S. HRG. 98-90

ADMINISTRATION'S FEDERALISM PROPOSALS

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

MARCH 4, 1983

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

20-689 O WASHINGTON : 1983

COMMITTEE ON FINANCE

ROBERT J. DOLE, Kansas, *Chairman*

BOB PACKWOOD, Oregon
WILLIAM V. ROTH, Jr., Delaware
JOHN C. DANFORTH, Missouri
JOHN H. CHAFEE, Rhode Island
JOHN HEINZ, Pennsylvania
MALCOLM WALLOP, Wyoming
DAVID DURENBERGER, Minnesota
WILLIAM L. ARMSTRONG, Colorado
STEVEN D. SYMMS, Idaho
CHARLES E. GRASSLEY, Iowa

RUSSELL B. LONG, Louisiana
LLOYD BENTSEN, Texas
SPARK M. MATSUNAGA, Hawaii
DANIEL PATRICK MOYNIHAN, New York
MAX BAUCUS, Montana
DAVID L. BOREN, Oklahoma
BILL BRADLEY, New Jersey
GEORGE J. MITCHELL, Maine
DAVID PRYOR, Arkansas

Robert E. Lighthizer, *Chief Counsel*
Michael Stern, *Minority Staff Director*

CONTENTS

Administration Witness

	Page
Stockman, Hon. David, Director, Office of Management and Budget	3

Additional Information

Committee press release	1
Opening statements of:	
Senator Dole	1
Senator Heinz	3
Prepared statement of Hon. David Stockman	5

ADMINISTRATION'S FEDERALISM PROPOSALS

FRIDAY, MARCH 4, 1983

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Robert Dole (chairman) presiding.

Present: Senators Dole, Heinz, and Durenberger.

[The press release announcing the hearing and the prepared statements of Senators Dole, Heinz, and Durenberger follow:]

FINANCE COMMITTEE SETS HEARING ON ADMINISTRATION'S FEDERALISM PROPOSALS

Chairman Robert J. Dole (R., Kans.) announced today that the Senate Finance Committee will hold a hearing on Friday, March 4, 1983, on the Administration's federalism proposals. The Honorable David Stockman, Director of the Office of Management and Budget, will testify for the Administration.

In announcing the hearing, Senator Dole stated, "We look forward to reviewing the President's federalism proposals and to working with the Administration to improve the relations between the Federal Government and State and local governments in the implementation of public policy. Many governmental functions are best performed at the State and local level. In a year when we will be examining the revenue sharing program, unemployment, and other issues of great concern to States and localities, the Administration's federalism initiative should provide a valuable framework for reviewing intergovernmental relations."

The Finance Committee will schedule public witness hearings on the Administration's federalism proposals at a later date.

The hearing will commence at 10:00 a.m. in Room SD-215 (formerly 2221) of the Dirksen Senate Office Building.

STATEMENT OF SENATOR DOLE

FINANCE COMMITTEE HEARINGS ON REAGAN ADMINISTRATION FEDERALISM INITIATIVE

We in the Finance Committee have watched with considerable interest over the past year as the administration has worked to develop legislation to return major program responsibilities to States and localities, along the lines suggested by President Reagan in his State of the Union address of January, 1982. Clearly this has been a difficult process, and the legislative prospects for the new administration proposal are far from certain. But whatever happens from this point on, the thorough dialogue and debate that has been generated on issues of federalism is all to the good. This morning we are pleased to welcome Dave Stockman, who will outline the President's new federalism proposal for us and, I hope, respond to some questions and concerns members may have based on our initial review of the suggested legislation.

FINANCE COMMITTEE CONCERN

Issues of federalism are of paramount interest to the Finance Committee, because so many of the programs that are our responsibility involve shared policy or administrative duties on the part of the Federal government and State and local governments. Some of the most obvious examples are unemployment compensation, AFDC, Medicaid, and revenue sharing. In addition, there is a strong history of support on this committee for the block grant concept: for giving recipient governments the maximum flexibility, consistent with established national goals, in carrying out federally-funded program responsibilities. I know that Senator Long and I have had a long-standing interest in welfare reform that gives the States more flexibility; and the administration will agree that this committee has been receptive to block-grant proposals the President has made in the past. So clearly there are grounds to believe that we can work successfully with the President in advancing the cause of returning decision-making to the State and local level in cases where local decisions can better reflect local needs and concerns.

A DIFFICULT DISTINCTION

But even when we agree on some basic goals, matters become much more difficult when we get down to specific cases and decide what types of program responsibilities truly belong at the national level and which do not. There is no magic formula to give us an answer—if there were, we in Washington could have reached agreement with State and local officials on this matter long ago. There is very considerable, and very significant, disagreement on what functions the national government can best perform. We agree that the national defense is a responsibility of Washington and not of the individual states. But we may not agree that all types of income maintenance programs are better suited to the Federal government or to the States. In fact, what we have now is a complex system of shared responsibility for protecting the needy—and that is likely to remain the case, although some clarification and sorting out of functions along the lines the President has suggested in the past may yet happen, and could be all to the good.

So we are here to begin a discussion that we hope can lead to substantive action to clarify relations among the different units of government in our federal system. The four new block grants proposed by the administration are a good place to start, because their design shows considerable imagination and a realistic sense of what can be achieved. Many members here may have some reservations on the inclusion of one or another program in these blocks—particularly in the State block grant, which folds in a number of programs that are popular with this committee. But we do applaud the effort to move ahead with this sorting-out process, and we expect to have significant input on the federalism initiative as it develops in Congress.

SOME QUESTIONS

Before we proceed with this morning's testimony and responses from the members of the committee, I would just like to mention a few specific concerns about the legislation the President has proposed. First, two of the block grants—the State block grant and the transportation block grant—involve the earmarking of certain Federal excise tax revenues, within the budget, to fund these grant programs. Some of us have questions about the desirability of resorting to often tieing particular revenue sources to particular spending programs. If that practice gets out of hand, the whole budget might be tied up in this way, and it might be more difficult to make the year-to-year adjustments we need in a sometimes unpredictable economy. We all appreciate the desirability of certainty and stability in funding, but it is possible to have too much of a good thing.

The question of the future of general revenue sharing, which is proposed to consolidated with a portion of the Community Development Block Grant under the administration proposal. Some of us have expressed an interest in seeing revenue boosted in some way, either by an acceleration of payments into this year or by some permanent change in the program. It has occurred to some of us that, if we are interested in stimulus and job creation, we ought to give some thought to revenue sharing, which is one of the most efficient programs in terms of administrative overhead. I would hope that the administration might have some thoughts on how this might be done consistent with dealing with the deficit: perhaps by shifting funds or consolidating funds scheduled to go to other grant programs. Since that is the basic thrust of the administration's initiative as I see it, I assume there is opportunity for a meaningful debate here. Perhaps revenue sharing out to be the centerpiece of the federalism proposal to a greater extent than the President has suggested.

That said, we are glad to have this opportunity to get the administration's viewpoint first-hand. We are ready to listen.

STATEMENT FOR FINANCE COMMITTEE HEARING ON NEW FEDERALISM, U.S. SENATOR J. HEINZ

As you know, I have great faith in the General Revenue Sharing Program; and have every intention of seeing it through to quick reauthorization.

Therefore, I am highly ambivalent about the Administration's local block grant proposal—it too demonstrates great faith in GRS, but combining it with CDBGS would, in my opinion, be fatal to the reauthorization process.

I am concerned about the pattern of federal "disinvolvement" in targeting assistance to low income people and distressed areas. The Administration's actions on CDBGs over the last 6 months demonstrate and unmistakable trend toward "generalization" of CD funds primarily for the benefit of the urban disadvantaged.

In his statement to Congress on New Federalism, the President asserted that the national budget should just address national needs * * * I would argue that "eliminating and preventing slums and blight and preserving viable neighborhoods are important areas of national responsibility * * *" That is what Congress felt in 1974 when it wrote the CDBGS legislation, and it troubles me that under this proposal that responsibility will ultimately be lost. Even though this country's cities might enjoy the added flexibility, they oppose this proposal. There is no need to "block grant" two block grants with dissimilar purposes.

GRS is the "original new federalism" and it is probably the most efficient program in the federal repertoire, which is what prompted me to introduce a bill to accelerate GRS payments (S. 525).

GRS acceleration is the quickest vehicle for distributing funds to local communities pressed by increased demands for humanitarian relief.

My colleagues, Dave Durenberger, Pete Domenici, and others have been talking to the Administration since last fall about accelerating the payments for the purpose of providing emergency relief.

Since introducing S. 525, I have found that this acceleration will in fact have direct bearing not only upon emergency services in many communities, but it would also preserve the jobs of many on layoff status. Other local governments would use the funds to initiate overdue capital projects that will help boost local employment.

Whether the funds are used for humanitarian relief as they may be in Philadelphia where expenditures for the homeless have risen to $3 million from just $250 thousand in 1981—or for saving jobs in Youngstown where 90 workers have already been let go—accelerating the GRA payments would be a timely demonstration of federal support and concern for those on the firing line in local government.

Just when the nation as a whole begins to emerge from the recession local governments are beginning to feel the real burden of past cuts in federal aid; increased fiscal distress at the state level; and the decline in local revenue base.

The lag phenomenon in federal and state aid and the end of inflation in property tax assessments is now putting local budgets in a terrible crunch.

Even without the federal and state aid the local government is still responsible for basic safety net services.

GRS acceleration will pump out additional dollars just when it is needed, rather than is usually the case with the federal government's effort to address recessionary conditions—long after the data has come in, been analyzed, and reanalyzed.

The CHAIRMAN. The hour of 10 o'clock has arrived. We are pleased to have Mr. Stockman here this morning to discuss with us the administration's New Federalism initiative. And I have a statement which I would simply place in the record. Senator Heinz?

Senator HEINZ. Mr. Chairman, I am going to do the same with my statement. And I think the sooner we begin, the better.

The CHAIRMAN. Mr. Stockman?

STATEMENT OF HON. DAVID A. STOCKMAN, DIRECTOR OF THE OFFICE OF MANAGEMENT AND BUDGET

Mr. STOCKMAN. Thank you, Mr. Chairman. I, too, have a long statement, but since this apparently will be a short hearing, I would like to insert that in the record and summarize a few of the key points. I think both you and Senator Heinz are aware of the proposal that we have made this year. And then I will try to answer your questions. So with your permission I will submit my statement for the record and will try to summarize it.

The CHAIRMAN. We appreciate that very much.

[Prepared statement of Hon. David Stockman follows:]

Statement of David A. Stockman
Director of the Office of Management and Budget
Before the Committee on Finance
United States Senate

Mr. Chairman and Members of the Committee

I welcome the opportunity to appear before you today to discuss the President's Federalism Initiative.

In his January 1982 State of the Union Address the President outlined a $50 billion program to return responsibilities and revenue sources to state and local governments. Throughout the Spring and early Summer of the year the Administration engaged in extensive developmental discussions with state and local representatives on the details of the Administration's Federalism package. Teams representing the nation's Governors, state legislators, county, city and township officials were formed to fashion a Federalism program which would have broad-based support by elected officials at all levels of government. These discussions were useful and resolved many issues. The package that the Administration is placing before the Congress this year reflects the input which the Administration received from state and local officials during the past year.

20-689 O—83——2

This Year's Package

The legislation submitted this year consists of four separate -- State, Local, Transportation and Rural Housing -- block grant bills. The entire list of programs included in the four block grants is attached.

State Block Grant

- The State Block Grant provides authority to consolidate twenty-two existing assistance programs in the health, social services, education and community development areas into a single package. It is proposed to be funded at approximately $11 billion annually.

- This block grant includes several major programs such as HUD's Small Cities Block Grant; Education's State Education Block Grant, Rehabilitation Services, Vocational and Adult Education programs; USDA's Rural Water and Waste Disposal Grants; EPA's Construction of Municipal Waste Water Treatment Works; and HHS's Social Services Block Grant, Low Income Home Energy Assistance Block Grant, Maternal Child Health Services Block Grant, Foster Care and Child Welfare Services.

- A state may choose to take over one or more of the twenty-two programs over the five year period or continue to receive separate grants under the existing program authorities. When a state elects to take over a program, it may use the funds for the purpose of the program under simplified administrative procedures. A state is permitted to exercise maximum programmatic and administrative discretion within the purpose authorized by the original program statute. Also, a state may use 20% of the funds available for that program for any of the other programs included in the block. The 20% increases to 40% the second year and increases by 20% each succeeding year. The decreasing remainder of the funds must continue to be spent on the individual program purpose.

- There are passthrough restrictions on a state's use of these funds in order to provide protection to local units of government and rural areas. A state that participates in the block grant must continue to provide local governments, in the aggregate, with funds proportional to that which they received in the period 1981 through 1983. Rural areas will continue to receive all the funds available from the three Farmers Home Administration programs included in the block grant and approximately 70 percent of the total funds available from HUD's Small Cities program will go to cities with populations under 20,000.

- A state's share of the total $11 billion available under the block grant will be based on its relative share of (1) the total dollars available for the formula programs, based on by the 1984 enacted formulas, and (2) the total dollars available for the discretionary programs, based on the amount it received in the period 1981 through 1983. The state allocation will stay fixed over the five year period.

Local Block Grant

- The Local Block Grant provides authority to consolidate the existing General Revenue Sharing program and the entitlement portion of the Community Development Block Grant (CDBG). This block grant will be funded at approximately $7 billion annually.

- A local government chooses to participate in the Local Block Grant in the same manner as a state under the State Block Grant. A local government may choose to take over either the Revenue Sharing or CDBG program or both. When a local government takes over a program it may use the funds for the purpose of the program taken over in accordance with simplified administrative procedures. As in the State Block Grant a local government may transfer funds among programs based on the 20/40/60/80 percent rule. Each local government will receive the same share of the

$7 billion available for the two programs as it would if the federal government continued to run the CDBG and Revenue Sharing programs.

Transportation Block Grant

- The ground transportation block provides grants to states which may be used for any of the purposes now authorized by six existing federal highway grant programs. These cover urban and secondary systems, non-primary bridges, and safety activities of the FHWA. Funding is proposed at approximately $2.3 billion annually.

- A state may elect to assume responsibility for this program in any of the five years authorized by the bill, or continue to receive separate grants under the existing highway programs. If a state elects to participate, it may use the funds for any of the purposes authorized by the six existing programs. A state may only elect to accept this block grant in its total form, i.e., assume responsibility for all six programs.

- Each state receives an amount equal to what it would have received from the individual categorical programs if DOT were to continue to run them. State allocation will be based on the existing formula for these programs established in current law.

- One of the existing programs - the Urban System program funded at $800 million - has a passthrough provision to local governments in excess of 200,000 population. The new block grant would retain the same provision.

<u>Rural Housing Block Grant</u>

- The rural housing program establishes new broad block grant authority to states to provide housing assistance for low income persons in rural areas. Assistance provided by the state to individuals may be for construction, repair, or rental subsidy, and may be in the form of grants or loans. It replaces the existing rural loan insurance program and the following low income housing assistance programs for rural areas -- the Very Low-Income Repair Grants, Mutual and Self-Help Grants and the Rental Assistance Program. Funding is proposed at $850 million annually.

- States may elect to participate in this program at any time during the full five years of the program's authorization. However, since this is a new program, there will be no continuing federal administration of a comparable program. Therefore, a state must assume the block grant in order to receive any funds for this Act's purposes.

- Funds will be allocated among the states on a formula based on three equally weighted factors: substandard housing in rural areas, rural population, and low income rural households.

The funding level proposed for the State, Local, and Transportation Block Grants is equal to the 1984 - enacted levels for the categorical programs being consolidated in each. The Rural Housing block is a new grant program, which involves "cashing out" loan authority. As I noted, we propose to fund this block grant at $850 million a year.

The State Block Grant will be financed by earmarking federal excise tax revenues on alcohol, tobacco and telephones.

The Transportation Block Grant will be financed by a portion of the federal gas tax revenues.

The Local and Rural Housing Block Grants will be financed by general revenues.

During the five year period of the program, we will determine whether it would be feasible to return any or all of the revenue sources to the state or local governments along with the programs in the block grants. The President will appoint a commission to review this issue and develop recommendations.

SWAP Component Excluded From Package

In his original proposal the President proposed a "SWAP" and a turnback of specific federal programs. Under the SWAP component the federal government was to assume full responsibility for financing Medicaid while the states were to take over the two main welfare programs -- Food Stamps and Aid to Families with Dependent Children (AFDC), resulting in an approximately $20 billion SWAP. Our discussions showed that there was divided opinion among federal, state and local officials on the appropriate role of each level of government with respect to income maintenance, despite the willingness of the federal government to take over the fast growing and heavy financial burden of the Medicaid program. This lack of consensus on the proper roles of the various levels of government with respect to income maintenance persuaded us to defer consideration of these issues at this time. However, the Administration stands ready to continue development of legislative proposals to properly sort out relative state, local and federal roles in the income maintenance area. In our discussions with representatives of government at all levels, however, there was substantial agreement on the program turnback concept embodied in the original Federalism framework -- the concept on which this year's package is based. Therefore, we felt it was important to proceed with a specific legislative package that could be enacted this year.

Analysis of Current Package

This proposal is designed to achieve the fundamental Federalism principles outlined by the President in his 1982 and 1983 State of the Union Messages. It does so in a way which builds upon the experience which state and local governments have already gained in assuming more responsibilities through our block grant and deregulation initiatives of the last two years. The experience the states have gained through the enacted block grants in the social services, health, education and community development areas are similar to the areas covered by the new block grants.

For over a year now states have been administering eight of the nine block grants which were established in the Omnibus Budget Reconciliation Act of 1981. The one they have not administered, Primary Care, has been removed from the current proposal.

A number of independent investigators have reviewed the performance of the states in assuming the new block grants. Based on these reviews, and comments which we have received directly from state and local governments, there is every indication that the states have demonstrated their capacity to administer them well. For instance, the General Accounting Office concluded, on the basis of a study in 13 states, that states are making good progress in assuming their new responsibilities. State legisla-

20-689 O—83——3

tures are becoming more involved in the decision-making process, and numerous examples of potential administrative cost savings, and better targeting of resources to states' needs were cited. No major administrative or operating problems were observed.

Thus, states have demonstrated both their willingness and capacity to assume the added responsibilities of administering programs in the form of block grants, and have gained invaluable experience for assuming the even larger responsibilities contemplated in the current proposal.

The current proposal is fundamentally consistent with the turnback feature of the Federalism Initiative outlined last year by the President although some of the specific elements have been changed to accommodate suggestions which were made during our year-long consultation with state and local officials.

To illustrate:

- Last year's proposal was to transfer to state and local governments responsibility for administering a variety of programs in the social services, education, health and community development area. This year's proposal does also.

- As last year, we have given states and localities the option of choosing to administer the new flexible program, or continue to receive funds in their current program form.

- The programs and services included are those for which state and local governments have traditionally been responsible and thus are in the best position to administer for their citizens.

Based on consultation with state and local officials, we have made some significant improvements and refinements this year:

- The funding level is proposed at whatever level the Congress enacts for the programs in FY 1984. It is retained at that level for the full five years. This eliminates any possibility that the programs would be offered to the state at a lower funding level than they would operate if they were federally run.

- In response to concerns expressed by state and local government representatives, the proposal contains special provisions to protect the flow of funds to local governments. For instance, there is a general mandatory pass-through of state block grants to local governments, in aggregate, based on the historical percentages which localities have received under the existing programs.

Within this are included special provisions for urban areas for the transportation programs and rural areas in the state block grant. Strong consultation requirements are included and a state must provide formal assurance to the federal government before receiving funds.

- This year the program is offered as four separate blocks, rather than as a single mega-block including all programs consolidated.

- This year's proposal protects the program purposes of the existing federal programs which are being consolidated. Participants will be able to reallocate funds among programs on a phased basis, but all funds spent within a given block grant must be spent only for purposes of the programs consolidated with that block grant.

Need for Fundamental Federalism Reform

One of the most important goals of the Administration is to make government more efficient and more responsive to its citizens by restoring an appropriate balance among Federal, state and local governments. The dramatic growth of Federal programs over the past two decades has resulted in a serious intergovernmental imbalance.

- Between 1960 and 1981, Federal outlays for grant-in-aid programs increased at an annual rate of 13 percent, compared to a less than 10 percent annual increase in the Federal budget as a whole.

- In 1960, total federal grant outlays were at a $7 billion level; by 1981, they increased to $95 billion -- more than a tenfold increase.

- During the same 1960-1981 period, the number of narrow categorical grant programs almost tripled. The existence of more than 400 of these special purpose grants created program and administrative waste and duplication with no assurance that priority needs were being addressed.

- The grant programs usually were accompanied by numerous mandates and restrictions on the use of funds -- an average of 300-500 requirements for a typical grant program.

Between 1980 and 1982, the number of grant programs has declined from 428 to 280. Many categorical programs have been consolidated into block grants. This has significantly improved state and local program and administrative flexibility and dramatically reduced Federal red tape. More progress, however, has to be made.

In response to this explosive federal growth and encroachment of state and local government authority, we established the following principles for Federalism reform:

-- Federalism reform needs to be high on the national policy agenda.

-- The federal government is overloaded, having assumed more responsibility than it can efficiently manage.

-- Government responsibilities need to be sorted out so that elected officials at state and local levels can make government work effectively for their citizens with a minimum of federal interference.

-- Federalism reform is not a vehicle for budgetary savings.

-- States and localities should be given discretion over the pace at which they assume federal programs.

-- States and local governments should be given predictable levels of funding over the five fiscal years 1984-1988.

-- Many current federal programs should be turned back to state and local governments with the revenue sources to finance them.

-- Federal controls and mandates on state and local government need to be reduced or eliminated.

-- State and local officials are as competent and compassionate as federal administrators.

-- State and local governments should be encouraged to work together toward solutions to intergovernmental problems.

The Federal legislation we have developed meets these principles. It is a further step in the Administration's efforts to restore to state and local governments a dynamic and appropriate role in governing this country.

If this legislation is enacted by the Congress, I believe it will improve the present intergovernmental imbalance and have the following beneficial effects:

-- With stable and predictable funding levels for fiscal years 1984-1988, state and local governments will be able to use these resources for their citizens in a more effective manner than the federal government can.

-- Dislocations will be minimized because there will be a 5 year period during which state and local governments may take over the programs.

-- Discretion given to state and local governments on the use and allocation of the funds without needless restrictions will result in a better targeting of dollars to priority needs.

-- With passthrough protections, local governments, including rural and urban areas, will continue to receive an equitable share of resources.

-- Minorities will continue to have full access to these resources without fear of discrimination.

-- Drastic reductions in federal overhead and administrative/regulatory burdens will result as states and localities assume these programs.

The President's Federalism Initiative provides an important opportunity for us to restore authority and responsibility to state and local governments and to improve the intergovernmental system. I welcome any questions that Members might have.

PROGRAMS INCLUDED IN THE FEDERALISM INITIATIVE

State Block Grant

Rehabilitation Services
Vocational Education
Adult Education
State Education Block Grant (ECIA, Chapter 2)
WIN
Low-Income Home Energy Assistance
Social Services Block Grant
Community Services Block Grant
ADAMHA Block Grant
MCH Services Block Grant
Rural Water and Waste Disposal Grants (FmHA)
Water and Sewer Facility Loans (FmHA)
Community Facility Loans (FmHA)
CDBG–Non-Entitlement Portion
Grants for the Construction of Municipal Waste Water Treatment Works (EPA)
Child Welfare Services
Child Welfare Training
Adoption Assistance
Foster Care
Preventive Health and Health Services Block Grant
Child Abuse State Grants
Runaway Youth

Federal-Local Block Grant

General Revenue Sharing
CDBG–Entitlement Portion

Transportation Block Grant

Urban System
Secondary System
Non-Primary Bridges
Highway Safety (FHWA 402 Grants)
Hazard Elimination
Rail-Highway Crossing

Rural Housing Block Grant

Rural Housing Insurance Fund
Very Low-Income Repair Grants
Mutual and Self-Help Grants
Rental Assistance Program

Mr. STOCKMAN. Mr. Chairman, when we started in 1981, the Federal grant-in-aid system was totally out of control in a very literal and undeniable sense. Over the prior two decades the number of narrow categorical grant-in-aid programs had tripled to nearly 500, funding had exploded from 7 billion in 1960 to nearly 95 billion in 1981, and restrictions, reports, and earmarkings complicated application procedures, and Federal micromanagement of local delivery of these grant programs had become literally rampant.

And confronting that situation, we made major efforts both in the 1972 budget and in the 1983 budget to begin to reform and streamline and reverse this system that had gotten out of control.

I think if we take stock at the present time of what was accomplished legislatively, both in the 1981 Reconciliation Act and in some legislation last year, I think we can conclude fairly that dramatic progress toward rationalizing, streamlining, and sorting out this uncontrolled system, has been made. Let me briefly review what we have accomplished:

The number of grants is down from 428 to 280. Sixty categorical programs were consolidated in the 1981 and 1982 legislation into 10 broader block grants. The vast regulatory and paperwork simplification that has occurred result, for instance, just in the case of 60 old categoricals that required 885 pages of regulation, we now have only 31 pages of regulation to implement the 10 block grants that have taken their place.

Funding has stabilized, and the States and localities have proved, I think beyond any shadow of a doubt, that they are both capable and willing of taking on broader responsibilities, more policy control, more administrative responsibility for operating the grant-in-aid system.

I would note that in the consolidations that have been made previously, four of the block grant programs were entirely voluntarily. The States did not have to implement them. They could have stayed within the existing categorical structure. Nevertheless, in the case of the four voluntary block grants, nearly 90 percent of the States elected to go into the block grant in the case of three, and 75 percent of the States elected to go into the block grant in the case of the four. We have had studies by GAO and others indicating that the States are making very rapid and very healthy and constructive progress in taking over these responsibilities and implementing the program.

With that record of accomplishment in view last year, we attempted to move this thrust toward federalism reform forward in a giant step—in the form of a $50 billion program to return money and programs to the States. But after a year of very good-faith effort on the part of State and local governments, the administration, members of this committee, and others, the package just proved too big, too much, and too fast. There was broad agreement on the direction that we wanted to go, but it was not possible to translate that into policy choices and program design on which a consensus could be achieved. In particular, we found that it was impossible to reach a consensus on the issue of the appropriate role for the Federal and State government in the income maintenance system that we have created over the years. And we found that there are vast problems in attempting to match the return of tax sources and program responsibilities due to the enormous variations, such as economic basis and other factors, among the States.

So, therefore, in the 1984 budget we have attempted to continue the progress and the thrust toward reform and rationalism to the grant-in-aid system, but on a more modest scale in the form of an intermediate program based on packaging the remaining categoricals in basic education, social welfare, rural housing, transportation and community development areas, and the new block grants that we have successfully enacted, into four flexible megablock grants by broad functional area and levels of government.

I would characterize what we are proposing this year as evolutionary rather than revolutionary, and as incrementalist in terms of the structural changes that are needed rather than attempting to impose sweeping changes all at once. Perhaps the most important feature of what we have proposed in these four megablock grants is that the States and localities would really shape the process by which narrower programs are combined into wider blocks of funds and program responsibilities. They would control the timetable. They would have the option over the next 5 years—and on a program-by-program basis for two of the megablocks—of either continuing to operate programs under the existing program authority or electing into the block grant and the flexibilities that are contained in the legislation.

Let me conclude with a very quick review of precisely what we have programed and proposed in terms of the program features, the dollars, and so forth. Twenty-one billion dollars are proposed to be channeled into four megablock grants, and these would be built from the 34 existing categorical and block grant programs in the Federal-State grant-in-aid system. The largest of these would be the State block grant. It would involve $11 billion that are now channeled through 22 different programs, ranging from rehabilitation services to low-income energy assistance, maternal and child health, the small cities' portion of the CDBG grant program, child welfare services, and many others.

The key features that I think are important to call to the attention of the committee are, one, that there would be a hold-harmless in terms of the distribution among States so that no State would gain or lose relative to the formulas that allocate money under the existing programs.

Second, there would be a passthrough to localities in the proportion by which the existing programs have been split between State administration and local administration in the past. Third, there would be a scale of increasing flexibility so that if States opt to go into the block grant in the first year, 20 percent of any of the funds that would be attributable to the previous program could be allocated to other activities within the block grant, and in each subsequent year that percentage would rise by another 20 percent, so that by 1988, the last year of the program we proposed, there would be full flexibility to reallocate or interchange of funds among the program purposes within the ambit of the block grant.

And, finally, as I have previously indicated, it is entirely a voluntary election process on a program-by-program basis so that the States could move into these larger responsibilities at a pace which they choose and which is appropriate to their circumstances.

The second block grant, or megablock grant, is called the local block grant. It really consists of authority to merge two programs on the books today, the general revenue-sharing program and the entitlement portion of CDBG. These together are funded in the 1984 budget at about a $7 billion level. And as in the case of the State block grant, with each passing year an additional 20 percent of the funds, if the States choose to go into the block grant, that could be allocated from one program purpose to another. And so by 1988 they would have full interchangeability if they so chose.

The third element is the transportation block grant program that essentially consists of the noninterstate and nonprimary parts of the Federal grant-in-aid system for highways. Six programs would be involved, ranging from the urban highway program, the secondary, the nonprimary bridges, as well as smaller programs that we have for hazard elimination, railroad crossing improvements, and so forth. In this case though the States would have only a choice of opting into the entire six programs on a block grant basis, or continuing on a categorical basis for each. They could not choose to do it one program at a time, as in the case of the other two blocks.

We would estimate that it would take about 2 cents of the existing Federal gasoline tax to fund these programs, and the special trust fund, federalism transportation trust fund, within the overall highway trust fund would be created in order to fund this block grant.

Finally, the fourth feature is a smaller block grant proposal for rural housing. The committee is aware that there are a number of very small and generally not well funded programs in the budget for rural housing, self-help grants, repair, and so forth, as well as the big rural housing loan program through the insurance fund. What we are proposing here is that all of these be combined into one grant at a fixed level of $850 million per year—in a sense that the loan and the grant programs be cashed out and distributed to the States on a three-part formula based on rural population, substandard housing, and low-income population.

The States would be free to use this money for construction or rehabilitation, for temporary rental subsidies, or for loans. There would be complete flexibility as to how they would meet unfilled existing rural housing needs. I think the important feature is that the States would be required to spend 80 percent of this block grant on the housing needs of those with less than 50 percent of the median income in rural areas.

So this completes the description of what we have proposed in these four megablock grant categories. And as I said previously, I think it constitutes a part of an effort to continue the evolution toward rearranging, consolidating, reforming, and eliminating the enormous amount of unnecessary and excess paperwork and application process interference that has built up in the grant-in-aid system over the previous 20 years. We think that this is modest. We think it is designed with a view to what we learned last year about the ability to move forward legislatively and about the concerns of all parties who are interested in the grant-in-aid system.

So I would conclude with those remarks, Mr. Chairman, and I would be very happy to try to respond to your questions.

The CHAIRMAN. Thank you. Senator Heinz?

Senator HEINZ. Mr. Chairman, thank you very much. First I would like to address the issue of the local block grant. Certainly, we all know that general revenue sharing has been a great success. Senator Durenberger has a bill in to extend general revenue sharing for at least 3 years, maybe 7 years, I forget the exact number.

Senator DURENBERGER. Forever.

Senator HEINZ. Forever. The community development block grant program has also been an extraordinary important program to many cities in my State and others. As you know, that program was conceived as a means of targeting certain kinds of resources, money, but also some expertise on certain urban problems. I would suggest that the additional flexibility in the local block grant that you anticipate will run into a fair amount of controversy—it probably has already—because of the removal over time of the targeting requirements associated with the community development block grants. The question that we are going to have to answer is, What is the justification to our taxpayers of giving nontargeted money that has been targeted money heretofore to urban areas, except that it seems to reduce to a certain degree the paperwork? What is the answer to our taxpayers who say, "Listen, we sometimes like to know that you are giving money for a valuable purpose. We are against paperwork, too, but the reason we have been willing to go along with this is we thought you were helping solve some specific problems in our cities."

Mr. STOCKMAN. Senator, I think I would answer that by saying that real targeting occurs in the structure of the program, in the entitlement structure. That money does not go to every municipality, every jurisdictional unit in the country. It goes primarily to urban counties and large cities. And I think that wouldn't change obviously under what we are proposing. Now within the city or within the county there are requirements under the existing program that it be spent in areas of special need. But I think that feature of the program is far less important than the fact that the overall allocation formula puts it into the urban areas where it is needed.

Second, if you look at the purposes for which CBDG can be used, they are pretty broad. I would note that in the block grant reforms of 1981 it was substantially changed in terms of liberalized eligibility and use of funds. Beyond that, if you look at where the general revenue-sharing moneys are going in the cities that are also CBDG entitlement cities, I am not sure that you can find large differences in terms of the application of money.

So it seems to me that you have a pretty natural marriage there, that no city would lose funds relative to the two formulas. It would gain flexibility to interchange from open ended GRS to somewhat targeted but nevertheless very flexible CDBG money. And it seems to me from what we hear from local officials, the mayors, and others, that is not unreasonable to propose that kind of flexibility.

Now the other thing is they have built up an infrastructure over the 10 years that this program has been in existence on the CDBG side. Those people, those forces, those needs have weight within city government decisionmaking. And if they are meeting needs that are of the highest priority, I cannot believe that even with the flexibility those needs will be shortchanged.

Senator HEINZ. Let me ask you one question. Does the League of Cities and the Conference of Mayors support this proposal or not?

Mr. STOCKMAN. Well, we have just surfaced obviously the details of this recently, and I am not sure exactly what their commentary has been. Obviously, they are going to have concerns about any change in program design.

Senator HEINZ. One last question. As you know, local governments have been particularly hard hit by our success, strangely enough, in fighting inflation. They benefit from inflation the same as the Federal Treasury does. It is more difficult for them, of course, to do what we do, which is borrow hundreds of billions of dollars to finance our way through our problems. I, Senator Dole, Senator Durenberger, and Senator Domenici have proposed a short-term means of addressing this problem; namely, we propose to accelerate by a quarter the payment of general revenue sharing moneys to the localities.

And to give you a for-instance of why we believe this is necessary, in just one of my cities, the city of Philadelphia, expenditures on housing the homeless—many of whom, by the way, are sent from the suburbs into the cities to find shelter—have risen from a quarter of a million dollars in 1981 to $3 million, this year. So my question to you is. As we see our cities and our towns being forced to play an emergency role in housing the homeless, feeding the poor, the out-of-work, can we have your support for the acceleration of one-quarter's worth of general revenue sharing?

Mr. STOCKMAN. Senator, I don't think a large issue is involved there. It is primarily a cash-flow-timing issue in which we make payments that are required under law. I do recognize the need and I do point out that there is a bill moving toward the Senate right now from the House that is targeted on short-term job creation and meeting humanitarian needs and unfilled local housing, food, and other requirements.

It seems to me that this might be a better way of providing a short-term infusion of money to local governments who are closest to the area where the problem is than some of the detailed programatic provisions in the House bill. So if you are suggesting that this might be a better approach that the Senate could look at, I would encourage you to do that. But not as an add-on to the bill but as a better means of distributing the funds that the House has already provided.

Senator HEINZ. Thank you. My time has expired.

The Chairman. Senator Durenberger.

Senator DURENBERGER. Thank you, Mr. Chairman. I have a statement I would like to have made part of the record. I want to thank my colleague for raising the issue of acceleration. It seems to me that one of the problems with it though is the administration having endorsed the Federal Government's specific kind of approach. It is going to be very difficult to substitute this, now that every Senator is running around finding public works projects that he can stick into his district. It is going to be relatively difficult without some more substantial commitment from the administration to do that. But I would like to spend my time on a little broader scope of federalism. And I, as one who participated in last year's hearing, appreciate the fact that you put these blocks in the kind of real perspective that we went through last year.

Let me start by describing federalism as two major activities on the part of the National Government. One is the regulatory federalism, which is the pay we preempt State and local law, the cross-cutting requirements that we put in grants, State implementation requirements like we have in EPA for example, and the Federal courts operating to tell the states what to do. Then on the other hand, we have what we call fiscal federalism. And that, I believe, and I would just ask you if you agree, would divide itself into probably three major categories. One is the area in which we subsidize spending by local government. We do that usually through categorical grants and block grants and so forth. The second would be where we subsidize borrowing. And, of course, the example there is tax exempt bond financing. And the third is the subsidation of taxation, which is the deductibility of State and local taxes.

Would you agree that that is kind of a logical framework on——

Mr. STOCKMAN. Yes. That would be a pretty good classification.

Senator DURENBERGER. All right. Then to put a few dollars against that, our current grant-in-aid programs seem to run somewhere in the $80 to $90 billion category. Deductibility, I am told by the Joint Tax Committee, runs in the neighborhood of $31 billion a year, and tax exemption is somewhere in the neighborhood of $14 billion in revenue foregone. Is that the general ballpark?

Mr. STOCKMAN. I think those figures sound correct; although on deductibility I think you are counting everything including the income tax, property taxes, State sales tax, and so forth.

Senator DURENBERGER. Exactly.

Then, to follow that on a little bit farther and to get to the heart of the question that Senator Heinz was asking you, when you look at fiscal federalism as a subsidy for State and local government activity, there are really two questions that we seem to ask ourselves.

First, is the subsidized activity in the national interest? Is there some kind of a national purpose that we are trying to accomplish?

And the second question that occurs to me is the question of efficiency, just how efficient is the fiscal relationship between the Federal and the State and local governments when looked at as a subsidy? Are those two logical questions that we ought to ask ourselves?

Mr. STOCKMAN. Being aware of where they may lead? [Laughter]

Senator DURENBERGER. Well, I may run out of time before I get to where they may lead, but I just have to make sure we are on the same track as we are approaching this now.

I think of efficiency as the amount of benefit that gets realized at the other end, on the State and local end, compared to the dollar revenue that is lost or expended at this end.

Now my first question is, If you agree that that's one way to look at efficiency, can you take those three elements of fiscal federalism—that is, the spending subsidy, the taxation subsidy, and the borrowing subsidy—and talk to us about the relative efficiencies in those three?

Mr. STOCKMAN. I could do that. I notice the yellow light is on, and you have opened up a rather massive chapter that involves some four or five or six decades of history. This is the point I would make.

We tried to do some very major, sweeping things in 1981 and 1982 based on notions of efficiency, that there wasn't any reason for 30 or 40 categorical grants in many functional areas. But we ran into something called history. We ran into something called organizational interest. We ran into something called inertia, in the existing delivery system.

And so you have to come to an accommodation between efficiency and the reform direction that you want to move, and the vested interests in the existing system that are reluctant to move.

It seems to me that when you start talking about the tax subsidies you are heading into the thicket just as we did, obviously, in the grant area. And when you start talking about the exemptions for State and local bonds, we all know what the tax analysts and the tax economists have said about that over the years, and we all know what administrations and Congresses and Senate Finance Committees have done about that over the years.

So I think that this is an interesting line of academic inquiry, and it may shed some light on possible small steps that could be taken. But in terms of major policy conclusions or bold, sweeping new ideas, I doubt whether we are going to get very far given those factors that I have described.

Senator DURENBERGER. Well, I raised them; though in the second round I guess I can talk to you about the local block as John did, because they come up there and raise some other questions.

But one of my concerns during the last year is that the President took on the whole load of trying to redefine this Federal system, and I think the impression was laid out there that this is just the responsibility of the National Government to redefine the new federalism. And local government in particular, the mayors especially, I think got a free ride on the notion that the Federal Government is the bad guy; the Federal Government is the one that has all the paperwork, and it has all this, that, and the other thing, and there really isn't any responsibility on their side to look at the efficiency, if you will, of some of these relationships.

And I suppose as we go through this blocking process which we all assume is transitional, it seems to me appropriate to look behind it and place some responsibility at the local and the State level to give us some ideas about efficiency and fiscal disparities and a lot of these other things that they dodge because they still assume somehow or other there is an unlimited pot of money out here, and it's just a matter of giving them more revenue sharing, more block grants, more this, and more that.

And this whole efficiency argument, if we could reduce it to a better example so that somebody other than Seaspan would understand it—you know, I think there is an argument for going beyond the academic and trying to find some practical way to deal with these issues.

Mr. STOCKMAN. I would agree, but I think there is more than efficiency involved. I have looked at your proposal, your extended general revenue-sharing proposal, which I believe is interesting, and we are going to be taking a harder look at it in the weeks ahead. In terms of delivery of money to the local level, it is philosophically appealing, but it does raise another issue totally outside the efficiency area, because if you substantially increase the funding level under general revenue sharing and then pay for it by reducing tax deductibility of sales taxes or other State and local taxes that are now tax deductible, you have not only made the system perhaps more efficient but you have increased the aggregate level of Government spending and the aggregate level of Government taxing, unless you assume the States and localities are going to lower their taxes as a result of removing the deductibility.

I can't believe they will; they are too hard pressed. And as a result of that, we end up with a fiscal outcome that also has to be seriously analyzed. We are taking today 24 percent of GNP at the Federal level. If you add State and local, we are up near 40. We are getting into the European league, and we obviously would have some very serious reservations—philosophically, economically, politically, and every other way—about where that is heading.

I think this proposal inadvertently reinforces that trend, and so therefore it is something that I think you have to add to your consideration as well as the more narrow efficiency of fiscal transfer considerations, which are important.

Senator DURENBERGER. Thank you.

The CHAIRMAN. Mr. Stockman, of course we understand this is a preliminary indication of what might happen. There are a number of committees that have jurisdiction, and we are trying to sort that out. We have substantial jurisdiction in this committee, and I'm certain other committees do—Banking, even I think in the Labor Committee.

So we hope we can work quickly to move this along as much as we can, but obviously there will be some conflicts.

I agree with Senator Heinz. If there is some way we can accelerate revenue sharing, that's also an interest expressed by Senator Long and others I think on both sides of the committee as one way to maybe provide some stimulus this year.

And there is always some concern about special programs that you would block grant—the maternal and child health block grant is a very sensitive area, and some of us are concerned whether you want to shuffle that off in a megagrant somewhere, because we want to make certain that the special needs under this program are met. I am not certain what protections you provide.

And that is just one. I am certain there will be someone speaking for each group who will say, "Well, don't include this in the block grant." And this is only preliminary to a number of discussions we will probably be having with you on this matter.

I have some questions, but I know you are under time constraints, and I assume we will have other opportunities to discuss this with you. Is that correct?

Mr. STOCKMAN. That is correct.

The CHAIRMAN. So I will urge my colleagues, if we might defer other questions we could relieve Mr. Stockman at this time. Is that satisfactory?

Mr. STOCKMAN. Thank you, Mr. Chairman.

[Whereupon, at 10:30 a.m., the hearing was concluded.]

○