Reflections on Intergovernmental Re-Balancing: Back to the Future
By Carl W. Stenberg

The intergovernmental balance has shifted to the national government. Federal deficits, debt service, defense spending, and entitlement pressures will reduce discretionary spending, and could rekindle interest in decentralization and devolution. State leaders need to network horizontally and vertically to rebalance the federal system.

In the 1984–1985 edition of The Book of the States I contributed an article that attempted to sort out the reality from the rhetoric of the federalism debate taking place in Washington, DC, state capitols, county court houses and city halls. The debate focused on reallocation of functional and fiscal responsibilities, spurred by President Ronald Reagan’s “Big Swap” proposal for the national government to take over the states’ share of Medicaid in exchange for state assumption of full funding responsibility for welfare and food stamps. Other concerns were federal budget build-ups in defense and entitlements, elimination of grant-in-aid programs, and growing regulatory burdens and unfunded mandates. These developments contributed to tension and uncertainty at all governmental levels.

As then executive director of The Council of State Governments (CSG), I observed that “rebalancing” of intergovernmental relations had shifted the pendulum toward more state- and local-oriented federalism. I called upon states to capitalize on their increased institutional capacity and commit to pursue their historic roles as “laboratories of democracy,” to formulate innovative approaches to domestic challenges and forge productive partnerships with the national government and their local governments.

Two decades later, the resiliency and dynamism of the federal system are both apparent. States and localities are still key program “rowers” in delivering important services and implementing national programs and regulations.1 The national government is still the big borrower and big spender in the federal system, while “big government,” in terms of personnel payrolls and range of functional responsibilities, resides at the state and local levels. State and local representatives still complain about unfunded mandates, under-funded federal programs, and unwarranted preemptions.

Re-balancing has continued and produced a shift toward national-oriented federalism. The president, Congress and federal agencies have assumed significant policy “steering” roles, with the concurrence of the Supreme Court. Globalization, the New Economy, and the Information Age have raised important questions about matters on which the United States should speak with one or 50 voices.

This article comments on factors contributing to this latest intergovernmental power balance shift, and suggests steps state leaders could take to move the pendulum in a more sub-national direction.

Looking Upward

The changing relationship between the states and the national government can be captured in seven “d” words: deficit, debt, defense, demographics, discretion, deregulation and decentralization.

Deficits and Debt. Fiscal factors have been prominent determinants of intergovernmental balance. Although states enjoyed budget surpluses during most of the 1990s and the national government achieved a budget surplus during the Clinton administration, a current concern is the widening federal budget deficit, estimated at $413 billion by the Congressional Budget Office in FY 2004. States are recovering from severe budget crises accompanying the recent recession, and most must comply with constitutional balanced budget requirements. Tax cuts, coupled with politician’s promises to not raise taxes, reduce deficit reduction options of national and state policymakers. Accompanying mounting federal budget deficits is national debt growth, estimated by the Government Accountability Office (GAO) at $6.8 trillion, or about $24,000 gross debt per person. Interest payments for debt service will limit future spending options for the president and Congress.2

Defense. The war against terror is the latest contributor to the defense build-up that began during the Reagan administration. Although the defense share of total 2004 federal spending is about 20 percent,
FEDERAL-STATE RELATIONS

compared with 27 percent in 1984, heightened security concerns at home and abroad will call for greater defense investments.

Demographics. Americans are benefiting from health care advances and living longer, more productive lives. They will draw down Social Security and other retirement accounts and depend more on Medicaid and Medicare to help cover rapidly rising health care expenses. Medicaid’s growth over the past two decades produced a shift in major beneficiaries of federal grants-in-aid, from places to people, and there are no indications of slowdown; Medicaid now accounts for approximately 45 percent of total federal aid, and its share of state budgets has about doubled over the past 10 years.1

Discretion. The above factors reveal a sizable and expanding portion of the federal budget as non-discretionary. Debt service, entitlement payments for income support and health care, and defense spending will put much of the federal budget on “autopilot.” In times of budget pressure, the discretionary portion—mainly grants-in-aid, amounting to $412 billion in 2003—will be looked to as a revenue source for on-going commitments and new national priorities.2

Deregulation. Deregulation has been a powerful force in the New Economy and Information Age, affecting markets, production processes, communications and skill requirements. Like businesses, governments have been compelled to become more nimble, entrepreneurial, performance-based, and customer-oriented. While deregulation has been a key component of private sector economic activity, the intergovernmental record has been mixed. Three examples follow.

1. The Unfunded Mandate Reform Act of 1995 (UMRA) was initially a major victory for state and local government representatives. UMRA sought to discourage Congress from imposing mandates and to ensure that compliance costs of bills containing federal mandates would be brought to the attention of congressional committees and, if enacted, would be accompanied by compensatory funds. But these hopes have not been realized. Coverage exemptions—such as Social Security, voting rights, grant conditions, national emergencies, program reauthorizations, and preemptions—“grandfathering” of all pre-1995 mandates, focus on fiscal impacts of individual bills instead of on cumulative federalism assessments, and underestimation of state and local compliance costs by federal agencies have limited UMRA’s impact.3

2. Eligible states have received waivers of administrative requirements in Medicaid, environmental and other programs. Yet, over the past 20 years traditional instruments of regulatory federalism—cross-cutting requirements accompanying federal aid, crossover sanctions, full and partial preemptions, and direct orders - have become more popular with Congresses and presidents.

3. Two important Federalism Executive Orders have been issued, E.O. 12612 in 1987 by President Reagan and E.O. 13132 in 1999 by President Clinton. Together they contained “Fundamental Federalism Principles” and “Federalism Policy Criteria,” which sought to constrain preemptions and grant conditions, broaden intergovernmental consultation on regulation, streamline waiver processes, and promote states’ integrity and discretion. However, GAO found that federal agencies rarely identified federalism impacts in their administrative rulemaking.4

Decentralization. Observers called the 1990s the “devolution revolution” decade, featuring proposals to encourage states to play leadership roles as policy innovation “laboratories” and to shift significant federal program responsibilities to the states via administrative decentralization, rather than devolution of federal powers. K–12 education reform, environmental initiatives such as smart growth and anti-sprawl programs, and economic development incentives were examples of the former.5 The Clinton administration’s welfare reform initiative was the prime decentralization example. The Temporary Assistance to Needy Families (TANF) block grant, which replaced the Aid to Families with Dependent Children program established during the New Deal, gave states considerable latitude in setting priorities, determining eligibility, integrating state programs, and engaging private and non-profit organizations in case management and service delivery. At the same time, the national government retained major roles in funding, although capped at the 1996 level, and standard-setting, such as limiting aid to five years, requiring welfare recipients to find work within two years, and curbing benefits for legal and illegal immigrants.

The number of block grants has reached record levels (from 18 to 25, depending on definitions, compared with 12 in 1983), and three (TANF, community development, and social services) are among the 20 largest grant programs. Yet, Congress continues to do business with states and localities chiefly through narrowly focused categorical instruments and to limit broad-based assistance (to less than 20 percent of total aid).6 The Bush administration has
proposed giving states greater authority and discretion by converting Medicaid, low-income housing vouchers, Head Start, job-training and child welfare programs into block grants. From the states’ standpoint, the troubling trade-off with block grants is when, compared with the categorical programs they replace, more flexibility is exchanged for fewer federal dollars.

In summary, the seven “d’s” have been powerful forces in determining state-federal power balances. They suggest reappearance of a three-pronged scenario from the 1980s on the intergovernmental scene—sorting out and shifting of functions, decentralization of responsibilities through block grants, and disinvestment in categorical programs—leaving it to states and localities to shoulder increased responsibilities, pass along cuts, or eliminate programs. The functional turn-back or devolution of powers record has been sparse, administrative decentralization has been limited to a few block grants, and categorical grants have proven resilient (as underscored by the rebounding of categorical programs from the historic 25 percent reduction achieved by the Reagan administration and Congress, from 539 in 1980 to 404 in 1984, to over 660 programs 20 years later). But the budget pressures outlined above could well re-open the devolution debate.

Looking Outward

If re-balancing is to occur, state leaders will need to work together more strategically and build effective horizontal and vertical networks. This need is underscored by the advent of the New Economy, featuring globalization of commerce, communications and technology. Globalization has posed a serious question: on what matters should the United States speak with 50 voices, or with one voice? Business representatives, environmental and consumer groups, organized labor, and others engaged in interstate and international commerce often prefer a single, stable policy or standard—not a patchwork of 50—which clashes with the states’ role as “laboratories.” Congress has enacted 518 federal statutory preemptions since 1790, with 68 passed between 1995 and 2004. Some of these have been partial, featuring a national minimum standard that states may exceed, while others fully preempt a field or impose maximum federal standards. In recent years states have lost authority to regulate nationally traded securities, pesticides and local telecommunications. Federal preemptions are under consideration in a wide range of areas, such as electronics recycling, greenhouse gas emissions, prescription drugs, lawn mower and leaf blower emissions, appliance energy consumption and biotechnology. There is no clear line between the states’ police powers in enforcement and consumer protection, for example, and the demands of interstate commerce and global markets. But the common approach by the Congress and White House has been preemption.

In light of these national and international trends, what can state leaders do? One response has been efforts by state attorneys general to confront national authorities when they were acting too slowly or contrary to state interests. The state-led tobacco settlement, in which major tobacco companies agreed to make $250 billion in compensatory payments for costs of treating tobacco-related illnesses under state Medicaid programs, was a major breakthrough. As implementers of environmental policy, states have challenged administration efforts to weaken air quality regulations, criticized the Environmental Protection Agency’s (EPA) reluctance to regulate interstate emissions from coal-fired power plants, and sued the EPA for failure to regulate carbon dioxide emissions. This activism indicates states can be on the frontlines when Congress and the administration are at stalemate on important national policy issues or unwilling to ensure appropriate levels of regulation to protect the public and enhance the quality of life.

A second trend is steady increase in formal and informal interstate cooperation, marked by growth in the number of compacts to more than 200. The Streamlined State Sales and Use Tax Agreement, signed by over 40 states, is an example of what can be done even in a complex, confusing and controversial area as tax policy. Although the effort was unsuccessful in preventing approval of the Internet Tax Nondiscrimination Act, which imposed a moratorium prohibiting states and local governments from levying taxes on Internet access, interstate cooperation could be an alternative to federal preemption in other areas. CSG and other organizations of state officials play vital roles in helping states network together regionally and nationally to find solutions to domestic problems. The establishment of CSG’s National Center for Interstate Compacts to promote use of these instruments to address national and state priorities underscores their potential in facilitating state collaboration. Continued development of model state legislation by CSG to share “best practices” and issuance of uniform laws by the National Conference of Commissioners of Uniform State Laws also could boost interstate relations, or “horizontal federalism,” as a viable strategy for reducing
FEDERAL-STATE RELATIONS

pressures for national preemption and mandates.11

Looking Downward

States and localities are key “rowers” in the inter-governmental system. While national initiatives such as No Child Left Behind, Homeland Security, Elections Administration, and Community-Oriented Policing receive media attention, their success is dependent on effective implementation by sub-national units. Similarly, a productive partnership between state and local governments is essential for delivery of major state-assisted programs such as elementary and secondary education. To the extent state and local officials can successfully develop solutions to public problems, Congress may be less willing to play the roles of city council, county commission, or state legislature.

Generalizations about the “state of state-local relations” are difficult to make across 50 different systems and are often subject to the “Miles Law” factor—where you stand depends on where you sit. Just as in state-federal relations, friction points exist in state-local relations, such as financial aid cutbacks, unfunded mandates, and preemptions of authority.

State leaders could use at least six indicators to assess current conditions and remedial actions. These are extent to which states: (1) give localities greater discretionary authority over their forms of government, personnel policy, services and especially revenues; (2) provide financial aid to replace lost federal dollars and state recession budget cuts, and resist further cutbacks in local assistance payments; (3) work with localities to make their tax systems more progressive and fair; (4) assume greater financial and administrative responsibility for functions that are costly, ignore local boundaries, have negative spillovers, require inter-jurisdictional equity, or of regional or statewide impact—such as social welfare, courts, mental health, education, corrections and transportation; (5) exercise restraint in imposing state mandates on local governments, and demonstrate willingness to compensate for compliance costs or allow local implementation flexibility; and (6) provide inter-local and regional collaboration incentives.

These steps could go a long way toward building a more positive and productive state-local relationship. But they are difficult to sell. It is tempting for state officials to merely pass along aid cuts, unfunded mandates, and intrusive administrative conditions; there is not much local units as state “subdivisions” can do constitutionally or politically to stop such actions. But from the standpoint of effective implementation at the local level—which public opinion polls have found to be the most trustworthy and capable of delivering the most for their money—states should consider pursuing a “second-order devolution” approach outlined above.

Looking Ahead

Forecasting the future is a difficult and daunting task, particularly in a complex, dynamic federal system. Power balances between the states and the nation and states and their localities are affected by a variety of forces, such as international commerce, security, information technology, finances and demographics. For state leaders, the bad news during the past 20 years is that these and other factors have produced centralizing pressures that strengthened the role of the national government and supported “one size fits all” domestic and international approaches. But the good news is that while the deficit, debt, defense and demographic demands on the federal budget will put pressure on discretionary spending, which could lead to program cutbacks, more decentralization and even devolution initiatives could be on the horizon. And the states will remain on the frontlines as chief implementers of national programs and regulatory policy and innovation “laboratories.”

Capitalizing on these trends and moving the pendulum in a more sub-national direction will require states to work together and with their local governments in more sustained and strategic ways than has been customary. Forging effective networks among state leaders on interstate issues and between state and local officials on state and sub-state issues that leads to effective collective action on common problems will be key to demonstrating their capacity and commitment to partnership federalism and to reducing centralizing pressures.

Notes
FEDERAL-STATE RELATIONS


About the Author

Carl W. Stenberg is a professor of public administration and government at the School of Government, University of North Carolina at Chapel Hill. He served previously as assistant director of the U.S. Advisory Commission on Intergovernmental Relations and executive director of The Council of State Governments.
The plot of Back To The Future 1-3 is pretty complicated and takes some time to describe! The rest is covered in the next episode. 

SPOILER ALERT! Little do they realise that while they’re at Marty’s future house, old Biff has broken into the DeLorean and travelled back in time to give the sports almanac to his younger self. Biff, exhausted by his efforts struggles to get out of the car, breaking his walking stick in the process. A part of the stick is left in the car, which later will show to Doc Brown & Marty that Biff stole the car. Until markets focus shifts away from risk and back to the underlying economic fundamentals, we expect a protracted period of choppy trade with firmer support and resistance bands. Key Movers. The Great British Pound was the days top performer on Tuesday, advancing three quarters of a percent after Boris Johnson promised an injection of 5billion pounds into new infrastructure projects in a bid to drive domestic growth and employment. The GBP jumped back through 1.23 and 1.2350 before resistance on moves at 1.2390/1.24 stopped further gains. While fundamental still take a back seat to risk, improved manufacturing conditions may over some hope a broader economic rebound is still on track. Expected Ranges. AUD/USD: 0.6830 – 0.6950 ▲.