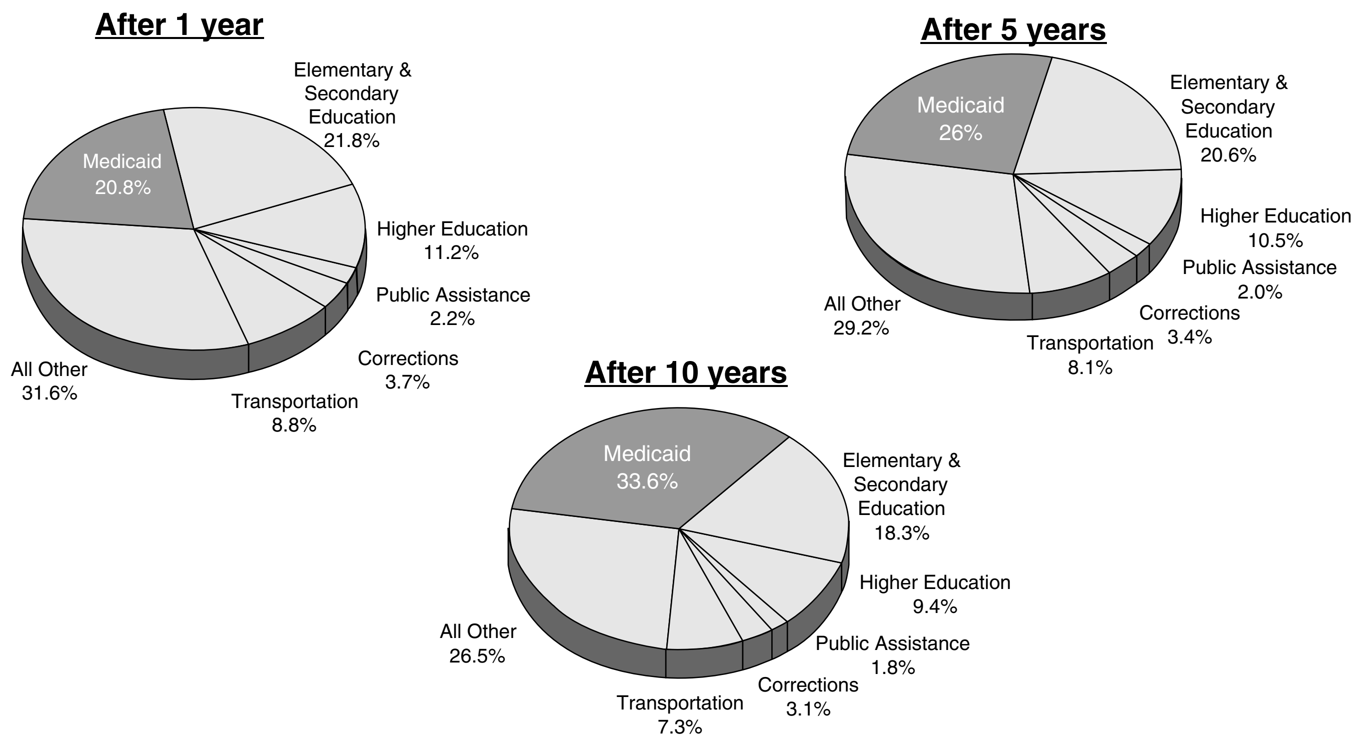

Federal and State Revenue Trends
Real year-over-year quarterly percent change
15
10
5
0
-5
-10
-15
State tax revenue
Federal revenue
1996Q1
1997Q1
1998Q1
1999Q1
2000Q1
2001Q1
2002Q1
Source: State tax revenue from Rockefeller Institute/NASBO. Federal revenue from Bureau of Economic Analysis, Department of Commerce.

State Medicaid Spending as a Percent of Total State Spending



Source: National Association of State Budget Officers (NASBO)

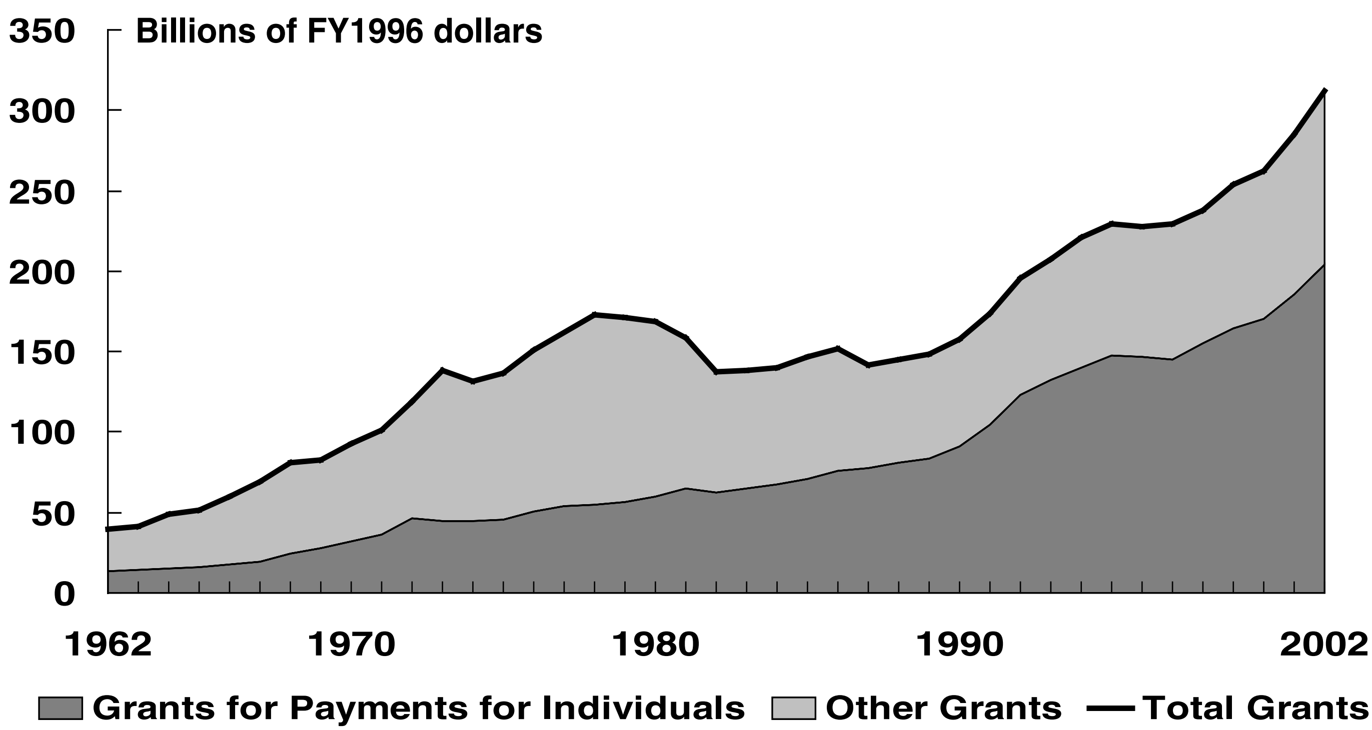
State Spending by Function as a Percent of Total State Spending, After 1, 5, and 10 Years



Note: Assuming Current Growth Rate for Medicaid and Current Average Growth for All Other Categories.

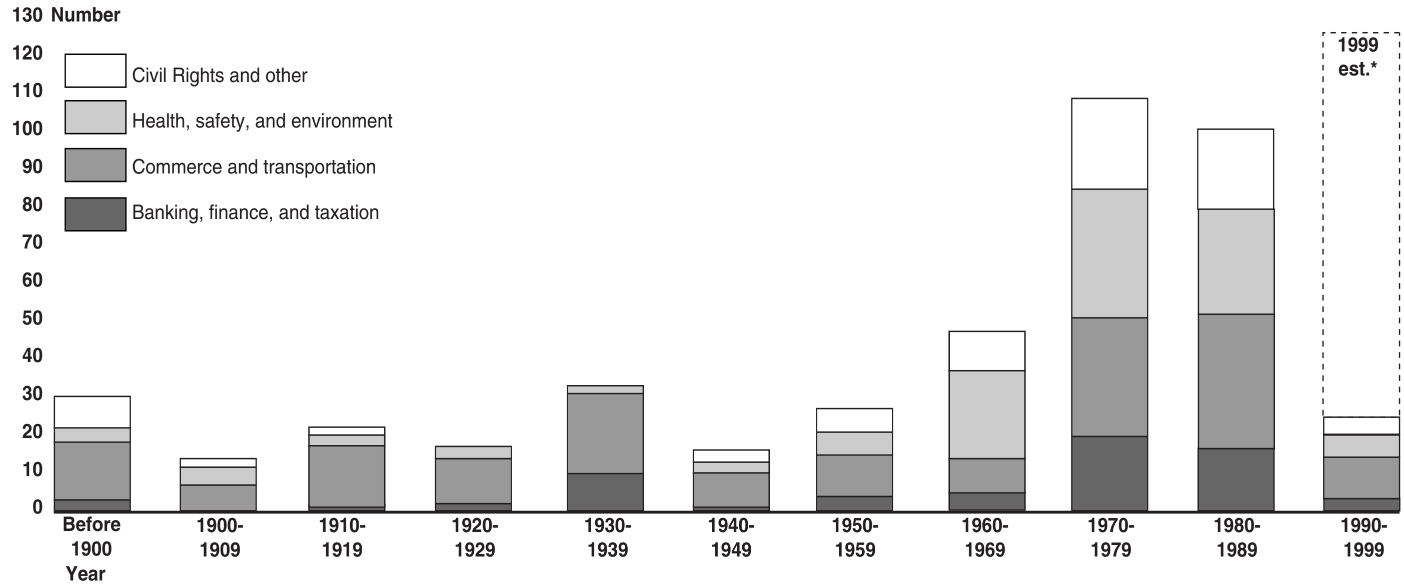
Source: National Association of State Budget Officers.

Total Outlays for Grants to State and Local Governments (Fiscal Years 1962-2002)



Source: *Budget of the United States Government, FY2004,* Office of Management and Budget.

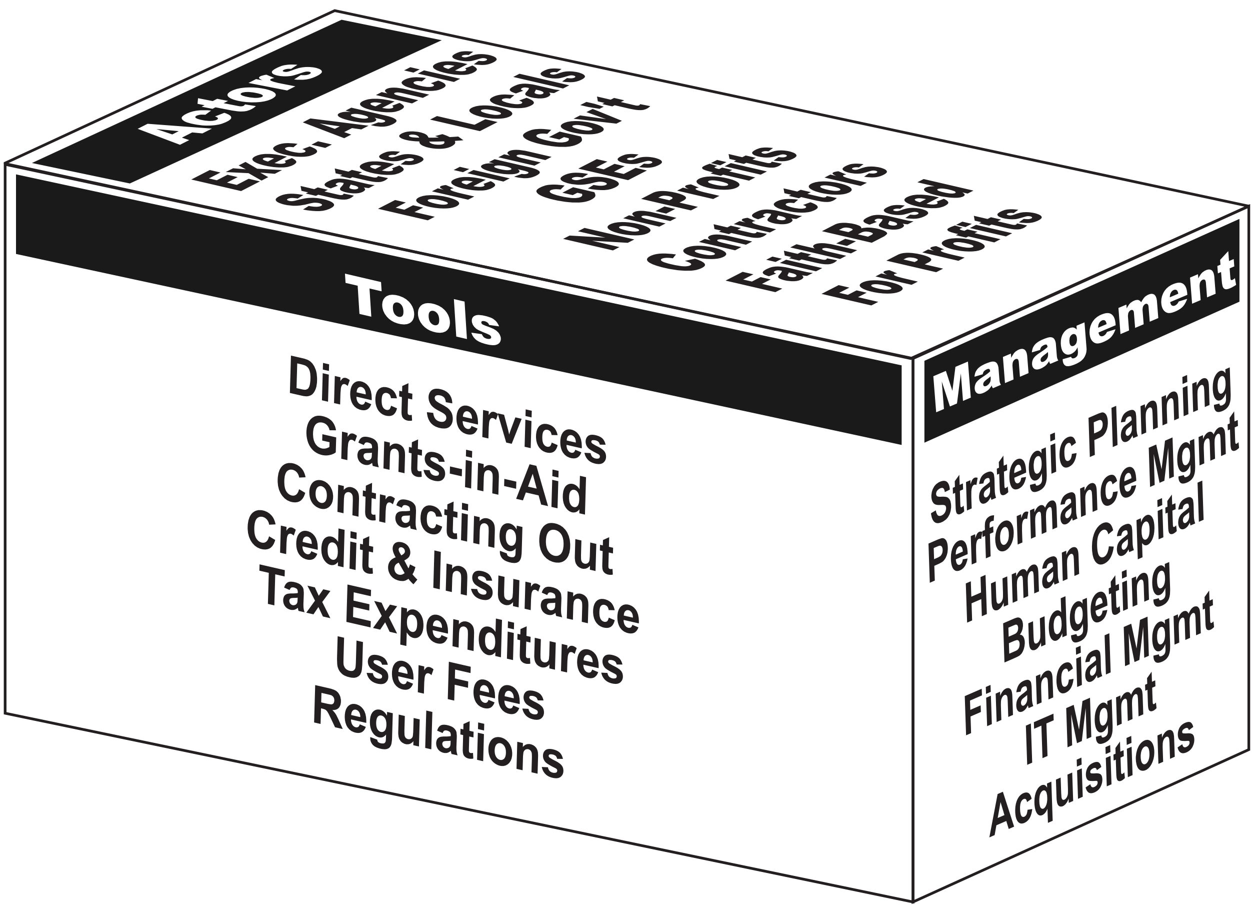
Number of Federal Preemption Statutes Enacted per Decade



*The 1990-1991 rate was multiplied by 5 to estimate how many preemptions might be enacted during 1990-1999.

Source: U.S. Advisory Commission on Intergovernmental Relations,Federal Statutory Preemption of State and Local Authority: History, Inventory, and Issues (Washington, D.C., 1992), p.7.

Policy Tools and Actors



Source: GAO.

Grant Programs to State and Local Governments

Figure 5: Summary of the Number of Grant Programs to State and Local Governments: Fiscal Year 2001

Department or Agency	Number of programs	Obligations in millions)
Agriculture	63	$20,141
Commerce	38	986
Defense	4	66
Education	119	31,928
Energy	5	217
Health and Human Services	158	191,028
Housing and Urban Development	33	27,443
Interior	62	2,582
Justice	55	4,060
Labor	20	7,559
Transportation	24	40,571
Treasury	1	13
Veterans Affairs	6	483
Environmental Protection Agency	44	3,395
Social Security Administration	1	23
Appalachian Regional Commission	5	102
Corporation for National and Community Service	6	324
Equal Employment Opportunity Commission	1	30
Federal Emergency Management Agency	11	331
Denali Commission	1	24
National Foundation on the Arts and the Humanities	8	259
Total	**665**	**$331,565**

Source: OMB analysis of data from December Update to the 2001 Catalog of Federal Domestic Assistance (December 2001).

Note: Excludes grants with no reported obligations.

Figure 6: The 20 Largest Grant Programs to State and Local Governments: Fiscal Year 2001 (obligations in billions)

Agency/Program	FY 2001 Obligations	Percent of total
1. HHS: Medicaid	$130.2	39.3%
2. Transportation: Highway Planning and Construction	30.7	9.2%
3. HHS: Temporary Assistance for Needy Families	19.1	5.7%
4. HUD: Section 8 Housing Choice Vouchers	11.4	3.4%
5. Education: Title I Grants to Local Educational Agencies	8.6	2.6%
6. Agriculture: National School Lunch Program	6.5	2.0%
7. Education: Special Education - Grants to States	6.3	1.9%
8. HHS: Head Start	6.2	1.9%
9. HHS: Foster Care - Title IV-E	5.1	1.5%
10. HHS: State Children's Health Insurance Program	4.2	1.3%
11. Agriculture: Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)	4.1	1.2%
12. HUD: Public and Indian Housing	3.3	1.0%
13. HHS: Child Support Enforcement	3.2	1.0%
14. Transportation: Airport Improvement Grants	3.1	0.9%
15. HUD: Community Development Block Grants/Entitlement Grants	3.1	0.9%
16. HUD: Public Housing Capital Fund	3.0	0.9%
17. Transportation: Federal Transit Formula Grants	2.9	0.9%
18. Transportation: Federal Transit Capital Investment Grants	2.8	0.8%
19. HHS: Child Care Mandatory and Matching Funds of the Child Care and Development Fund	2.6	0.8%
20. Labor: Unemployment Insurance Grants for State Administration	2.3	0.7%
Subtotal, 20 largest programs	258.7	78.0%
Remaining 645 programs:		
Programs of more than $50 million but not in the top 20 (190 programs)	66.7	20.1%
Programs of $50 million or less (455 programs)	6.1	1.8%
Subtotal, remaining 645 programs	72.8	22.0%
Total, 665 programs	$331.6	100.0%

Source: OMB analysis of data from December Update to the 2001 Catalog of Federal Domestic Assistance (December 2001).

Note: HHS indicates the Department of Health and Human Services. HUD indicates the Department of Housing and Urban Development.

Figure 7: Trend in the Number of Federal Grant Programs to State and Local Governments 1980-2001

Fiscal year	Number of funded programs
1980	434
1981	367
1982	303
1983	320
1984	330
1985	335
1986	349
1987	381
1988	415
1989	434
1990	463
1991	513
1992	539
1993	573
1994	593
1995	608
1996	570
1997	583
1998	591
1999	630
2000	653
2001	665

Source: OMB analysis.

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